

STATE OF MICHIGAN  
IN THE COURT OF APPEALS

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

Petitioner,

Court of Appeals No. 312470

Ingham Circuit Court No. 10-397-CR

**[IN REHABILITATION]**

v

AMERICAN COMMUNITY MUTUAL  
INSURANCE COMPANY,

Respondent.

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In re: the Matter of:

AMERICAN COMMUNITY MUTUAL INSURANCE  
COMPANY'S FORMER OFFICERS MICHAEL TOBIN,  
ELLEN DOWNEY, FRANCIS DEMPSEY, MICHAEL  
McCOLLOM, BETH McCROHAN, and LESLIE GOLA,

Claimants/Appellants,

v

OFIR COMMISSIONER, AS REHABILITATOR OF  
AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY,

and

SURPLUS NOTEHOLDERS TRAPEZA CDO IX, LTD. AND  
CDO X, LTD., and HOLDCO ADVISORS, L.P., on behalf of SURPLUS  
NOTEHOLDER FINANCIAL RESTRUCTURING PARTNERS, LTD.,

Respondents/Appellees.

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**BRIEF OF APPELLEE REHABILITATOR OF  
AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY  
IN SUPPORT OF DENIAL OF FORMER OFFICERS' CLAIMS FOR  
SEVERANCE AND OTHER POST-TERMINATION BENEFITS UNDER  
PRE-REHABILITATION EXECUTIVE EMPLOYMENT AGREEMENTS**

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Dated: February 26, 2013

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## STATEMENT OF JURISDICTION

Respondent-Appellee the Commissioner of the Office of Financial and Insurance Regulation, as court-appointed Rehabilitator of American Community Mutual Insurance Company (the Rehabilitator), agrees with the Claimants-Appellants' statement of jurisdiction.

## COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. In the rehabilitation of a financially troubled insurance company under Chapter 81 of the Insurance Code, MCL 500.8137(4) limits claims made under pre-rehabilitation employment contracts by the officers and directors of the failed insurer to “payment for services [they] rendered prior to the issuance of” the rehabilitation order. This statutory limitation on “insider” claims requires that the purpose of a claimed payment must be in direct exchange “for” services actually performed, and that the services must be “rendered” and the payment fully earned and payable “prior to” entry of the rehabilitation order. Here, six former officers of American Community, who remained employed at the company when the rehabilitation order was entered, have made claims against the rehabilitation estate for severance and other non-wage, post-termination benefits arising under their pre-rehabilitation “golden parachute” agreements. Did the Rehabilitator and circuit court correctly decide that MCL 500.8137(4) bars payment of these claims?

Appellants’ answer: No.

Appellees’ answer: Yes.

Trial court’s answer: Yes.

2. American Community’s former management reviewed, approved, and stipulated to 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. In addition to their claims being legally barred under MCL 500.8137(4), did the Rehabilitator and circuit court properly deny the former officers’ claims for severance and other non-wage, post-termination benefits under their pre-rehabilitation golden parachute agreements because the rehabilitation order they agreed to expressly prohibits these claims?

Appellants’ answer: No.

Appellees’ answer: Yes.

Trial court’s answer: Yes.

3. MCL 500.8137(4) evidences the Legislature's determination that when an insurance company fails, the officer and director insiders who managed the company to financial collapse should not be rewarded with severance and other non-wage, post-termination benefits that they granted themselves in pre-rehabilitation golden parachute agreements. The statute is supported by sound public policy, where a contrary rule requiring payment of these claims: (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 insurance company receiverships. Given these policies supporting the Legislature's enactment of MCL 500.8137(4), did the Rehabilitator and circuit court correctly enforce the statute as written to deny payment of the former officers' claims?

Appellants' answer: No.

Appellees' answer: Yes.

Trial court's answer: Yes.

## CONSTITUTIONAL PROVISIONS, STATUTES, RULES INVOLVED

**MCL 500.8137 Contingent claims; discounting claims at legal rate of interest; claims made under employment contracts.**

Sec. 8137.

\* \* \*

(4) 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.

## INTRODUCTION

This appeal seeks to affirm a fundamental, legislatively-enacted rule that applies when an insurance company collapses financially and is placed into a court-ordered rehabilitation at the request of the Michigan Insurance Commissioner. That rule flatly prohibits officer and director “insiders” who managed the insurance company to financial ruin from collecting any post-termination severance or other “golden parachute” benefits that the insiders attempted to award themselves in employment contracts pre-dating the rehabilitation.

MCL 500.8137(4) expressly codifies the rule, limiting claims under an insider’s pre-rehabilitation employment contract to payment for services that he or she rendered prior to issuance of the rehabilitation order. In other words, insiders may claim any unpaid salary or wages that were both directly attributable to pre-rehabilitation services that they actually performed and that became fully earned and payable before entry of the rehabilitation order. All other claims are barred.

The Insurance Commissioner, as the court-appointed Rehabilitator who conducts every rehabilitation involving a Michigan insurance company, has consistently understood and applied this rule to bar payment of severance and other non-wage, golden parachute benefits claimed by the insiders of a failed insurer under their pre-rehabilitation employment contracts. In fact, in this case, the Rehabilitator intentionally incorporated MCL 500.8137(4)’s prohibition against paying officer severance claims into the April 8, 2010 Rehabilitation Order placing American Community Mutual Insurance Company (American Community) into rehabilitation. American Community, acting by and through the former officers

pursuing this appeal, reviewed and stipulated to that Rehabilitation Order. In addition, sound public policy supports the Legislature's (and Rehabilitator's) decision to prohibit payment of officers' non-wage severance claims.

Despite the clear statutory bar in MCL 500.8137(4), six former officers of American Community (the Former Officers)—who were in charge of the company when it failed and agreed to the rehabilitation—now ask this Court to overrule both the Rehabilitator's and circuit court's decision denying their claims for severance and other post-termination benefits arising under golden parachute agreements they executed prior to the rehabilitation. But the Former Officers' arguments for allowing their claims notwithstanding MCL 500.8137(4) are fatally flawed.

First, the officers gloss over the plain language of MCL 500.8137(4) in favor of case law discussing the general enforceability of unilateral employment contracts. No one disputes, however, that their agreements exist and may have otherwise been enforceable outside of rehabilitation. The only issue is whether *in this rehabilitation*, MCL 500.8137(4) bars the non-wage benefits those agreements purport to confer. The cases cited by the Former Officers do not address this issue.

Second, although the officers provide a scattershot recitation of various (and mostly irrelevant) provisions found in their golden parachute agreements, they ignore the most pivotal terms, which under the plain language of MCL 500.8137(4) establish unmet pre-conditions to any payment of their severance and other post-termination benefits. Specifically, unlike wages or salary that are payments made in direct exchange "for" services rendered, severance benefits serve another purpose

entirely—they are designed to provide economic security and facilitate career readjustment upon termination of the employment relation. Moreover, severance benefits may never become earned or payable regardless of how long an officer “renders services” to the company (e.g., if the officer works until retirement, dies on the job, or voluntarily resigns). Because these benefits are only triggered by the “severance” or actual termination of employment (not by the mere performance of services) and because they have a distinct purpose, they are not payments “for services rendered” as the statute requires.

Similarly, because severance and other post-termination benefits only become earned and payable following termination of employment—rather than earned incrementally as work is performed, like wages—this timing further disqualifies the officers’ claims under MCL 500.8137(4). Under the statute, the payment must be for services “rendered” and fully earned/payable “prior to” entry of the rehabilitation order. As the circuit court ruled, the Former Officers were still employed on the date of the Rehabilitation Order, so their claims for severance and other *post-termination* benefits did not pre-date the rehabilitation as the statute also requires.

Finally, the Former Officers contend that upon signing a golden parachute agreement and continuing to work for a single day, *every benefit* contained in that agreement becomes payable in a rehabilitation. In other words, the statute prohibits nothing. This interpretation would swallow MCL 500.8137(4) and defeat its purpose. For each of these reasons, the Court should reject the Former Officers’ arguments and affirm the Rehabilitator’s and circuit court’s denial of their claims.

## COUNTER-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. (Dkt #160, Ex A, Rehabilitation Petition [without Exhibits]; Ex B, Rehabilitation Order.) Importantly, American Community's then-management reviewed, authorized, and agreed to both the Petition and Order. (Dkt #160, Ex A, p 6; Ex B, p 13; Exhibit C, Certificate of Resolution.) Pursuant to the Rehabilitation Order and Michigan law, the circuit court appointed the Commissioner as Rehabilitator of American Community, along with two Special Deputy Rehabilitators. (Dkt #160, Ex 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 post-termination severance and other golden parachute benefits.<sup>1</sup> 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

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<sup>1</sup> 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.

surplus.” (Dkt #160, Ex 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. (Dkt #160, Ex E.) On 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. (Dkt #160, Ex 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. (Dkt #160, Ex 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 Appellee 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." (Dkt #160, Ex 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 insurance company receivership this rehabilitation has not been able to avoid all harmful consequences. Unfortunately, the rehabilitation has caused at least 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 these 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 to the replacement insurer, etc. At the close of this rehabilitation, the Rehabilitator does not anticipate sufficient funds to pay all creditor claims in full. Specifically, there are insufficient assets to pay the \$30 million in claims owed to the Surplus Noteholders, representing funds loaned to American Community in 2005. At best, the Surplus Noteholders will receive about \$16.1 million, or 54%, of their claims. (Dkt #160, Ex H, Financial Summary and Projection.) This amount would be reduced by 17.6%, to about \$13.3 million or a 44% payment, if this Court

reverses the Rehabilitator and circuit court by ordering priority payment of the Former Officers' claims. (*Id.*)

**B. The Former Officers' post-rehabilitation employment.**

All six of the Former Officers remained employed at American Community on April 8, 2010, the date the circuit court issued the Rehabilitation Order. 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. (Dkt #160, Ex B, pp 5-6, ¶8.) Pursuant to this authority, the Rehabilitator discharged Former Officer Michael Tobin on April 16, 2010. (Dkt #160, Ex I, Tobin Discharge Letter; Ex 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.<sup>2</sup> (Dkt #160, Ex K, 5/19/10 Retention Bonus Plan and Signature Pages.) On August 17, 2010, after receiving a nearly

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<sup>2</sup> 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.

\$3,000 retention bonus (in addition to her normal salary), Former Officer Ellen Downey was permanently laid-off. (Dkt #160, Ex L, WARN Act Notification; Ex 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,<sup>3</sup> and even earning raises during that time. (Dkt #160, Ex 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. (Dkt #160, Ex N, Resignation Letters; Exhibit J.)

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<sup>3</sup> 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. (Dkt #160, Ex M, 10/26/10 and 5/16/11 Retention Bonus Plans and Signature Pages.)

## PROCEEDINGS BELOW

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 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.<sup>4</sup> (Dkt #160, Ex 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. (Dkt #160, Ex 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. (Dkt #160, Ex R.) Subsequently, on April 10, 2012, all six of the Former Officers filed a Petition to Allow Claims requesting the circuit court to lift the stay against litigation in this rehabilitation, thereby allowing

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<sup>4</sup> Mr. 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 submitted as Exhibit P to its principal circuit court brief (Dkt #160, Ex P) a copy of Mr. Tobin's agreement only, because the agreements were previously filed with the circuit court (Dkt #147, Petition to Allow Claims, Exs 2-7) and are believed to be identical in all material respects except for identifying information and the amount of the "Change in Control multiplier."

the Former Officers to file and litigate their claims with the Court. (Dkt #147, Petition to Allow Claims.) The Court entered the Former Officers' proposed Order to Allow Claims lifting the stay and permitting litigation of their claims on April 11, 2012. (Dkt #145.) 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.<sup>5</sup> (Dkt #150.)

Following full briefing and oral argument held on August 15, 2012, the circuit court entered an Opinion and Order on August 24, 2012 affirming the Rehabilitator's denial of the Former Officers' claims. (Dkt #178.) In its Opinion, the court agreed with the Rehabilitator and Surplus Noteholders that MCL 500.8137(4) bars payment of the Former Officers' claims for severance and other non-wage, post-termination benefits. (*Id.*) The circuit court then entered a Final Order Denying Claims on September 10, 2012. (Dkt #185.) The Former Officers timely filed their claim of appeal with this Court on September 19, 2012.

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<sup>5</sup> As Exhibits H and J reflect, if this Court were to reverse the Rehabilitator and circuit court by concluding that the Former Officers' claims are not prohibited, and further assuming that on remand the circuit court determined that a "Change in Control" occurred (which the Rehabilitator contests, as argued in his briefing below, Dkt #160, pp 18-19), payment of the Former Officers' claims 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. The Rehabilitator and circuit court correctly concluded that Michigan insurance receivership law flatly prohibits payment of the Former Officers' claims.

#### A. Standard of Review

The court reviews questions of statutory interpretation de novo. *Kuznar v Raksha Corp*, 481 Mich 169, 176; 750 NW2d 121 (2008).

#### B. Analysis

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 issuance of" the April 8, 2010 Rehabilitation Order. All other officer claims are statutorily barred, and cannot be paid by the Rehabilitator. Applying the statute's plain language, this limitation on insider claims requires both: (1) that the purpose of a claimed payment must be in direct exchange "for" services actually performed; and (2) that the services must be

“rendered” and the payment fully earned and payable “prior to” entry of the rehabilitation order.

Insider claims for earned but unpaid pre-rehabilitation wages or salary satisfy these statutory requirements (although at a reduced payment priority, see Subsection 3, *infra*), because they are made in direct exchange for, and become fully earned and payable contemporaneously with, the performance of services prior to entry of the rehabilitation order. Conversely, the Former Officers’ claims for severance and other non-wage, post-termination golden parachute benefits are barred by the statute because they are not payments made in direct exchange “for” services rendered. They fulfill an entirely different purpose, are contingent on the actual termination of employment independent of any services performed, and under many employment circumstances may never become earned or payable. In addition, the Former Officers’ claims do not satisfy MCL 500.8137(4) with respect to timing because they were still employed when this rehabilitation commenced, meaning their severance and other post-termination benefits were neither earned nor payable “prior to” entry of the Rehabilitation Order.

- 1. MCL 500.8137(4) bars the Former Officers’ claims because unlike wages or salary, severance and other post-termination benefits do not constitute payments in direct exchange “for” services rendered.**

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 (10<sup>th</sup> ed 1996). Black’s Law Dictionary defines “for” as “in exchange for” or “by reason of.” *Black’s Law Dictionary*, p 644 (6<sup>th</sup> ed 1990). “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].” *Merriam Webster’s Collegiate Dictionary*, p 1070. “Render” is defined as “to do (a service) for another.” *Id.* at 990. Taken together, “payment for services rendered” as used in MCL

500.8137(4), therefore means compensation in direct exchange for (or by reason of) 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 unpaid *wages or salary*, which are payable solely by reason of the officer's pre-rehabilitation work performed and are earned contemporaneously with the performance of that work.

Unlike earned but unpaid wages, the severance and other golden parachute benefits sought by the Former Officers are not payments in direct exchange 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." (Dkt #160, Ex P, p 1.)

That severance and other golden parachute benefits represent payment for something other than "services rendered" is further supported by legal authority, including Black's Law Dictionary, 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. [*Black's Law Dictionary*, p 1375 (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 that severance pay is not “earned” in exchange for services rendered like wages or salary:

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 (10<sup>th</sup> 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 in direct exchange 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.

The fact that severance and other post-termination golden parachute benefits have a non-service-based purpose—and are therefore not payments “for services rendered” as MCL 500.8137(4) requires—is further evidenced by the circumstances under which they become payable. By definition, these benefits require a “severance” or actual termination of the employment relation to become earned and payable. Thus, an officer with a severance package can continue to work or “render services” to the company until they retire, die on the job, or voluntarily resign, yet never be entitled to severance benefits. Standing alone, the mere performance of services, no matter the duration, is not enough. Stated another way, performing services is a *necessary* but not a *sufficient* condition for the payment of severance benefits. On the other hand, performing work provides both a necessary and sufficient condition for the payment of wages and salary. Nothing more is needed. For this additional reason, wages and salary are payments in direct exchange “for services rendered” under MCL 500.8137(4), while severance and other post-termination benefits—which require something *beyond* mere services—are not.

Because the Former Officers’ claims for severance and other non-wage benefits do not constitute payments “for services rendered,” MCL 500.8137(4)

prohibits their payment. Accordingly, this Court should affirm the Rehabilitator's and circuit court's denial of the Former Officers' claims.

2. **MCL 500.8137(4) also bars the Former Officers' claims because unlike wages or salary, severance and other post-termination benefits are not earned and payable until there is a "severance" or termination of the employment relation, which in this case did not occur until after entry of the Rehabilitation Order.**

The Former Officers' claims also fail under MCL 500.8137(4) with respect to timing. All of the Former Officers remained employed at American Community on the date of the Rehabilitation Order. Under their agreements, and consistent with the very definition of "severance," they were not entitled to any severance<sup>6</sup> or other *post-termination* benefits *unless and until their employment was actually terminated*. For each of the six Former Officers, this undisputedly did not occur until *after* entry of the Rehabilitation Order.

As the circuit court ruled, in addition to MCL 500.8137(4)'s requirement that a payment's purpose must be "*for services rendered*," the statute also requires those services to have already been "rendered" and the payment to be fully earned and

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<sup>6</sup> The Former Officers alternatively seek two types of severance. First, they assert that the rehabilitation constituted a "Change in Control" entitling them to "enhanced" severance payments equal to 200% or 300% (depending on the officer's specific agreement) of their "Annual Compensation" (a term defined in the agreement). (See Dkt #160, Ex P, ¶ 5(e)(ii)(b), p 6.) Alternatively, if the courts conclude there was no "Change in Control," the officers' seek their basic or "unenanced" severance benefits under Paragraph 5(c)(i) of the agreement. (*Id.* at p 3.) For purposes of MCL 500.8137(4), however, severance is severance, and both types are statutorily barred. Severance is not a payment "for" services rendered, nor in this case was it earned and payable before entry of the Rehabilitation Order because the officers were still employed. Thus, for purposes of this appeal, it is does not matter whether there was a "Change of Control" or which type of severance benefits are at issue. The severance benefits sought by the Former Officers are not payable, period, as the circuit court correctly ruled.

payable “prior to” entry of the rehabilitation order. This is consistent with the “all or nothing” timing of severance payments, which are earned in full upon (and only upon) actual termination, unlike wages or salary that are earned incrementally during the course of employment and contemporaneously with the work performed. Because all of the Former Officers were still employed at American Community when the Rehabilitation Order was entered on April 8, 2010, the benefits sought under their golden parachute agreements remained completely contingent, and were neither earned nor payable, “prior to the issuance” of the Rehabilitation Order. For this additional reason, their claims are barred. 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).

3. **Chapter 81’s claim payment priority statute, MCL 500.8142, further supports the Rehabilitator’s and circuit court’s interpretation that MCL 500.8137 prohibits the payment of the Former Officers’ severance and other non-wage, post-termination benefits.**

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.<sup>7</sup> 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).

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<sup>7</sup> The Former Officers attempt to twist this argument, stating that while they agree their severance claims are not entitled to Class 1 or Class 4 payment priority as the Rehabilitator contends, their claims are entitled to Class 5 or 7 priority. The Rehabilitator's argument is not simply that the officers' severance claims cannot receive Class 1 or Class 4 priority. His argument is that under MCL 500.8137(4), the officers' severance claims are not payable *at all*. They do not fall within any payment class, and there is no “priority” that applies to these statutorily barred claims. MCL 500.8142 supports this position, because even as to the insider wage claims that MCL 500.8137 would permit, these wage claims are expressly denied the enhanced Class 1 or Class 4 payment priority afforded to “normal employee” wage claims. In other words, where the Legislature treats even insider *wage claims* this disfavorably, it makes perfect sense that the Legislature further decided to completely bar insiders' claims for severance and other non-wage, golden parachute benefits under MCL 500.8137(4).

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 at all under MCL 500.8137(4).

The annotated version of Wisconsin’s Insurers Rehabilitation and Liquidation Act of 1967 (Wisconsin Act), upon which Michigan’s Chapter 81 is based,<sup>8</sup> explains 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,”<sup>9</sup> 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.” (Dkt #160, Ex S, p 3.) Like MCL 500.8142(1)(a)(vii) and (d), the Wisconsin Act then excludes

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<sup>8</sup> 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. (Dkt #160, Ex S, Excerpts from the Wisconsin Act, Annotated Version, p 1.) As Exhibit S explains, many of the 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.

<sup>9</sup> It 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.

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 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.

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 purpose of golden parachute benefits, the timing of when those benefits become earned and payable, and most importantly, would swallow MCL 500.8137(4) and defeat its purpose.

Nevertheless, the Former Officers continue to advance an interpretation of MCL 500.8137(4) that renders the statute completely meaningless. According to the Former Officers, the directors and officers of an insurance company can sign golden parachute agreements at any time before the company enters rehabilitation promising themselves rich payouts if their employment is later terminated. Then, by working for a single day after signing the agreements, the directors and officers “earn” their payouts and are entitled to payment in full—even if the company fails and is placed in a court-ordered rehabilitation. Under this interpretation, *every* benefit built into an officer’s or director’s pre-rehabilitation employment contract would be payable in rehabilitation. Nothing would be precluded. MCL 500.8137(4) would be eviscerated. This interpretation directly conflicts with two axiomatic rules of statutory construction: (1) “that the Legislature did not intend to do a useless thing,” *City of South Haven v Van Buren County Bd of Comm’rs*, 478 Mich 518, 532; 734 NW2d 533 (2007); and (2) 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.

The Court should reject the Former Officers' limitless interpretation in favor of the Rehabilitator's and circuit court's interpretation, which comports with the statute's plain language, gives it meaning, and effectuates the Legislature's intent.

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

**A. Analysis**

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.* [Dkt #160, Ex 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 incorporating the payment restrictions found 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.<sup>10</sup> 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. (Dkt #160, Ex T, 4/7/10 e-mail.) 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.

Although the Former Officers attempt to distance themselves from the Rehabilitation Order by asserting that it was stipulated to by “the corporation,” a corporation can only act through its officers and directors. Undisputedly, and on behalf of the company, themselves, and their fellow Former Officers, at a minimum Mr. Tobin and Mr. Dempsey reviewed and stipulated to this provision in the Rehabilitation Order that incorporates MCL 500.8137(4) and unequivocally prohibits payment of any officer claims for severance or other non-wage benefits under their pre-rehabilitation employment contracts. These circumstances further

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<sup>10</sup> 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.” (Dkt #160, Ex C.)

support the propriety of the Rehabilitator's and circuit court's decision to deny the Former Officers' claims, which the officers expressly disclaimed at the outset of this rehabilitation by stipulating to the Rehabilitation Order.

Finally, the Former Officers offer a tortured reading of Paragraph 14 by claiming that its first sentence, which allows the payment of claims for pre-rehabilitation "goods and services provided" upon "further order of the court," somehow applies to the paragraph's last sentence flatly prohibiting any payment of officer claims for severance or other non-wage benefits. A plain reading of Paragraph 14, however, evidences that the latter provision is absolute, and is neither governed by nor connected with the introductory sentence permitting court approval of certain pre-rehabilitation claims for "goods or services provided." The severance claim prohibition is not a timing provision, it is an absolute bar. Because the Former Officers are bound by this provision, the Court should additionally affirm the Rehabilitator's and circuit court's decision denying their claims.

**III. Sound public policy further supports the Legislature's determination, embodied in MCL 500.8137(4), that the officer and director insiders who manage an insurance company to financial collapse should not be rewarded with severance and other non-wage, post-termination benefits that they granted to themselves in pre-rehabilitation golden parachute agreements.**

**A. Analysis**

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.<sup>11</sup> 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. Given these policies supporting the Legislature's enactment of MCL 500.8137(4) and its prohibition on non-wage officer claims, again the Court should affirm the Rehabilitator's and circuit court's denial of the Former Officers' claims.

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, guaranteeing officers these payments even if the company fails (or as the Former Officers argue, actually enhancing their payments *because* the company failed) provides little incentive to avoid rehabilitation.

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<sup>11</sup> See Dkt #163, Surplus Noteholder Trapeza's Brief Opposing the Former Officers' claims.

Third, subordinating the claims of other legitimate creditors<sup>12</sup> to the Former Officers' golden parachute claims, particularly where this result is not reasonably expected given Chapter 81's prohibition against such payments, is patently unfair to current creditors like the Surplus Noteholders.<sup>13</sup> 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,

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<sup>12</sup> If granted Class 5 general creditor priority status as argued for by the Former Officers, 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 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).

<sup>13</sup> 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%. (Dkt #160, Exs H and J.)

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 the officers responsible for an insurer's rehabilitation. Consistent with MCL 500.8137(4) and these policies supporting it, the Court should affirm the Rehabilitator's and circuit court's denial of the Former Officers' claims.

## CONCLUSION AND RELIEF REQUESTED

There are three dispositive reasons why this Court should deny the Former Officers' claims. First, Michigan law, specifically MCL 500.8137(4), precludes payment of these claims. Second, the stipulated Rehabilitation Order anticipated that these claims might be made and expressly prohibits their payment. Third, public policy supports the Legislature's decision to prohibit the payment of 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.

The Rehabilitator has no financial stake in this payment dispute. As the courts direct, the Rehabilitator will pay funds remaining at the close of this rehabilitation to the Surplus Noteholders, either in full or net any amounts determined payable (and having priority) under the Former Officers' golden parachute agreements. As a legal matter, however, the Rehabilitator is duty-bound to faithfully apply and enforce the laws enacted by the Legislature governing this and all other insurance company receiverships. This includes MCL 500.8137(4), the plain language of which prohibits payment of the Former Officers' claims.

For the reasons stated above, the Rehabilitator respectfully requests this Court to affirm the Rehabilitator's and circuit court's decision denying the Former Officers' claims.<sup>14</sup>

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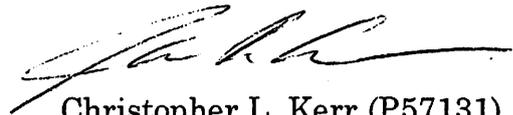
<sup>14</sup> If this Court concludes that the claims are not prohibited by law, the Rehabilitator requests the Court to remand to the circuit court for a determination whether there was a "Change in Control" and to otherwise determine what amounts, if any, are payable to each of the Former Officers.

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