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June 19, 2012

Hand Delivered

Clerk of the Court
Ingham County Circuit Court
313 W. Kalamazoo
Lansing, MI 48933

RE: ***Ken Ross, Commissioner of OFIR v American Community Mutual Ins. Co.***
Ingham County Circuit Court File: 10-397-CR

Dear Clerk:

Enclosed are:

1. "Brief Of Holdco Advisors, L.P. On Behalf Of Surplus Noteholder Financials Restructuring Partners, Ltd. In Support Of Rehabilitator's Denial Of Former Officers' Claims For Severance And Other Benefits Under Pre-Rehabilitation Executive Employment Agreements."
2. Proof of Service of copies of same upon the interested parties.

By a copy of this letter service upon the (other) interested parties is being accomplished.

Thanks for your assistance.

Sincerely yours,

John L. Noud

lb
Enclosures
cc: Christopher L. Kerr
Phillip L. Sternberg
Carolyn R. Thagard
Vik Ghei
Mudassir Mohamed
Seth McCormick (via email)

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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BRIEF OF HOLDCO ADVISORS, L.P. ON BEHALF OF SURPLUS NOTEHOLDER FINANCIALS RESTRUCTURING PARTNERS, LTD. IN SUPPORT OF REHABILITATOR'S DENIAL OF FORMER OFFICERS' CLAIMS FOR SEVERANCE AND OTHER BENEFITS UNDER PRE-REHABILITATION EXECUTIVE EMPLOYMENT AGREEMENTS

INTRODUCTION

After driving one of Michigan's oldest and most respected mutual insurance companies into failure and rehabilitation, the company's management team now seeks to reap a $2.8 million windfall in severance payments as their reward, personally enriching themselves at the expense of the company's creditors. And this grab for company cash comes ***after*** five of these six former officers received substantial retention bonuses for their services following entry of the rehabilitation order.

These claims for severance payments fly in the face of basic notions of fairness and equity. It was this management team that controlled the company and oversaw its demise. That in and of itself justifies disallowing any severance claims. But, in addition, the company has creditors to pay – specifically, $30 million in surplus notes. If allowed, the former officers' severance claims would substantially reduce the noteholders' already-limited recovery from approximately 54% to approximately 44%. Thus, having already reduced creditor recoveries to a fraction of their original investment by mismanaging the company, the former officers now seek to add insult to injury and walk away with a nearly $3 million cash bonus while creditors watch their recoveries dwindle even further. Such actions should not be rewarded, and the Court should not permit such inequity.

In addition, the claims are facially invalid under Michigan insurance rehabilitation law. Claims by the officers of a company in rehabilitation are limited to claims for services rendered prior to the rehabilitation proceeding. These are severance obligations, and are not obligations for any services rendered. Further, the officers were discharged (or voluntarily resigned) ***after*** the Court entered the order for rehabilitation. Accordingly, the claims are not permissible and should not be allowed.

STATEMENT OF FACTS

American Community began its downward spiral into this rehabilitation proceeding in the mid-2000s. By 2008, A.M. Best Company, the premier insurance rating and information agency, reported that American Community's instability and decline were due to "a series of operational missteps made . . . over the past few years, which contributed to net losses and corresponding lower surplus." *See* Exhibit D to the Rehabilitator's *Brief in Support of Rehabilitator's Denial of Former Officers' Claims for Severance and Other Benefits Under Pre-Rehabilitation Executive Employment Agreements*, filed substantially contemporaneously herewith. By April 8, 2010, the company's continued decline, sparked by those initial "operational missteps," resulted in the commencement of this rehabilitation proceeding.

On, April 16, 2010, the Rehabilitator discharged one of the company's officers, Michael Tobin, pursuant to the powers granted by this Court under the rehabilitation order. On May 19, 2010, the company's five remaining officers were offered continued salary and retention bonuses for continued service to the company during the rehabilitation process. One of these officers, Ms. Ellen Downey, was discharged after receiving an approximately $3,000 retention bonus. The four remaining officers received retention bonuses totaling over $50,000 and raises of over $32,000. These four officers then voluntarily resigned between December 2010 and August 2011.

Between January 18, 2012, to April 10, 2012, each of the six former officers asserted claims for severance payments pursuant to their pre-rehabilitation employment contracts.[1] The Rehabilitator has disputed each such claim.

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[1] The agreements are dated September 27, 2004, February 27, 2007, April 5, 2007, and May 29, 2009 (three agreements).

ARGUMENT

I. This Management Team's Failure Led American Community into Rehabilitation, and Reducing Surplus Noteholder Recoveries to Reward Their Failure Would Be Grossly Inequitable.

The holders of the $30 million of surplus notes (the "Surplus Notes"), already facing substantial losses on the Surplus Notes, should not be further harmed by the payment of gratuitous and unwarranted bonuses for the company's failed management team. The Surplus Notes represent a passive investment at a fixed coupon rate with no upside potential but much stronger downside protection than traditional equity. The mismanagement of the company by its officers, however, has cut recoveries on the Surplus Notes nearly in half. Yet these same officers now seek to further reduce these recoveries by nearly $3 million – $3 million sought as a reward for their failure. Their failure, however, should not be rewarded by a seven-figure payout.

Without question, it was the officers' failure as managers that pushed American Community into financial distress and resulted in this rehabilitation proceeding. As the Rehabilitator's brief clearly outlined in its statement of facts, American Community started its downward spiral because of "a series of operational missteps" made by its management team. These "operational missteps" have left the company's investors with limited recoveries and no prospect of recouping their losses. Still, shockingly, the company's officers seek to further harm their investors, after driving the company into the ground, by demanding priority payment on their severance claims (the "Severance Claims"). This demand comes ***after*** they were paid post-rehabilitation salaries, raises of over $32,000 and retention bonuses totaling over $50,000. As such, these officers have already received more than the benefits they bargained for: they were paid to oversee the fallout of their failure. To now claim that they are owed ***more*** money because the Rehabilitator no longer requires their services is unreasonable.

Indeed, the management team's overreaching is highlighted by their claims for the "enhanced" benefits that allegedly come along with a "change of control." They assert that the rehabilitation itself constitutes a "change of control" entitling them to an even greater payout. Not only is this wrong, it is insulting to the creditors that are scrambling to limit their losses in the wake of this management team's incompetence. For one, the obvious intended meaning of "change in control" is a change of control resulting from the sale or merger of the company, not from the company's failure and the resulting rehabilitation proceeding. No fiduciaries could, within the boundaries of their duties, build in a bonus for themselves that triggers upon the company's failure. Further, it would be both inequitable and absurd to ***increase*** the management team's recoveries ***because*** the company failed.

This absurdity only becomes more apparent by looking at the relative positions of the Surplus Noteholders and the former officers. The Surplus Notes are passive investments that, unlike traditional equity, share none of the upside gain if the company performs well. Rather, the Surplus Notes were designed to mitigate risk in the event the company performed poorly by guaranteeing a specific rate of return, a benefit that tradition equity, which shares in the upside, does not receive. The former officers, on the other hand, were in a position to reap the upside potential if the company performed well, such as increased compensation or bonuses, but were not entitled to any downside guarantees.[2]

The former officers were thus entrusted to run the company successfully and to meet the obligations of the Surplus Notes. The holders of Surplus Notes, by contrast, had no say in how the company was run, and instead put their faith in the former officers to manage the company.

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[2] Indeed, the severance payments were designed not to mitigate former officers' losses in the even the company failed, but to protect them from the potentially harmful downside of a potential no-cause termination in the event of a sale or merger of the company – a "change of control."

Now, not only have the holders' expectations been shattered by the former officers' "operational missteps," but the former officers also seek to cut into the Surplus Noteholders' downside protections (which have already ben reduced to nearly half of what was promised). The former officers seek to improperly expand the scope of their benefit as officers, reap a downside benefit in the wake of the failure that they themselves caused, and actually ***reduce*** Surplus Noteholder recoveries in the process. It already grates against all notions of equity to provide, at any priority level, nearly $3 million of golden parachute payments to the officers whose mismanagement has eviscerated the value of the Surplus Notes. To suggest that these claims should be paid ahead of or even *pari passu* with the Surplus Notes, and that such claims should further reduce the Surplus Noteholders' recovery, is beyond the pale and must not be allowed.

Moreover, as explained in the Rehabilitator's brief, the former officers agreed ***not*** to pursue the Severance Claims under the stipulated rehabilitation order. Holdco, as Surplus Noteholder, relied on the stipulated rehabilitation order when assessing this proceeding, and believed that the Severance Claims were barred by the order and by Michigan law. If Holdco would have been aware that the former officers were going to assert nearly $3 million in claims for purported severance obligations and claim that such obligations should reduce noteholder recoveries, Holdco would have conducted an investigation into the potential claims that the company may have against the former officers. Indeed, leading one of Michigan's largest and most respected insurance companies into a tailspin resulting in this rehabilitation proceeding likely involved breaches of fiduciary duties along the way (such as the duty of care). Specifically, the decision to provide three officers of the failing company with a robust severance package in May of 2009, well into the company's downward spiral, is itself highly suspect. Regardless, such claims could likely have offset the claims that are now being brought by the

former officers. But Holdco was not aware that the former officers could or would make any such claims, none of which were brought until 21 months into this rehabilitation proceeding. As such, the inequity stretches beyond the relative positions and expectations of the parties, and the former officers should be held to their agreement not to bring any such claims under the stipulated rehabilitation order.

Lastly, it is simply bad policy to pay the former officer claims in the wake of the company's failure. Public furor over extravagant bonuses paid to company officers despite poor-to-abysmal job performance has been a fixture in this country for the last several years. In 2009, the public was outraged when AIG paid $165 million in bonuses on the heels of its federal bailout using taxpayer money.[3] Just last month, JPMorgan Chase's Chief Investment Officer resigned from her role in the company suffering over $2 billion in investment losses, yet she is due to receive a severance package estimated at nearly $15 million.[4] Actions like these have led to investigations, Congressional hearings, proposed legislation, and vigorous debate. Here, paying generous golden parachute benefits to the very officers responsible for causing American Community to fail is, put bluntly, outrageous. It is the epitome of rewarding incompetence, and this Court should not bless any action that creates such perverse incentives.

II. The Severance Claims are Not Claims for Services Rendered and Cannot Be Paid Under Michigan Law.

Although the equities alone prevent payment of the Severance Claims, the claims should also be disallowed as a matter of law. The Rehabilitator's brief, filed substantially contemporaneously herewith, clearly outlines why the Severance Claims are legally invalid

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[3] *See* Wall Street Journal Online, *Some Will Pay Back AIG Bonuses* (March 19, 2009), *available at*: http://online.wsj.com/article/SB123743055512280701.html (accessed June 14, 2012).

[4] *See* CNN Money Online, *Ex-JPMorgan exec may face pay 'claw back'* (June 6, 2012), *available at*: http://money.cnn.com/2012/06/05/news/companies/JP-morgan-senate/index.htm (accessed June 14, 2012).

under Michigan insurance rehabilitation law. Specifically, MCL 500.8137(4) states that "[c]laims made under employment contracts by directors [or] principal officers . . . are limited to payment for services rendered prior to the issuance of any order of rehabilitation." The severance payments at issue here are not payments for services rendered prior to the rehabilitation order, and, accordingly, the Severance Claims cannot be allowed.

A. Bankruptcy Law Highlights the Distinction Between Severance Payments and Payments for Services Rendered.

Bankruptcy law provides a helpful lens through which to view severance payments. Under bankruptcy law, payments for services rendered before the commencement of the bankruptcy case are treated differently than payments that arise after the bankruptcy case is filed. *See* 4-507 Collier on Bankruptcy P 507.04 ("Administrative expenses may be granted for the actual, necessary costs and expenses of preserving the estate, including wages, salaries and commissions for services rendered after the commencement of the case."). Accordingly, when an officer is discharged after the commencement of a bankruptcy case, the bankruptcy court must determine whether severance payments for the terminated manager are on account of such manager's pre-bankruptcy services.

Bankruptcy case law makes clear that when a manager is discharged after a bankruptcy case is filed, claims for severance payments are not claims made on account of pre-bankruptcy services. Specifically, the case law highlights the distinction between (i) compensation that accrues over the course of employment, which is payment for services rendered during the period of employment, and (ii) severance payments that simply trigger upon termination, which is given in exchange for the hardship caused by the termination. For example, in *Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, the Second Circuit explained that

severance payments are compensation for the termination itself, not for the services leading up to it:

> [S]everance payments are a form of compensation for the termination of the employment relation . . . primarily to alleviate the consequent need for economic readjustment but also to recompense [the terminated parties] for certain losses attributable to the dismissal. The severance payment at issue . . . did not accrue day to day over the course of employment, but rather was triggered by termination, and as such it represented a new benefit payable because of termination . . . .

479 F.3d 167, 173 (2d Cir. 2007). Similarly, in *Matson v. Alarcon* the Fourth Circuit highlighted the uniqueness of severance payments as compensation for ***termination***, in contrast with ordinary wages as compensation for ***services rendered***:

> The purpose of such severance compensation is to alleviate the consequent need for economic readjustment and to recompense [the employee] for certain losses attributable to the dismissal . . . . [E]mployees 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.

651 F.3d 404, 409 (4th Cir. 2011) (citations and quotes omitted); *see also In re Eutsler*, Case No. 11-31133, 2012 Bankr. LEXIS 90, at *6 (W.D.N.C. Jan. 5, 20120) ("[A] severance package [is] earned on the date the employee became entitled to receive such compensation.") (citations and quotes omitted); *Straus-Duparquet, Inc. v. Local Union No. 3, Int'l B'hood of Elec. Workers*, 386 F.2d 649, 651 (2d Cir. 1967). ("Severance pay is not earned from day to day and does not 'accrue' so that a proportionate part is payable under any circumstances. After the period of eligibility is served, the full severance pay is due whenever termination of employment occurs . . . . [S]everance pay is compensation for termination of employment.").

The case law is clear: severance payments are not payments on account of services rendered ***at all***, let alone on account of services rendered prior to the commencement of the bankruptcy case. This bankruptcy-law understanding of severance payments is directly

applicable to this case. The Severance Claims are not claims for services rendered of any sort, and are certainly not claims for services rendered prior to the order for rehabilitation.

B. Michigan Insurance Rehabilitation Law Prohibits Payment of the Severance Claims.

Although bankruptcy case law is useful for understanding the nature of the Severance Claims, the treatment of such claims is governed exclusively by Michigan insurance rehabilitation law. MCL 500.8137(4) limits payments to officers to "payment for services rendered prior to the issuance of any order of rehabilitation." Thus, in addition to the equities of this case weighing exclusively and powerfully in favor of disallowing the Severance Claims, such claims are also not payable as a matter of statutory law.

CONCLUSION

For the foregoing reasons, as well as the reasons contained in the Rehabilitator's brief, the Court should deny the former officers' claims.

June 19, 2012

Respectfully Submitted,

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STATE OF MICHIGAN
IN THE 30th CIRCUIT COURT FOR THE COUNTY OF INGHAM

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

Petitioner,

vs.

AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY,

Respondent.

File No. 10-397-CR

Judge William E. Collette

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STATE OF MICHIGAN)
COUNTY OF INGHAM)

Lisa M. Bodell, being first duly sworn, deposes and says that on the 19th day of June 2012, she served copies of "Brief Of Holdco Advisors, L.P. On Behalf Of Surplus Noteholder Financials Restructuring Partners, Ltd. In Support Of Rehabilitator's Denial Of Former Officers' Claims For Severance And Other Benefits Under Pre-Rehabilitation Executive Employment Agreements" upon the following, by first class mail, with postage fully prepaid thereon:

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Lisa M. Bodell

Subscribed and sworn to before me, a Notary Public, in and for the County of Ingham, State of Michigan, on this 19th day of June 2012.

John L. Noud
My commission expires: 9/24/2013
Acting in the County of Ingham