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Health Republic's Curious Liquidation: Part 4

Law360, New York (August 30, 2016, 2:49 PM ET) -- In Health Republic's Curious Liquidation: Part 1, I traced Health Republic's birth as a New York state-authorized not-for-profit company funded under the Affordable Care Act's Consumer Operated and Oriented Plan Program and its subsequent liquidation.

In Part 2, I set out several areas where committees of policyholders and service providers would aid in Health Republic's liquidation, just as creditors' committees in bankruptcy courts add value and expedite those proceedings.

Yesterday, in Part 3, I reported on a July 28 status conference during which Justice Carol Edmead, in her role as the court overseeing Health Republic's liquidation, directed that the liquidator's contracts with outside counsel and third-party administrators, as well as the liquidator's administrative expenses incurred to date, be posted online in order for policyholders and service providers to see how Health Republic's assets are being spent.



James Veach

Here, in Part 4, I provide more reasons why Health Republic's estate would benefit greatly from committees of policyholders and service providers that would bring their perspectives to the liquidation process.

More Reasons Why the Health Republic Liquidation Needs Committees

As I mentioned in Part 2, committees of creditors, equity holders and other interested parties are standard features in bankruptcy court.[1] Congress provided for these committees because they add value and give creditors and shareholders a voice in the proceedings. Creditors' committees also help bankruptcy courts understand and address issues that might otherwise be obscured or overlooked or addressed much later than would otherwise be the case.

We identified in Part 2 instances in which courts overseeing New York insurer liquidations, as well as courts overseeing liquidation proceedings in other states, have reached out to or recognized committees of reinsurers or cedants or others. But we also pointed out that creditors' committees in insurance company insolvencies are the exception rather than the rule. Health Republic itself, however, is also an exception to many rules with respect to insurer insolvencies and warrants full policyholder and service provider participation through committees recognized by the court.

Consider the following circumstances that distinguish Health Republic from most insurance company insolvencies.

First, all of Health Republic's capital came from the federal government. In most insurer insolvencies, shareholders have skin in the game and follow the proceedings and the treatment of the company's assets. The Freelancers Union has not participated in Health Republic's liquidation because, reputational risk aside, it had very little skin in the game and has none now. Federal taxpayers may or may not have standing to jump into the Health Republic liquidation, but there are no shareholders watching the Health Republic proceedings.

Second, Health Republic has caught the attention of New York legislators, who have asked why it took so long to liquidate the company (and, to my knowledge, have never received an answer). I discussed in Part 2 how legislators have proposed a fund to reimburse the service providers whose claims will never be paid. Health Republic's failure came up several times during Superintendent Vullo's televised confirmation hearings a few months ago. Health Republic's failure and subsequent liquidation is of considerable public interest and, as a result, its liquidation should be fully explored in open court.

Individual policyholders and even individual service providers should not be expected to follow along on their own. Committees would allow for policyholders and service providers to pool their experience and knowledge and help the court — and each other — understand where Health Republic's liquidation is headed.[2]

Third, the New York Liquidation Bureau, with few exceptions, has handled almost every insurance company insolvency in New York since 1909.[3] But in the case of Health Republic, outside counsel for the superintendent, counsel that represented Health Republic before the liquidation proceeding began, a financial advisory firm and a third-party administrator that still operates Health Republic's website are apparently all working together to fashion a liquidation plan and a claims procedure for Health Republic. The bureau's role, thus far, appears to be confined to posting Health Republic's liquidation order and a copy of transcript of the May hearing on its website.

The bureau has handled far more complicated insolvencies than Health Republic, e.g., the liquidations of Midland Insurance Company, Frontier Insurance Company, Ideal Mutual Insurance Company, Union Indemnity Insurance Company, and the ancillary liquidation proceedings for Lumbermens Mutual Casualty Insurance Company, The Home Insurance Company, and Reliance Insurance Company. These insolvencies all involve insurers that wrote many lines of business in all, or almost all, 50 states, Washington D.C., and Canada. These insurers all have complicated reinsurance programs and their liquidators must deal with guaranty funds in all, or almost all, 50 states. Health Republic, on the other hand, wrote one line of business for about twenty months. Its reinsurance program is limited to a couple of surplus treaties and, unfortunately, there are no guaranty funds involved.[4]

The superintendent has the authority to appoint "special deputy superintendents, and employ such counsel, clerks, and assistants as [she] deems necessary." [5] In this proceeding, Superintendent Vullo appointed four special deputies, three of whom are employed by the bureau and one of whom is the former head of the bureau who now also serves as the executive deputy superintendent of the U.S. Department of Financial Services and thereby oversees the division of insurance.[6] Despite this, the design of the claims procedures has been delegated to outside counsel, a financial advisory firm and a third-party administrator, the fees for none of which have been approved by the court.

Despite all these agents and outside advisers, the superintendent has not yet included Health Republic's policyholders and largest creditors in the liquidation process. At the July status conference, the court asked whether the explanations of benefits (EOBs) for policyholders would provide enough meaningful information for policyholders to know whether to appeal. What better way to get an answer than to refer that issue, and other related claims adjudication questions, to a policyholders committee for input? And, along the way, that committee could explore why Health Republic needs so many cooks in this kitchen.

Fourth, claims procedures are being drafted for service providers, such as New York University Hospital Centers, North Shore University Hospital and St. Catherine of Siena Medical Center, even though hospitals, practice groups and doctors are being told that they will receive nothing. It appears that a lot of time and effort may be going into explanations of payments (EOPs) for providers that will never see a nickel. Has anyone consulted with service providers on this issue? A committee of service providers could add real and immediate value to the liquidation proceedings on matters such as these.

Fifth, Health Republic's last financial statement was its 2015 second quarter financial

statement, which showed assets of \$152 million and liabilities of \$530 million.[7] The bureau is required to publish a balance sheet of sorts concerning the Health Republic estate, but that nonstatutory balance sheet is not due until May 2017![8] To date the court has not been presented with any information with respect to Health Republic's current assets and liabilities. As a result, policyholders lack even a ballpark idea of how much money is available to pay a portion of their claims.

If a simple balance sheet were made available now, the court would be in a much better position to evaluate the proposed claims procedures. And if it turns out that, hypothetically, Health Republic has \$500 million in liabilities, but only \$50 million in assets, then many policyholders may not bother to submit claims. A policyholders committee could step in and ask that this search for false precision cease until policyholders have at least a rough idea of how much money remains in the estate.

All of these circumstances cry out for committees of policyholders and providers to help the superintendent and the court close the Health Republic estate as quickly and economically as possible. Nevertheless, Justice Edmead, despite the lack of policyholder and service provider participation, has already focused on one very important issue: how much money has already been spent during the months after Health Republic's board consented in October 2015 to liquidation? Rather than wait for "periodic reports" months or years from now, the court has demanded that contracts be posted and moneys accounted for now, and recent past insurer insolvencies support these demands.[9]

Time's A-Wastin'

In 2008, the then-superintendent, acting in his role as liquidator, presented Justice Eileen Bransten with an "Initial Report on the Status of the Liquidation of Union Indemnity Insurance Company of New York." Union Indemnity had been placed in liquidation in 1985. The initial 2008 report sought approval to pay administrative expenses already incurred by the liquidator and to allow for a pro rata share of policyholder claims. (At that point, the Union Indemnity estate had been open for 23 years.)

The court declined to approve the initial report and noted that "Union's assets total \$106,419,398 and the administrative expenses are \$83,704,661," thus calling for "approximately 80% of the estate ... going toward satisfaction of administrative expenses, which leaves the policyholders ... with a very small proportionate share." [10] One objector to the initial report, a reinsurer, called for an audit of the estate and the appointment of a creditors' committee.

The liquidator had admitted in his "initial" report that the Union Indemnity estate had been poorly administered and even alluded to "criminal conduct," but the liquidator assured the court that significant reforms at the bureau had been implemented. The court ordered that the liquidator prepare another report and "demonstrate that [Union Indemnity's] administrative expenses [were] not attributable to poor management, criminality, or audit failure." [11] But given the liquidator's representations about its "mandate for reform," the court chose not to "interfere with the liquidator's discretion to manage the estate by requiring a creditor's committee ... *at this time* (emphasis added)." [12]

Part of the reforms referred to in the initial report included 2008 legislation amending NYIL 7405(g) and adding provisions for annual "audits" of the estates under the bureau's management. [13] The effectiveness and value of these "audits" has been questioned, [14] but the concern here is not verifying that moneys were spent, but determining whether money should be spent in the first place. And it should be noted that "audited" statements prepared pursuant to NYIL 7405(g) won't appear until August 2017.

Unlike Union Indemnity, where expenses were presented decades into the liquidation proceeding, the Health Republic liquidation has just begun. Justice Edmead is on the right track in insisting that administrative expenses and the terms of the third-party engagements be presented now, and not after the estate's assets have been dissipated.

The court is also correct in requiring that expenses and contracts be placed online, where policyholders and providers can see them. A policyholders committee and a service providers committee, however, would assist mightily in evaluating these expenses and commenting on the proposed claims adjudication procedures.

Health Republic's creditors, including over 200,000 policyholders and its dozens of service providers, are a relatively sophisticated lot. The superintendent could solicit applications for committees through the HR site, the bureau website and a press release. A representative policyholders committees might include policyholders with large claims, policyholders with out-of-network issues, and policyholders from different parts of the state. The service provider committee might include representatives from the larger hospitals, a couple of practice groups and an individual doctor.

Clearly, it would be easier for the liquidator to proceed at the current pace and behind closed doors with sporadic appearances before the court to seek approval for procedures and, eventually, approval of expenses that have already been incurred, but by that time the money will have been spent. The issue here is not auditing files to determine if money in matches money out; the issue here concerns the expeditious winding up of the Health Republic estate (and not wasting more taxpayer money).

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[1] K. Klee and J. Shaffer, *Creditors' Committees under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. Rev. 995, 999 (1993). The authors, of course, acknowledge the distinction between near-mandatory creditors' committees under Chapter 11 and the limited responsibilities of a creditors' committee under Chapter 7. Those responsibilities (rights) under Chapter 7 include making recommendations to the Chapter 7 Trustee and submitting to the court recommendations concerning the administration of the estate. Note 17.

[2] During both the May hearing and the July status conference, Justice Edmead gave counsel for the service providers an opportunity to address the court, an opportunity that counsel passed up. That was unfortunate because the service providers probably have a lot to say about how policyholder claims should be processed and how much money is being spent processing the claims.

[3] In 1994, Superintendent Ed Muhl, one of the rare superintendents of insurance who had executive insurance experience before being appointed superintendent, appointed a special agent, who himself had substantial insurance regulatory experience, to oversee the liquidation of United Community Insurance Company located in Schenectady, New York. For an account of United Community liquidation see P. Bickford, *The Insurance Receivership Process in New York* at 4-5.

[4] The bureau may not have experienced many health insurer failures recently, but did close two health maintenance organizations (HMOs) in 2015: Essence Healthcare of New York Inc. and CIGNA Healthcare of New York Inc.

Neither of these HMOs had any open claims and the only creditors were the HMOs' owners. Note, however, that: (1) a deputy bureau chief in the DFS health bureau submitted affidavits in support of the liquidations of both of the HMOs, which was not the case for Health Republic; and (2) the CIGNA estate, even though it was open for less than a year and had no claims, incurred \$134,165 in administrative and direct costs. Report on the Status and Request to Close the Liquidation Proceedings of CIGNA Healthcare of New York, Inc., dated Sept. 28, 2015, a copy of which may be bound on the Bureau's website.

[5] NYIL 7409 (c). The fees paid these special deputy superintendents and counsel "shall be fixed by the receiver, subject to the approval of the court, and shall be paid out of the funds or assets of the insurer." Orders of liquidation and orders approving expenses and closing these estates may be found on the bureau's website.

[6] You can find the June 17, 2016, certificate of appointment on the Health Republic website under "Docket."

[7] For example, Health Republic's second quarter financial statement has this liability entry: "Uncollected Premiums and Agent's Balances in the Course of Collection - \$240 million." Uncollected premiums? A committee could explore what this entry means.

[8] NYIL 7405(g).

[9] July Trans at 7-8.

[10] In Re Matter of the Liquidation of Union Indemnity Insurance Company of New York, Index. No., 41292/85, slip op. at 26 (filed February 6, 2009).

[11] Id., Slip Op. at 27

[12] Id. For an example of an estate that would have profited from a policyholders committee, see generally, P. Bickford, Opinion: Ongoing ELNY Debacle Exposes Serious Problems, Insurance Advocate at 22-24 (February 18, 2013).

[13] Bickford, Part V at 19-24.

[14] Id.