Commentary

What's Wrong With The New York Insurance Liquidation Bureau?

By
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New York's Liquidation Bureau is an arm of the Insurance Department and acts under the authority of the Superintendent of Insurance of the State of New York. That is a mouthful — but of great importance to the insurance-buying public. The Liquidation Bureau manages all insolvent or impaired New York insurance companies in both Rehabilitation and Liquidation proceedings pursuant to Article 74 of New York's Insurance Laws. (Another mouthful.)

In this day of financial distress to the entire financial sector, including insurance, how our government officials handle distressed carriers becomes all the more important.

The pre-eminent purpose of Article 74 is to "insure equitable treatment for [all] creditors and to avoid preferences . . ." Knickerbocker Agency, Inc. v. Holz, 4 A.D.2d 71, 73 (1st Dep't 1957). If the goal is followed, the insurance-buying public can "trust" the management of insurance company rehabilitations and liquidations because they know they will be treated equally with other similarly-situated policyholders. Equal treatment among creditors is the guiding principle of insurance insolvencies throughout the country (see, e.g., Cal. Ins. Code § 1010 et seq.; Article XIII of the Illinois Insurance Code) and in Federal Bankruptcy Court. See 11 U.S.C. § 1121.

The New York Liquidation Bureau follows these principles and manages those estates with the primary motivation of protecting the interests of policyholders — right?

Wrong!

From direct experience with at least one insurance company in "rehabilitation" — Frontier Insurance Company — this author can openly state that the pre-eminent purpose of Article 74 is being ignored by the "Rehabilitator." (And, rest assured, — from what one hears on the street — such abuses are not limited to the Frontier estate.

From my experience of more than 20 years in this area, the rehabilitation/liquidation of an insurance company, throughout the country, has been a straight forward process — with the primary purpose to protect the interest of the insurance-buying public. A company that is distressed (commonly discovered through an Insurance Department financial examination) is placed into "rehabilitation" — which is akin to a Chapter 11 reorganization in Bankruptcy. The "rehabilitator" reviews the financial condition of the company, attempts to protect its solvency and quickly determines (within six months under the National Association of Insurance Commissioners' Insurer Receivership Model Act (the "Model Act")[2] whether the company can be "rehabilitated" through a Rehabilitation Plan and placed on its own. If rehabilitation is deemed impossible, the "rehabilitator" petitions to have the company placed in "Liquidation" — with all the statutory payment safeguards for policyholders and other creditors.

But, this is not how the current New York Rehabilitator is operating. For example, it has been more than six years since Frontier was placed in rehabilitation, but the Frontier Rehabilitator has failed to submit any "Plan of Rehabilitation."[3] Nor has Frontier been placed into Liquidation Proceedings. Nor is the Frontier "Rehabilitator" making prompt payments to policyholders. In too many cases, the modus operandi is delay, delay, delay, delay.

And there is no end in sight. The Frontier Rehabilitator could not state recently to an appellate court when Frontier would submit a plan of rehabilitation or be placed into liquidation.

What is more troublesome than the appalling delay, is that during the "rehabilitation" the Frontier Rehabilitator has chosen to pay certain creditors and not other similarly-situated creditors.

How does the Rehabilitator justify his actions? He claims that he has sole and absolute discretion to pay whatever claim he sees fit.

In doing so, the Rehabilitator ignores case law throughout the country mandating that rehabilitation plans cannot discriminate or prefer one creditor over another in the same class. See, e.g., In re Conservation of Alpine Ins. Co., 741 N.E.2d 663, 668 (Ill. App. Ct. 2000); Commercial Nat'l Bank v. Superior Court, 14 Cal. App. 4th 393, 403 (1993). In Frontier, the Rehabilitator is attempting to get around this requirement by simply ignoring the law and not submitting any plan (and thereby running his little estate in any way he see fit).

In deciding who to pay, the Rehabilitator has unilaterally mandated "negotiated" settlements reflecting Frontier's insolvency and "poor financial condition." But, these so-called "negotiations" (actually arbitrary take-it or leave-it offers by a Rehabilitator who just happens to have "total" control over the disbursement of funds) occur in a vacuum. Indeed, without a plan or similar company-wide report, etc., it is impossible for one creditor to ascertain the settlements or payments — much less the payment percentages — received by other similarly-situated creditors. So individual policyholders have no idea whether they are getting a "good" offer.

In sum, the Frontier rehabilitation is a stealth "rehabilitation" being run as if it is the personal bailiwick of the Liquidation Bureau.

In one case, a policyholder obtained a judgment against Frontier — more than six years ago! The Rehabilitator refused to pay, fought the judgment, but lost before the Fifth Circuit, before the Appellate Division, First Department and before the New York Court of Appeals. The Rehabilitator still refused to pay . . . on the supposed grounds that:

- Despite the prior court rulings, the judgment is not entitled to "full faith and credit" (that doctrine apparently applies to everyone in America other than the Rehabilitator); and

- The Rehabilitator has "sole" discretion to settle claims (i.e. not subject to judicial review).

What has become obvious is that those who are running the Frontier Rehabilitation believe they are the Sun Kings — the Louise XVI's — with absolute power over the policyholders.

Finally, the Supreme Court of the State of New York ,Appellate Division — Third Department recently aught up to the Rehabilitator and ruled that his conduct in ignoring the policyholder's judgment and the decisions of at least three courts was arbitrary and capricious. Callon Petroleum v. Superintendent of Insurance of the State of New York, as Rehabilitator of Frontier Insurance Company, Appellate Division, Third Department, July 10, 2008 (Reported in Mealey's Insurance Insolvency).

It is now four months later. Has the Rehabilitator paid? Has the Rehabilitator negotiated with the policyholder?

What do you think?

This is just one case and we will pursue our remedies in the courts. What is called for here is collective action by many policyholders to knock some sense into our public officials. What the Liquidation Bureau is doing is running this rehabilitation off the backs of, and at the expense of, existing policyholders and creditors. It pays Frank 100%, Charlie, 80%, Joe 10%, Mary 1% (each of whom can only negotiate his or her percentage without knowledge as to what the others received) and then at the end of the day, the Rehabilitator "declares":

1. The company has been "successfully" rehabilitated so it can continue to sell insurance and pay 100 cents on the dollar — too bad for all the Franks, Charlies, Joes and Marys (particularly the Marys); **or**

2. The company is placed into liquidation — where the creditors are paid according to a statutory scheme depleted by almost seven years of Rehabilitator "management."

This is against the law. See, e.g., In re Van Schaick (Nat'l Surety), 239 A.D. 490, 496 (1st Dep't 1933).[4]

Some say he Rehabilitator is merely promoting his primary purpose which is to protect the disabled insurance company at the expense of its policyholders. This is misguided and wrong. This is the reverse of the statutory goal of New York's Insurance Laws, which is to ensure the primary and equitable treatment of all policyholders. See Knickerbocker, 4 A.D.2d at 73. This issue profoundly affects the public interest of those who buy insurance from New York insurance companies.

If a Rehabilitator has the power to pay Peter and not Paul or prefer Peter over Paul at his sole discretion — why would the public trust anything in the rehabilitation proceedings? Further, with such power (and all things being equal) why would a policyholder buy insurance with a New York company?

It is well established that New York brokers must expressly advise policyholders when a policy is issued by a non-admitted carrier that the policy does not have the protection of New York's guaranty funds. 11 NYCRR 27.17 (2006). Should the warning now be extended to state that under rehabilitation, the Liquidation Bureau can circumvent guaranty fund protection, fail to submit a plan, prefer one creditor over another, and in essence self-liquidate the company in his sole discretion — without any statutory protections?

The government agency that was created to protect the interests of policyholders has clearly lost sight of its primary purpose. Policyholders shouldn't put up with it.

Endnotes

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2. The Model Act provides that "the protection of the interests of insureds, claimants and the public requires the timely performance of all insurance policy obligations; therefore, if the payment of policy obligations is suspended in substantial part for a period of six (6) months at any time after the appointment of the rehabilitator and the rehabilitator has not filed an application for approval of a plan under Section 403, the rehabilitator shall petition the receivership court for an order of liquidation or seek an order, on good cause shown, for a longer suspension period." Model Act § 404(b).

3. According to the Model Act, the Rehabilitator "shall prepare and file a plan to effect rehabilitation with the receivership court within one year after the entry of the rehabilitation order or such further time as the receivership court may allow." Model Act § 403(a).

4. The Rehabilitator will state that he has internal "criteria" to resolve claims with policyholders — e.g. whether there is collateral or reinsurance. But those requirements are unilateral and illegal vis-à-vis a policyholder or creditor. A solvent insurance company couldn't use it as a defense to a claim nor could Warren Buffet — nor should a rehabilitator. ■