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August 8, 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 **Reply 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,

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Enc

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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,

v

AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY,

Respondent.

No. 10-397-CR

HON. WILLIAM E. COLLETTE

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

INTRODUCTION

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.

As expected, the Former Officers 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. It is a fundamental rule of statutory construction that the Legislature does not intend to enact useless laws. Because the Former Officers' interpretation of MCL 500.8137(4) violates this rule, the Court should reject it outright.

In contrast, the Rehabilitator's interpretation of MCL 500.8137(4) comports with the statute's plain language, gives it meaning, and effectuates the Legislature's intent.

By statute, "insider" claims made by officers and directors under pre-rehabilitation employment contracts are allowed only if they represent "payment for services [the insiders] rendered prior to" issuance of the rehabilitation order. Accurately applied, this means earned but unpaid *wages*, which are paid in direct exchange for and earned contemporaneously with services performed. Conversely, it does not mean severance and other post-termination benefits, which by definition are payments in exchange for *termination of employment* that are not (and may never be) earned until termination actually occurs.

In addition, the Rehabilitator intentionally incorporated MCL 500.8137(4)'s prohibition against paying officer severance claims into the Rehabilitation Order. American Community, acting by and through the Former Officers, expressly stipulated to this prohibition. Enforcement of the Court's order establishing the ground rules for a receivership promotes fair and orderly administration. Changing those rules raises further Rehabilitator concerns, particularly when the order was stipulated.

Finally, the Rehabilitator has serious policy concerns with paying officer and director golden parachute claims in a receivership. If given class 5 priority, these claims would reduce payments to general creditors (lawyers, accountants, utility providers, etc.), while eliminating payments to state/local governments, late policyholder claims, and surplus noteholders. Guaranteeing officers these payments even if the company fails provides little incentive to avoid rehabilitation. It encourages last-minute, self-interested agreements at the expense of other creditors. It creates further risks to surplus lenders, reducing insurers' access to needed capital.

For each of these reasons, the Court should deny the Former Officers' claims.

ARGUMENT

I. MCL 500.8137(4) bars payment of the Former Officers' claims.

To support their claims, the Former Officers cite authority that, in general, employment severance agreements are supported by consideration and enforceable under Michigan law. The Rehabilitator does not dispute the existence of the Agreements, or their enforceability outside the context of this rehabilitation. If the Former Officers had secured the sale or merger of American Community as their Agreements envisioned (thereby avoiding this rehabilitation), they presumably could have collected their golden parachute benefits. That did not occur. The question thus remains whether the Former Officers' claims are payable *in this rehabilitation.*

The answer to this question lies in whether the Former Officers' golden parachute claims represent "payment for services [they] rendered prior to" the Rehabilitation Order. MCL 500.8137(4). The "unilateral contract" cases cited by the Former Officers do not address this issue, nor do the officers directly respond to the Rehabilitator's arguments that, unlike wages, the nature of severance benefits and the timing of when those benefits are earned preclude their payment under MCL 500.8137(4).[1] Instead, the Former Officers contend that upon signing a golden parachute agreement and continuing to work, *every benefit* contained in the agreement becomes payable in a rehabilitation. In other words, the statute prohibits nothing. 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*

[1] While the Former Officers' suggest that they were hired or retained to save the company, passed up other employment opportunities during their tenure, and/or stayed in reliance on their severance benefits, these statements are unsupported, self-serving, and in any event, irrelevant under the statute.

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 v Ameritech Servs, Inc*, 466 Mich 304, 312; 645 NW2d 34 (2002).

The Former Officers' interpretation cannot be correct. When an insurance company enters rehabilitation, the Legislature has imposed a special rule—specifically directed at the former directors and officers in charge of the ruined insurer—that prohibits employment contract claims by these "insiders" unless they represent "payment for services rendered prior to" the rehabilitation order.[2] Applying this language in its simplest, most straightforward manner, "payment for services rendered" 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*, which are paid in direct exchange for and earned contemporaneously with services performed.

Unlike earned but unpaid wages, the golden parachute benefits sought by the Former Officers are not payments for pre-rehabilitation services that they rendered. Rather, they were contingent benefits designed to provide economic security and facilitate career readjustment if their employment ended (particularly following an acquisition by another insurer). This is evidenced 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

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[2] As discussed in the Rehabilitator's principal brief, at pp 10-13, the Legislature's disfavored treatment in MCL 500.8142 of even officer and director *wage claims* further supports the Rehabilitator's position that non-wage severance claims are flatly prohibited in a rehabilitation or liquidation proceeding.

decisions without undue time pressure and financial uncertainty." (Ex P to Rehabilitator's Br, p 1.) It is supported by the dictionary definition of "severance pay," which "represents a form of compensation *for the termination of the employment relation . . . primarily to alleviate the consequent need for economic readjustment.*" Black's Law Dictionary, p 1375 (6th ed 1990)(emphasis added). It is supported by the decision in *Matson v Alarcon*, 651 F3d 404, 409 (CA 4, 2011), where the court distinguished between wages—which are earned in exchange for services rendered at the time the services are performed—and severance pay—which is earned for the injuries resulting from job loss at the time when employment is terminated.[3]

Severance benefits do not constitute "payment for services rendered prior to" a rehabilitation order under MCL 500.8137(4). They are paid to provide economic security in the event of an (unanticipated) termination, not for "services rendered." They are "earned" only upon termination—not incrementally during the course of employment—and therefore were not payable to the still-employed Former Officers "prior to" the date of the Rehabilitation Order. Any broader interpretation would swallow MCL 500.8137(4) and defeat its purpose.

CONCLUSION AND RELIEF REQUESTED

To secure payment of their golden parachute benefits, the Former Officers rely on unsupported (and irrelevant) "facts" and a legal argument that has no limits. This Court should uphold the Rehabilitator's denial of the Former Officers' claims.

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[3] *See also Howell v. FDIC*, 986 F2d 569, 573 (CA 1, 1993); Exhibit S to Rehabilitator's Brief (the Wisconsin's Insurers Rehabilitation and Liquidation Act of 1967, upon which Michigan's Chapter 81 is based, which placed the heading "Wages" on the section granting priority to "[d]ebts due to employees for *services performed*" evidencing that the definition of "services performed" (as used in MCL 500.8142) and "services rendered" (as used in MCL 500.8137(4)) was intended to mean "wages").

Respectfully submitted,

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Dated: August 8, 2012

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PROOF OF SERVICE

The undersigned certifies that a copy of Reply 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 8th day of August, 2012.

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