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June 19, 2012

Clerk of the Court
Ingham County Circuit Court
Veterans Memorial Courthouse
313 W. Kalamazoo
P.O. Box 40771
Lansing, MI 48901-7971

**Re: *Ken Ross, Commissioner of the Office of Financial and Insurance Regulation v
American Community Mutual Insurance Company***
Case No. 10-397-CR

Dear Clerk of the Court:

Enclosed for filing in the above referenced case, please find the **Brief in Support of Rehabilitator's Denial of Former Officers' Claims for Severance and Other Benefits Under Pre-Rehabilitation Executive Employment Agreements** along with a Proof of Service. This filing is being submitted via hand delivery directly to the court.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Kerr", written over a circular stamp.

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STATE OF MICHIGAN
CIRCUIT COURT FOR THE 30TH JUDICIAL CIRCUIT
INGHAM COUNTY

KEN ROSS, COMMISSIONER OF THE
OFFICE OF FINANCIAL AND INSURANCE
REGULATION,

Petitioner,

No. 10-397-CR

v

HON. WILLIAM E. COLLETTE

AMERICAN COMMUNITY MUTUAL
INSURANCE COMPANY,

Respondent.

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**BRIEF IN SUPPORT OF REHABILITATOR'S DENIAL OF FORMER
OFFICERS' CLAIMS FOR SEVERANCE AND OTHER BENEFITS UNDER
PRE-REHABILITATION EXECUTIVE EMPLOYMENT AGREEMENTS**

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CONCISE STATEMENT OF ISSUES PRESENTED

1. Does MCL 500.8137(4), which limits claims by the officers and directors of a failed insurer to “payment for services rendered prior to the issuance of” a rehabilitation order, prohibit payment of the claims made by six former officers of American Community for severance and other non-wage benefits arising under their pre-rehabilitation golden parachute agreements?
2. Where American Community’s former management reviewed, approved, and stipulated to the Rehabilitation Order, are the former officers’ claims for severance and other non-wage benefits under their pre-rehabilitation golden parachute agreements further barred by the Rehabilitation Order, which provides consistent with MCL 500.8137(4) that “the Rehabilitator shall not pay” any severance or other non-wage claims arising under an officer’s pre-rehabilitation employment contract?
3. In addition to the statutes and Rehabilitation Order precluding payment of the former officers’ claims, should the Court deny the claims on public policy grounds because paying generous golden parachute benefits to the officers responsible for causing an insurer’s failure: (a) sets bad precedent for future insurance receiverships, both in Michigan and in other states with comparable receivership laws; (b) creates perverse incentives for those currently running insurance companies; and (c) unfairly subjects the claims of legitimate creditors to the risk of non-payment or greatly reduced payments, which in turn could diminish insurers’ access to capital and result in more companies entering receivership?
4. Even if the Court determines that Michigan receivership law, the Rehabilitation Order, and/or public policy do not bar the former officers’ claims, where the terms of their golden parachute agreements indicate that a “Change in Control” was intended to mean a financial transaction involving a third-party, did the financial failure of American Community necessitating rehabilitation nevertheless constitute a “Change in Control” triggering enhanced benefits under those agreements?

CONTROLLING OR MOST APPROPRIATE AUTHORITY

Authority: MCL 500.8137(4)

INTRODUCTION

Due to its deteriorating financial condition, this Court ordered American Community Mutual Insurance Company (American Community) into rehabilitation on April 8, 2010. American Community's then-management reviewed and stipulated to both the Rehabilitation Petition and Order, voluntarily relinquishing control of the company to be operated as the Court and Rehabilitator deemed appropriate.

Although the resulting rehabilitation has been largely successful, it could not avoid all negative effects. About 85,000 policyholders who had health insurance with American Community (plus thousands of policyholders with other types of coverage) have been forced to move to another insurer. Over 200 American Community employees lost their jobs. There are insufficient assets to pay the \$30 million in claims owed to the holders of two surplus notes (the Surplus Noteholders), representing funds loaned to American Community in 2005.

Against this backdrop, six former officers of American Community—who were in charge of the company when it failed and agreed to the rehabilitation—now ask the Court to overrule the Rehabilitator's decision denying their claims for severance and other benefits arising under "golden parachute" agreements the officers signed prior to the rehabilitation. The Court should uphold the Rehabilitator's claim denial, for three conclusive reasons. First, Michigan law, specifically MCL 500.8137(4), precludes payment of these claims. Second, the stipulated Rehabilitation Order foresaw that these claims might be made and expressly prohibits their payment. Third, public policy dictates against paying golden parachute benefits to the officers responsible for an insurance company's failure. For these reasons, the Court should uphold the Rehabilitator's decision denying the former officers' claims.

STATEMENT OF FACTS

A. Rehabilitation background and effects.

Following several years of negative financial performance, on April 8, 2010, the Commissioner of the Office of Financial and Insurance Regulation (Commissioner) filed a Stipulated Rehabilitation Petition and secured a Stipulated Rehabilitation Order placing American Community into rehabilitation. (Exhibit A, Rehabilitation Petition [without Exhibits]; Exhibit B, Rehabilitation Order.) Importantly, American Community's then-management authorized and agreed to both the Petition and Order. (Exhibit A, p 6; Exhibit B, p 13; Exhibit C, Certificate of Resolution.) Pursuant to the Rehabilitation Order and Michigan law, the Court appointed the Commissioner as Rehabilitator of American Community, along with two Special Deputy Rehabilitators. (Exhibit A, pp 4, 11-12.)

The collapse of American Community resulting in this rehabilitation is well-documented, and occurred under the direction and management of the six former officers now seeking payment of their golden parachute benefits (the Former Officers).¹ On May 23, 2008, A.M. Best revised the outlook for American Community from stable to negative, citing "a series of operational missteps made . . . over the past few years, which contributed to net losses and corresponding lower surplus." (Exhibit D.) On February 24, 2009, A.M. Best downgraded the financial strength rating of the company to B (Fair) from B+ (Good), maintaining its earlier negative outlook. (Exhibit E.) On

¹ The six Former Officers are: (1) Michael E. Tobin, former President and Chief Executive Officer; (2) Ellen M. Downey, former Vice President, Corporate Communications; (3) Francis P. Dempsey, former Senior Vice President, General Counsel, and Corporate Secretary; (4) Michael A. McCollom, former Vice President, Underwriting; (5) Beth L. McCrohan, former Vice President and Chief Information Officer; and (6) Leslie J. Gola, former Vice President, Human Resources.

November 5, 2009, A.M. Best further downgraded American Community's financial strength rating to C+ (Marginal) from B (Fair), again maintaining the company's negative outlook. (Exhibit F.)

When the dust settled at the end of 2009, American Community's financial performance for the year was dreadful. The company reported a year-end 2009 net loss of \$49,135,134, resulting in a decrease of American Community's capital and surplus totaling \$53,404,628—or a 72% decrease—from the prior year-end. (Exhibit A, p 3.) Consequently, the company's year-end 2009 capital and surplus stood at \$21,101,431, down from \$74,506,058 in 2008. *Id.* Outweighing the company's dwindling capital were surplus notes totaling \$30,000,000, which remain outstanding and are held by the Surplus Noteholders that have joined with the Rehabilitator in opposing the Former Officers' claims. As of December 31, 2009, American Community's Risk-Based Capital level stood at 155.5% (a "Company Action Level Event" under OFIR rules), a significant decline from its 564% Risk-Based Capital level one year earlier. *Id.* The company's 2009 negative cash flow from operations equaled 85% of its total capital and surplus, and was the fifth consecutive year it reported negative operational cash flow. *Id.*

Following the company's disastrous 2009, on March 8, 2010, A.M. Best again downgraded American Community's financial strength rating from C+ (Marginal) to D (Poor), citing the company's "sizeable net operating loss and corresponding significant deterioration in surplus incurred in fourth quarter 2009." (Exhibit G.) The Commissioner's action to place the company into rehabilitation occurred exactly one month later, on April 8, 2010.

Although the Commissioner's intervention was early enough to achieve relative success in terms of paying policyholder claims and most outstanding creditors, like any receivership this rehabilitation has not been able to avoid all harmful consequences. Unfortunately, the rehabilitation has caused 216 American Community employees to lose their jobs, forcing them to seek other employment in a difficult job market. Moreover, the roughly 85,000 individual and small group policyholders who had health insurance with American Community as of April 30, 2010 have been forced to seek other coverage. In addition to subjecting policyholders to general inconvenience, in many cases this also had real financial consequences if, for example, the replacement coverage was more expensive, annual deductibles already paid to American Community had to be repaid, etc. At the close of this rehabilitation, the Rehabilitator does not anticipate sufficient funds to pay all creditor claims in full. Specifically, the Surplus Noteholders owed \$30 million will receive, at best, about \$16.1 million or 54% of their claims. (Exhibit H, Financial Summary and Projection.) This amount would be reduced by 17.6%, to about \$13.3 million or a 44% payment, if the Court orders priority payment of the Former Officers' claims. *Id.*

B. The Former Officers' post-rehabilitation employment and golden parachute claims.

The Rehabilitation Order: (1) gave the Rehabilitator full authority to hire and discharge American Community's officers and employees; (2) terminated any outstanding pre-rehabilitation employment contracts subject to any contractual rights and applicable law; (3) provided that officers and employees remained employed at-will until notified they were discharged; and (4) authorized the Rehabilitator to re-contract with officers and employees on terms agreeable to the parties. (Exhibit B, pp 5-6, ¶8.)

Pursuant to this authority, the Rehabilitator discharged Former Officer Michael Tobin on April 16, 2010. (Exhibit I, Tobin Discharge Letter; Exhibit J, Summary of Former Officers' Employment Contracts, Termination Date, and Rehabilitation Payments.)

On May 19, 2010, the Deputy Rehabilitators offered an initial retention bonus plan, whereby officers and employees retained by the Rehabilitator re-contracted to earn bonuses for their continued service. The remaining five Former Officers signed this retention bonus plan.² (Exhibit K, May 19, 2010 Retention Bonus Plan and Signature Pages.) On August 17, 2010, after receiving a nearly \$3,000 retention bonus (in addition to her normal salary), Former Officer Ellen Downey was permanently laid-off. (Exhibit L, WARN Act Notification; Exhibit J.)

The other four Former Officers—Francis Dempsey, Beth McCrohan, Leslie Gola, and Michael McCollom—continued to work at American Community until between December 2010 and August 2011, drawing salary, retention bonuses,³ and even earning raises during that time. (Exhibit J.) In total, the Rehabilitator paid these four Former Officers over \$50,000 in retention bonuses, plus gave three of them raises totaling over \$32,000. *Id.* More importantly, all four of these Former Officers voluntarily resigned; none of them were discharged. (Exhibit N, Resignation Letters; Exhibit J.)

Nearly two years into this rehabilitation, by letters dated January 18, January 25, and January 26, 2012, four of the Former Officers, through their counsel, submitted

² Although Leslie Gola signed the retention bonus plan and continued working until she voluntarily resigned on April 5, 2011, the Rehabilitator cannot produce her documents because Ms. Gola took her entire, original employment file when she left the company.

³ The Deputy Rehabilitators offered two additional retention bonus plans on October 26, 2010 and May 16, 2011. Former Officer Francis Dempsey signed both plans, and the other three Former Officers signed only the October 26, 2010 plan because they resigned before or shortly after May 16, 2011. (Exhibit M.)

claims to the Deputy Rehabilitator seeking payment of benefits under their respective Executive Employment, or golden parachute, Agreements entered into prior to the April 8, 2010 Rehabilitation Order.⁴ (Exhibit O, Claim Letters.)

After reviewing the claims, the Rehabilitator and Deputy Rehabilitator, through their counsel, responded by letter dated February 7, 2012, and advised the Former Officers of the Rehabilitator's position that MCL 500.8137(4) prohibits the payment of claims under pre-rehabilitation employment contracts of the type sought by them. (Exhibit Q, Rehabilitator's Claim Denial.) Accordingly, the Rehabilitator denied the Former Officers' claims. *Id.*

On February 17, 2012, counsel for the Former Officers advised that Beth L. McCrohan was also submitting a claim, and further objected to the Rehabilitator's denial of the Former Officers' claims. (Exhibit R.) Subsequently, on April 10, 2012, all six of the Former Officers filed a Petition to Allow Claims requesting the Court to lift the stay against litigation in this rehabilitation, thereby allowing the Former Officers to file and litigate their claims with the Court. The Court entered the Former Officers' proposed Order to Allow Claims lifting the stay and permitting litigation of their claims on April 11, 2012. Finally, on May 8, 2012, the Court entered the parties' Stipulated Order deeming the claims filed, allowing the Surplus Noteholders to participate in this dispute, and establishing a briefing schedule.

⁴Mr. Dempsey's Agreement is dated September 27, 2004. Ms. McCrohan's Agreement is dated February 27, 2007. Mr. Tobin's Agreement is dated April 5, 2007. Ms. Downey's, Mr. McCollom's, and Ms. Gola's Agreements are all dated May 29, 2009. The Rehabilitator has attached as Exhibit P a copy of Mr. Tobin's Agreement only, because the Agreements have been previously filed with the Court and are believed to be identical in all material respects except for identifying information and the amount of the "Change in Control multiplier."

As Exhibits H and J reflect, assuming the Court concludes that the Former Officers' claims are not prohibited and that a "Change in Control" occurred (both of which the Rehabilitator contests, as discussed below), their payment would cost the estate over \$2.8 million. These payments, if given priority, would come at the direct expense of the Surplus Noteholders' claims.

ARGUMENT

I. Michigan insurance receivership law flatly prohibits payment of the Former Officers' claims.

Chapter 81 of the Insurance Code, MCL 500.8101 - 500.8159, governs Michigan insurance company receiverships. MCL 500.8137(4) specifically addresses the Former Officers' claims, and provides a special limitation on claims made under employment contracts by "insiders" (i.e., directors and officers) of a failed insurance company:

Claims made under employment contracts by directors, principal officers, or persons in fact performing similar functions or having similar powers are limited to payment for services rendered prior to the issuance of an order of rehabilitation or liquidation under section 8113 or 8118. [MCL 500.8137(4)(emphasis added)].

Accordingly, in this rehabilitation, the only claims payable under the Former Officers' golden parachute Agreements ("employment contracts") are claims for "services [they] rendered" prior to the April 8, 2010 issuance of the Rehabilitation Order. All other officer claims are statutorily barred, and cannot be paid by the Rehabilitator.

When interpreting the provisions of a statute, the Court's primary goal is to discern and give effect to the intent of the Legislature as reflected in the statute's plain language. *Koontz v Ameritech Servs, Inc*, 466 Mich 304, 312; 645 NW2d 34 (2002). As the Michigan Supreme Court has instructed, "[i]n defining particular words within a statute, we must consider both the plain meaning of the critical word or phrase and its

placement and purpose in the statutory scheme.” *People v Jackson*, 487 Mich 783, 790; 790 NW2d 340 (2010)(citations omitted). “[W]e give undefined statutory terms their plain and ordinary meanings. In those situations, we may consult dictionary definitions.” *Koontz*, 466 Mich at 312. Moreover, when interpreting statutes involving the insurance industry, the Supreme Court has held “that the insurance business is affected with a public interest; and that the law should be liberally construed in favor of policyholders, creditors and the public.” *Commissioner of Ins v American Life Ins Co*, 290 Mich 33, 43; 287 NW 368 (1939).

Applying these rules of statutory construction, the Court must interpret “payment for services rendered prior to the issuance of an order of rehabilitation” according to its plain meaning, in a manner that gives effect to the Legislature’s purpose for imposing this special limitation on employment contract claims made by officers of an insurer in rehabilitation. The dictionary defines “pay” as “to give in return for goods or service [~ wages].” *Merriam Webster’s Collegiate Dictionary*, p 853 (10th ed 1996). “Service” is defined as “the work performed by one that serves” or “useful labor that does not produce a tangible commodity—usu. used in pl. [charge for professional ~s].” *Id.* at 1070. “Render” is defined as “to do (a service) for another.” *Id.* at 990. “Payment for services rendered,” as used in MCL 500.8137(4), therefore means compensation in return for the *work, labor, or professional services* that an officer actually performed on behalf of the insurer prior to the order of rehabilitation. In other words, any earned but unpaid *wages* or *salary* payable in exchange for the officer’s pre-rehabilitation work performed.

Unlike earned but unpaid wages, the severance and other golden parachute benefits sought by the Former Officers are not payments for the work, labor, or professional services that they performed on behalf of American Community prior to the Rehabilitation Order. Rather, these benefits were designed to provide economic security and facilitate career readjustment if the Former Officers' employment ended, particularly following an acquisition by another insurance company. This is demonstrated by the Agreements themselves, which provide that their purpose is "to assure fair treatment of [the Company's] executives in the event of a Change in Control and to allow them to make critical career decisions without undue time pressure and financial uncertainty." (Exhibit P, p 1.)

That severance and other golden parachute benefits represent compensation for something other than "services rendered" is further supported by legal authority, including *Black's Law Dictionary*, p 1375 (6th ed 1990), which defines "severance pay" as:

Payment by an employer to employee beyond his wages on termination of his employment. *Such pay represents a form of compensation for the termination of the employment relation, for reasons other than the displaced employee's misconduct, primarily to alleviate the consequent need for economic readjustment but also to recompense the employee for certain losses attributable to the dismissal.* (emphasis added).

Similarly, in *Matson v Alarcon*, 651 F3d 404 (CA 4, 2011), the court considered when severance pay was "earned" for purposes of the bankruptcy priority statute that expressly allows claims for severance "earned" within the 180-day pre-petition period. In holding that severance pay was "earned" in full upon an employee's termination from employment and satisfaction of other plan conditions (rather than earned incrementally over the entire course of employment, as the Trustee argued), the court explained:

In contrast to wages, salaries, and commissions, the triggering events allowing employees to receive “severance pay” lie within the employer’s control and its decision both to provide severance compensation and to terminate the employment relationship. Thus, *employees do not “earn” “severance pay” in exchange for services rendered as they do when they “earn” wages, salaries, and commissions. Rather, employees receive “severance pay” as compensation for the injury and losses resulting from the employer’s decision to terminate the employment relationship.* [Matson, 651 F3d at 409 (emphasis added)].

See also *Merriam Webster’s Collegiate Dictionary*, p 501 (10th ed 1996) (defining “golden parachute” to mean “a generous severance agreement for an executive in the event of a sudden dismissal (as because of a merger)”; *Howell v. FDIC*, 986 F2d 569, 573 (CA 1, 1993)(upholding FDIC’s denial of severance claims by former officers of failed bank under federal law, while analogizing severance payments to “liquidated damages” that protect against the employee’s inability upon discharge to prove the actual loss from “alternative employments foregone”).

Accordingly, the golden parachute benefits sought by the Former Officers do not constitute payments for “services they rendered” to American Community prior to the Rehabilitation Order. They are benefits that existed for another reason entirely, namely economic security in the event of an (unanticipated) termination. Because MCL 500.8137(4) prohibits the payment of all officer claims other than wage claims for “services rendered,” this Court should deny the Former Officers’ claims.

Further support for denying the Former Officers’ claims is found in MCL 500.8142, the priority statute, which mirrors and reinforces MCL 500.8137(4)’s disfavored treatment of claims made by the officers and directors responsible for an insurance company’s financial collapse. Consistent with MCL 500.8137(4) limiting officers and directors to claims for their earned but unpaid pre-rehabilitation wages,

MCL 500.8142 addresses the priority given—or more accurately, not given—to these officer wage claims. MCL 500.8142(1)(a) grants first priority (Class 1) status to the costs and expenses of estate administration, including:

(vii) *Debts due to employees for services performed* to the extent that they do not exceed \$1,000.00 and represent payment for services performed within 1 year before the filing of the petition for liquidation, if the court determines that the payments are reasonably necessary to an orderly and effective administration for the protection of class 2 claimants. ***Officers and directors are not entitled to the benefit of this priority.*** [MCL 500.8142(1)(a)(vii)(emphasis added)].

MCL 500.8142(1)(d) then relegates to Class 4 status employee wage claims for “services performed” that are not deemed “reasonably necessary to an orderly and effective administration for the protection of class 2 claimants.” But again, this statute denies Class 4 status to officer and director wage claims: “***Officers and directors are not entitled to the benefit of the priority for debts due to employees for services performed.***” MCL 500.8142(1)(d)(emphasis added).

Thus, although the Legislature viewed wage claims as sufficiently important to receive priority if they were attributable to pre-rehabilitation work performed by regular employees, it expressly denied Class 1 or Class 4 priority status to even the unpaid *wage claims* of officers and directors. *A fortiori*, officer and director claims for severance and other *non-wage benefits* contained in their golden parachute agreements—which are far less deserving than wage claims—are not payable.

The annotated version of Wisconsin’s Insurers Rehabilitation and Liquidation Act of 1967 (Wisconsin Act), upon which Michigan’s Chapter 81 is based,⁵ explains the

⁵ The National Association of Insurance Commissioners (NAIC) recommended adoption of the Wisconsin Act as model insurance receivership legislation from 1968 to 1977, and relied on the Wisconsin Act as a basis for developing the NAIC model act. (Exhibit S, Excerpts from the Wisconsin Act, Annotated Version, p 1.) As Exhibit S explains, many of the

reason for the priority distinction between the wage claims of regular employees and the wage claims of officers and directors. The Wisconsin Act grants Class 2 priority to claims for “Wages,”⁶ defined as “[d]ebts due to employees for services performed, not to exceed \$1,000 to each employee which have been earned within one year before the filing of the petition for liquidation.” (Exhibit S, p 3.) Like MCL 500.8142(1)(a)(vii) and (d), the Wisconsin Act then excludes officers from the benefit of this wage claim priority. *Id.* The comment to this section explains why:

Priority is denied to officers (which term includes directors), on the grounds that *they are in a position to protect their own interests*, and that *those directly involved in what is likely to have been mismanagement leading to liquidation should not be accorded special privileges in a financial debacle of their own making.* (emphasis added).

“It is a well-established rule of statutory construction that provisions of a statute must be construed in light of the other provisions of the statute to carry out the apparent purpose of the Legislature.” *Farrington v Total Petroleum, Inc*, 442 Mich 201, 209; 501 NW2d 76 (1993). Here, MCL 500.8137(4) must be read in conjunction with MCL 500.8142 in a manner that carries out the Legislature’s intent. Taken together, these statutes evidence the Legislature’s intent to severely limit claims by officers and directors whose (mis)management drove an insurance company into receivership. MCL 500.8137(4) evidences the Legislature’s intent to bar claims by former officers for

Wisconsin Act’s “provisions have been incorporated into the current NAIC Model Act and state laws.” *Id.* Michigan is no exception. The Rehabilitator possesses a complete copy of the annotated Wisconsin Act and can provide it to the Court and counsel upon request.

⁶It is notable, if not dispositive, that the Wisconsin Act placed the heading “Wages” on the section granting priority to “[d]ebts due to employees for services performed.” This evidences that the Wisconsin Act, and in turn Michigan’s Chapter 81, intended the definition of “services performed” (as used in MCL 500.8142) and “services rendered” (as used in MCL 500.8137(4)) to mean “wages”—not non-wage claims for severance and other golden parachute benefits.

severance and other non-wage payments arising under their pre-rehabilitation employment contracts. And under MCL 500.8142, the Legislature specifically excluded officer and director wage claims permitted by MCL 500.8137(4) from the enhanced Class 1 or Class 4 priority status granted to regular employee wage claims. These statutes reflect the Legislature's clear intent to prohibit the payment of officer claims for severance and other non-wage benefits in a rehabilitation proceeding. The Court should effectuate the Legislature's intent by denying the Former Officers' claims.

Finally, because all of the Former Officers were still employed at American Community on April 8, 2010, the benefits sought under their Agreements remained completely contingent and were neither vested nor effective "prior to the issuance" of the Rehabilitation Order. Thus, even if the Court construed these benefits to be for "services rendered," MCL 500.8137(4) still prohibits their payment because the Agreements remained executory in nature, and none of the benefits thereunder were vested or payable, as of the date of the Rehabilitation Order. *See, e.g. Matson*, 651 F3d at 409 (concluding that the bankruptcy claimants who were terminated pre-petition "earned" severance compensation "upon their termination from employment and their signing a severance agreement and release"); *Hennessey v. FDIC*, 858 F. Supp. 483, 488 (ED Pa, 1994) (concluding that because managers of failed bank "were not terminated prior to the appointment of the FDIC as receiver, their rights to severance pay did not vest until after" the bank entered receivership).

In summary, Chapter 81 definitively bars the Former Officers' claims for severance and other non-wage benefits under their golden parachute agreements. Any broader interpretation of MCL 500.8137(4) would be inconsistent with the nature of

golden parachute benefits, the timing of when those benefits vest, and most importantly, would render the statute's intended limitation on officer claims meaningless. If, as the Former Officers will likely argue, their golden parachute benefits constituted "payment for services rendered" and became fully vested upon execution of their pre-rehabilitation employment contracts, then MCL 500.8137(4) would prohibit no officer claims at all. The Legislature's clear intent to limit claims by officers and directors would be completely nullified. The Court should reject this limitless interpretation, which flies in the face of the Legislature's intent and violates the well-settled rule of statutory construction that "[c]ourts must give effect to every word, phrase, and clause in a statute, and must avoid an interpretation that would render any part of the statute surplusage or nugatory." *Koontz*, 466 Mich at 312.

II. The Rehabilitation Order—which American Community's former management stipulated to—categorically prohibits payment of the Former Officers' claims.

The Rehabilitation Order stipulated to by American Community's former management also unequivocally prohibits payment of the Former Officers' claims:

[T]he Rehabilitator shall pay . . . (b) all Creditor claims for wages of American Community's officers, managers, and employees that were earned but unpaid as of the date of this Order. ***This provision requiring payment of pre-Rehabilitation employee wages does not apply to, and the Rehabilitator shall not pay, any severance or other non-wage payments otherwise due to an American Community officer, manager, or employee upon the termination of his or her employment contract entered into prior to the date of this Order.*** [Exhibit B, p 7, ¶14 (emphasis added)].

The Order did not include this prohibition by chance. The Rehabilitator and Deputy Rehabilitators were fully aware that the golden parachute Agreements existed and included this language, consistent with the limitations in MCL 500.8137(4).

The Former Officers expressly agreed to and are bound by this provision. Prior to filing and entry, drafts of both the Rehabilitation Order and Rehabilitation Petition were submitted to American Community's former management through its legal counsel.⁷ American Community proposed revisions to the draft documents, which the Rehabilitator accepted and made. At least two of the Former Officers pursuing claims—President Michael Tobin and General Counsel Francis Dempsey—specifically reviewed and approved the Rehabilitation Petition and Order. (Exhibit T, E-mail from J. Pirich dated April 7, 2010.) At no time during negotiation of the Order's language did the Former Officers revise or object to Paragraph 14 barring the claims they now assert. On April 8, 2010, American Community's former management, through their legal counsel, executed the Rehabilitation Order under the heading "Stipulated and Agreed." Given these circumstances, it would be grossly inequitable and contrary to the rules established and agreed to by all parties at the outset of this rehabilitation to allow the Former Officers to now assert claims that the stipulated Rehabilitation Order definitively bars. The Court should deny the Former Officers' claims.

III. It is against sound public policy to require the payment of golden parachute benefits to the Former Officers in charge of an insurer when it experienced severe financial distress necessitating rehabilitation.

Paying generous golden parachute benefits to the very officers responsible for causing American Community to fail sets bad precedent for future insurance receiverships, both in Michigan and in other states with comparable receivership laws.⁸

⁷ Earlier, on March 25, 2010, Former Officer Michael Tobin signed the Board of Directors' Resolution "authorizing the Company to consent to any relief sought by [OFIR] or ordered by a court of competent jurisdiction with regard to seeking rehabilitation, supervision and/or receivership of the Company." (Exhibit C.)

⁸ See Surplus Noteholder Trapeza's Brief Opposing the Former Officers' claims.

It creates perverse incentives for those currently running insurance companies. It unfairly subjects the claims of legitimate creditors (in this case, the Surplus Noteholders) to the risk of non-payment or greatly reduced payments, which in turn could diminish insurers' access to capital and result in more companies entering receivership. Thus, in addition to Chapter 81 and the Rehabilitation Order compelling denial of the Former Officers' claims, the Court should deny payment of these claims because it would promote bad policy.

These policy concerns require further brief discussion. First, a ruling that guarantees the Former Officers their golden parachute benefits despite American Community's financial failure and resulting rehabilitation creates an obvious incentive for officers of other troubled insurers to enter into similar agreements as the "ship is sinking." Promoting last-minute agreements made in bad faith for the personal benefit of a few select officers at the expense of other legitimate creditors is, quite plainly, bad policy. *See Howell v. FDIC*, 986 F2d at 573 (discussing the FDIC's policy argument that golden parachute agreements present an opportunity "by which insiders take advantage of the crisis to assure themselves of a handsome farewell gift from a failing bank.").

Second, subordinating the claims of other legitimate creditors⁹ to the Former Officers' golden parachute claims, particularly where this result is not reasonably

⁹ The Former Officers have not indicated into which priority under MCL 500.8142 they believe their claims would fall, if not prohibited. This question is significant. For example, if the claims were determined to be Class 5 general creditor claims, then the golden parachute claims made by the former officers of a failed insurance company would share pro rata with claims by other general creditors of the company. Assuming the estate only possesses funds sufficient to pay a portion of Class 5 claims, and because most golden parachute agreements provide for lavish payouts (like the over \$2.8 million in severance payments here), the officers' claims would overwhelm the class and significantly reduce the

expected given Chapter 81's prohibition against such payments, is patently unfair to current creditors like the Surplus Noteholders.¹⁰ Going forward, such a ruling may cause banks and investment companies further reluctance in making surplus note loans to troubled (or any) insurance companies. This reduced access to capital through surplus notes is particularly problematic for mutual insurance companies like American Community, which are owned by policyholders, not shareholders, and cannot raise capital merely by selling stock. Instead, mutual insurance companies must issue surplus notes (or increase premiums) to raise capital. Surplus notes are a type of loan that count as capital, but tend to be regarded by investors as relatively high-risk because they are both unsecured and subordinated to the interests of policyholders and most other creditors (except shareholders or members, see MCL 500.8142). Further, surplus note interest and principal payments cannot be made without the prior approval of the OFIR Commissioner.

Because there are already substantial risks that holders of surplus notes will not be paid, there tend to be few investors in surplus notes. Again, the task of insurers finding surplus note lenders would become even more difficult if recovery on a surplus note is further jeopardized by giving priority status to the golden parachute claims of

payments made to general creditors (e.g., lawyers, accountants, utility providers, etc.). State and local governments would fare even worse. As Class 5 claimants, the officers' claims must be paid in full ahead of these Class 6 claimants, jeopardizing the collection of unpaid taxes and fees that state and local governments desperately need. Class 7 late claims, even those of policyholders for covered expenses paid out-of-pocket, would be similarly subordinated, as would the claims of surplus note holders (Class 8) and shareholder/owner claims (Class 9).

¹⁰ As indicated in the Statement of Facts, payment of the Former Officers' claims in full ahead of the Surplus Noteholders' claims would reduce the Noteholders' recovery by over \$2.8 million, or 17.6%. (Exhibits H and J.)

the officers responsible for an insurer's rehabilitation. For each of these policy reasons, the Court should also deny the Former Officers' claims.

IV. Even if the Court determines that Michigan receivership law, the Rehabilitation Order, and/or public policy do not bar the Former Officers' claims, under the Agreements the four Former Officers who voluntarily resigned are entitled to no benefits and the two terminated Former Officers are entitled to only basic, "unenanced" benefits because there was no "Change in Control."

Even if the Court determines that the Former Officers' claims are not barred by Michigan law, the Rehabilitation Order, and/or public policy, the rehabilitation does not constitute a "Change in Control" under the terms of their Agreements. Barring a "Change in Control," the four Former Officers who voluntarily resigned from American Community—Francis Dempsey, Beth McCrohan, Leslie Gola, and Michael McCollom—are not entitled to any severance or other benefits pursuant to Paragraph 5(d) of their Agreements. (Exhibit N, p 4.) Moreover, the two Former Officers who were involuntarily terminated—Michael Tobin and Ellen Downey—are entitled to severance totaling at most one year's salary (depending on years of service) under Paragraph 5(c)(i) of their Agreements, not the enhanced severance payment of 200% (Downey) or 300% (Tobin) of "Annual Compensation" triggered by a "Change in Control." *Id.* at p 3.

The Agreements provide that a "Change in Control" occurs following "a demutualization, reorganization,¹¹ consolidation, merger, combination, sale of all or

¹¹ The Former Officers cannot credibly argue that American Community's rehabilitation constituted a "reorganization" for purposes of the "Change in Control" definition found in their golden parachute agreements. In fact, the court in *Hennessey v. FDIC*, 858 F. Supp. at 487, found expressly to the contrary. In holding that the former managers of a failed bank were not entitled to severance pay from the FDIC, the *Hennessey* court found that there was no "reorganization" triggering the managers' severance rights when the FDIC was appointed receiver, simultaneously transferred about 67% of the bank's assets to another bank, and proceeded to liquidate the remainder of the failed bank's assets.

substantially all of the assets of the Company, or similar transaction involving the Company” (Exhibit N, p 5.) The financial failure of American Community requiring it to be placed into rehabilitation constitutes none of these. Rather, the “Change in Control” provision, and the Agreements generally, were intended to protect against the sale, merger, or other restructuring of the company following its acquisition by *another insurance company*. Not its financial collapse and resulting takeover by the State.

The recitals discussing the purpose for the Agreements evidence that a “Change in Control” means a *financial transaction involving a third party* that could jeopardize the employment status of the Former Officers:

WHEREAS, the Company recognizes that its executives may be involved in *evaluating or negotiating other offers, proposals or other transactions which could result in Changes in Control of the Company* and believes that it is in the best interest of the Company and its members for such executives to be in a position, free from personal, financial and employment considerations, to be able to assess objectively and pursue aggressively the interests of the Company’s members. [Exhibit N, p 1 (emphasis added)].

Consistent with this stated goal and the Agreement’s other plain terms, it is clear that the definition of “Change in Control” does not include rehabilitation.¹² Thus, if the Court decides that the Former Officers’ claims are not prohibited, it should additionally determine that no “Change in Control” occurred under the Agreements.

According to the court, where “reorganization” requires the new entity to carry forward the business enterprise of the former entity, these circumstances did “not constitute a continuation of business, but rather a termination of business.” *Id.*

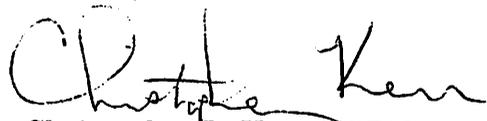
¹² See also *Black’s Law Dictionary*, p 692 (6th ed 1990) (defining “golden parachute” to mean: “A slang term for a termination agreement which shelters executives from the effects of a *corporate* change in control. . . . Such an agreement generally provides for substantial bonuses and other benefits for top management and certain directors who may be forced to leave the *target company* or otherwise voluntarily leave upon a change in control.”)(emphasis added).

CONCLUSION AND RELIEF REQUESTED

There are three dispositive reasons why the Court should deny the Former Officers' claims. First, Michigan law precludes payment of these claims. Second, the Rehabilitation Order—which American Community's former management reviewed, approved, and stipulated to—anticipated that these claims might be made and expressly prohibits their payment. Third, public policy dictates against paying golden parachute benefits to the officers responsible for an insurance company's failure. Doing so opens the door to abuse and threatens the payment of claims made by other legitimate creditors. For these reasons, the Court should uphold the Rehabilitator's decision denying the Former Officers' claims.¹³

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Dated: June 19, 2012

¹³ If the Court concludes that the claims are not prohibited, the Rehabilitator requests the Court to determine that there was no "Change in Control" and to allow additional briefing regarding the amounts payable to the two Former Officers who did not resign.

STATE OF MICHIGAN
CIRCUIT COURT FOR THE 30TH JUDICIAL CIRCUIT
INGHAM COUNTY

KEN ROSS, COMMISSIONER OF THE
OFFICE OF FINANCIAL AND INSURANCE
REGULATION,

Petitioner,

No. 10-397-CR

v

HON. WILLIAM E. COLLETTE

AMERICAN COMMUNITY MUTUAL
INSURANCE COMPANY,

Respondent.

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PROOF OF SERVICE

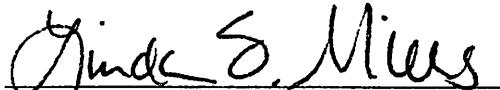
The undersigned certifies that a copy of the Brief in Support of Rehabilitator's
Denial of Former Officers' Claims for Severance and Other Benefits Under Pre-Rehabilitation

Executive Employment Agreements, together with this Proof of Service, was served upon the parties listed below by mailing the same to them at their respective addresses with first class postage fully prepaid thereon, on the 19th day of June 2012.

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