

STATE OF MICHIGAN

IN THE CIRCUIT COURT OF THE COUNTY OF INGHAM

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

Case No. 10-397-CR

Petitioner,

Hon. William E. Collette

vs.

AMERICAN COMMUNITY MUTUAL  
INSURANCE COMPANY,

Respondent.

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

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**STATEMENT OF QUESTION PRESENTED**

- I. Should this Court confirm the Rehabilitator's decision denying the claims of the former officers for golden parachute payments based on pre-rehabilitation employment agreements when those officers' claims are barred by law and when those officers presided over American Community's slide into solvency?

DYKEMA COSSETT+A PROFESSIONAL LIMITED LIABILITY COMPANY CAPITOL VIEW 301 TOWNSEND STREET, SUITE 900 LANSING, MICHIGAN 48233

The issue before this Court is whether it will enforce the plain language of the Insurance Code by denying the claims by the former officers of American Community Mutual Insurance Company (“American Community”) who were at the helm as it moved into insolvency. Michigan’s statutory framework governing insurance insolvencies is highly specific with regard to claims by former officers and directors of the insolvent company, limiting such claims to payment for services rendered prior to rehabilitation. Given the paramount interest that Michigan has in enforcing its own laws in accordance with their terms, and its interest in promoting uniformity in the interpretation of the insolvency laws across the country, the claims of the former management should be denied.

**STATEMENT OF FACTS**

**A. Current Status of Proceedings**

As this Court is well aware, American Community was placed into rehabilitation by Order dated April 8, 2010. The claimants here were all officers of American Community while it was being run into the ground financially, such that by the time of the April, 2010 rehabilitation order, it was no longer financially secure enough to assure that the claims of its policyholders would be satisfied. The financial demise of American Community was so obvious that the company stipulated to the Petition and Order placing it into rehabilitation, including the finding that it was in a financially hazardous position. (Rehabilitation Petition, Ex. 1.)<sup>1</sup>

Following the Rehabilitation Order, the Rehabilitators appointed by the Court began the difficult and complex process of preserving American Community’s assets and paying claims of the creditors consistent with the requirements of the Michigan Insurance Code, MCL 500.8101 *et*

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<sup>1</sup> The exhibits are on file with this Court and are not attached here because of their volume.

*seq.* Claims have now been asserted by six former officers of the company, seeking payments attributable to the “change of control” which they contend occurred solely because the company was placed into Rehabilitation.

**B. Interests of the Surplus Note Holders**

Trapeza CDO IX, Ltd. and Trapeza CDO X, Ltd. (jointly “Trapeza”) are the current beneficial holders of the surplus notes, originally purchased by Credit Suisse, Cayman Islands Branch, in the aggregate principal amount of ten million dollars (\$10,000,000.00). (Affidavit of Carolyn Thagard, attached as Exhibit 2. A copy of the Surplus Note is attached to Exhibit 2.)

The surplus note issued by American Community is a unique source of capital used in the insurance industry. Unlike a commercial loan issued by a bank or a credit union, the holder of a surplus note does not receive security for the debt obligation, or receives collateral that is already pledged to secure other debts to which the surplus note is subordinated. In addition, American Community may not make any payments of the principal or interest on the surplus note without prior approval of the Michigan Commissioner of the Office of Financial and Insurance Regulation (“OFIR”). Because the surplus note holder agrees to subordinate the debt to other outstanding obligations of the company (such as the claims by policyholders to benefits under their policy, as well as other types of obligations), it is treated differently for purposes of the statutory accounting principles applicable to insurance companies. In particular, a surplus note is treated as capital and surplus of the company, rather than as a liability for purposes of statutory accounting. Surplus notes therefore present double advantages to issuers of the notes (like American Community): the interest payments are tax deductible as surplus notes are reported as debt on a GAAP basis, and at the same time, they are treated as statutory surplus by state regulators and the National Association of Insurance Commissioners (“NAIC”). Cox and Zhang,

*The Securitization of Surplus Notes by Property and Casualty Insurers: Empirical Evidence*  
(July 7, 2006)(excerpts attached as Exhibit 3.)

Because a mutual insurance company, like American Community, does not have the ability to sell stock to raise capital, the issuance of surplus notes is one of the few ways in which a mutual insurance company can obtain additional capital to run its business. Currently there are relatively few potential investors in surplus notes because of the subordinated nature of the debt and because they cannot be repaid without prior regulatory approval. See NAMIC online, *Focus on the Future Options for the Mutual Insurance Company*, available at <http://www.namic.org/Home/ReadArticle/86935b7a-bb05-45b5-b6ab-cc78c144cf93>. Because of these limitations, when American Community started to experience financial problems, the surplus notes provided a valuable protection to American Community's policyholders as additional security to pay policyholder claims. Because the notes were one of the few available avenues for American Community to raise capital, as well as for the industry in general, the availability of surplus notes is scarce.

The surplus note at issue reflects that the parties understood that, in the event of American Community's insolvency, the provisions of Chapter 81 of the Michigan Insurance Code would govern the right to repayment of the note. The surplus note issued by American Community itself stated that it is subject to the priority scheme of Chapter 81. The surplus note states, in pertinent part:

By acceptance of this Surplus Note, the Note Holder agrees that the payment of principal and interest hereunder is expressly subordinated to claims of creditors and members of the Company and any other priority claims provided by Chapter 81 of the Insurance Code (the "Senior Obligations) which provides that surplus notes are at the eighth level of priority.

Surplus Note, Ex. 2, p. 4. Therefore, the issue presented here is whether the claims of the former officers for "change of control" payments under their severance agreements are entitled to

treatment as a priority level eight or higher under Michigan’s priority scheme. If the claims do not have higher priority than Trapeza’s, then Trapeza’s claim must be paid in full before there is any payment to the former officers. MCL 500.8142(1).

It is important to also note that even if the claims of the former officers are denied (as they should be for the reasons stated herein), the surplus note holders will not be made whole as a result of their lower priority in the statutory scheme. The Rehabilitator currently estimates that, at best, Trapeza would receive only 54% of the principal balance of the note, and none of the interest. This is hardly the type of return that would be the envy of market investors when determining the investments of their portfolio funds.

**ARGUMENT**

**I. THE CLAIMS OF THE SURPLUS NOTE HOLDERS ARE HIGHER IN PRIORITY THAN THE CLAIMS OF THE FORMER OFFICERS, WHOSE CLAIMS ARE CAPPED BY THE INSURANCE CODE.**

Michigan has adopted a comprehensive statutory framework to address the rehabilitation and liquidation of insurance companies. MCL 500.8101 *et seq.* When interpreting the statute, there are several principles of statutory interpretation that guide the Court. First, if the language of the statute is unambiguous, it must be interpreted as written. As stated in *City of Romulus v Mich Dept of Environmental Quality*, 260 Mich App 54, 65; 678 NW2d 444 (2003), “[w]e start by reviewing the language of the...statute. If the language is unambiguous on its face, the drafter is presumed to have intended the meaning plainly expressed and further judicial interpretation is not permitted.” *Id.* See also, *Jarrad v Integon Nat’l Ins Co*, 472 Mich 207, 221; 696 NW2d 621 (2005) (“We emphasize that a court’s fundamental interpretive obligation is to discern the legislative intent that may reasonably be inferred from the words expressed in the statute.”)

The second guiding principle of statutory interpretation is that the insurance laws of

Michigan are “enacted for the benefit of the public and insurance laws should be liberally construed in favor of policyholders, creditors and the public.” *Murphy v Seed-Roberts Agency, Inc*, 79 Mich App 1, 9; 261 NW2d 198 (1977). *See also, Depyper v Safeco Ins Co of America*, 232 Mich App 433, 441; 591 NW2d 344 (1998). Given that the Legislature has specified the priority of claims in a receivership proceeding, the statutory provisions must be followed and construed to protect the policyholders, creditors and the public. *See e.g., In the Matter of Cadillac Ins Co in Liquidation*, unpublished decision of the Court of Appeals dated April 29, 2003 (Dkt. #234945)(interpreting Chapter 81’s predecessor statute, Chapter 78 of the Code)(Ex. 4.) In this case, only one result is compelled by the statute and the public interest involved.

**A. The Express Provisions Of Chapter 81 Disallow The Claims Asserted By The Former Officers.**

Chapter 81 addresses claims made by officers and directors pursuant to employment contracts in unambiguous terms. Section 8137(4) of the Code, MCL 500.8137(4), expressly limits the claims that may be made by officers and directors against the insolvent estate to payment for services rendered prior to the issuance of the rehabilitation order. This statute states:

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).

There can be no reasonable dispute that the claims asserted here by the former officers fall squarely within the limitations of Section 8137(4). Petitioners assert that they are former officers of American Community, and assert claims for “breach of contract” based on their employment contracts. (See, Petition to Allow Claims, ¶¶ 9-15.) In particular, petitioners seek to recover under the “change of control” provisions in their employment agreements, all of

which were entered into prior to rehabilitation. Payments attributable to the severance of these employees (four of whom resigned), are not wage payments for services already rendered. These are payments that would be made if a third party came in and terminated the employees, thereby depriving them of future wages, not wages for services already rendered. The Legislature has plainly stated that there is no right for these former officers, who were at the helm of the sinking ship, to recover for anything other than the hours worked prior to the issuance of the order of rehabilitation on April 8, 2012. As a result, the claims must be denied under Section 8137(4).

The Legislature’s clear intent is further confirmed by Section 8142, which governs the priority of distributions from the insurer’s estate. The statute establishes 9 categories of claimants that receive priority under the statute. Holders of surplus notes are Class 8 priority claimants pursuant to MCL 500.8142(1)(h). Employees who were officers and directors are expressly addressed in both Section 8142(1)(a)(vii) and Section 8142(1)(d).

In Section 8142(1)(a)(vii), the Code states that employees that are owed compensation for services rendered are Class 1 claimants, but only for claims that do not exceed \$1,000.00, and only for services rendered within 1 year before filing the petition of rehabilitation that are reasonably necessary for the orderly administration of the company for class 2 claimants. The section continues, however, to expressly state that “[o]fficers and directors are not entitled to the benefit of this priority.” Therefore, even if the claim was for wages, because the claimants here are former officers, they cannot - by the plain language of the statute - qualify for Class 1 priority treatment.

Section 8142(1)(d) defines a Class 4 claimant for purposes of determining priority of employee wage claims. Like the Class 1 definition, the Legislature expressly excluded officers and directors from being treated as Class 4 claimants, stating that “[o]fficers and directors are not

entitled to the benefit of the priority for debts due to employees for services performed.” Thus, the former officers are also not entitled to be treated as Class 4 claimants under the plain language of the statute. Indeed, they are not entitled to the benefit of any priority, which is consistent with Section 8137, which limits an officer’s claim made under an employment agreement.

As a result of the foregoing provisions, a former officer is barred by statute for seeking compensation for anything other than payment for services rendered (*i.e.*, wages) prior to the rehabilitation. The millions of dollars sought by the former officers here do not qualify under the statute for payment. Even if the claim were for wages, however, it would not receive a higher priority for payment under the priority scheme established by the Legislature than the surplus note holders. The plain language of the statutes must govern the outcome here, and it compels the denial of the former officers’ claims.

**B. The “Promissory Estoppel” Claims Asserted By The Former Officers Are Also Barred.**

The former officers also assert a claim for promissory estoppel, arguing that they are entitled to be paid the change of control payments because they continued to work for American Community pre-rehabilitation even though they recognized that its financial condition was worsening. Once again, these claims fail as a matter of law for several reasons.

First, the provisions of Section 8137(4) are absolute. They expressly limit all claims by officers and directors to payment for services rendered prior to rehabilitation. There is no exception in the statute for claims of promissory estoppel based on change of control agreements entered into prior to rehabilitation, and none should be implied by this Court. When the Legislature has established a comprehensive statutory framework governing the distribution of assets from an insolvent insurer’s estate, equitable relief different from that provided by statute is

not available. *In re Liquidation of Security Cas Co*, 127 Ill 2d 434; 537 NE2d 775, 782 (1989)(insurance liquidation scheme is comprehensive and equitable relief different from that is not available). This is consistent with Michigan law generally, which precludes a court from casting aside a plain statute in the name of equity in order to preserve the principles of separation of powers mandated by our Constitution. *Trentadue v Gorton*, 479 Mich 378, 406-07; 738 NW2d 664 (2007).

Second, a claim for promissory estoppel must be dismissed because Michigan “courts do not allow the equitable action of promissory estoppel where the plaintiff includes allegations of the existence of an express contract[.]” *Groeb Farms, Inc v Alfred L. Wolff, Inc*, No. 08-cv-14624, 2009 WL 500816 at \*7 (ED Mich, Feb. 27, 2009)(Ex. 5), citing *Campbell v Troy*, 42 Mich App 534, 537; 202 NW2d 547 (1972). And, while a plaintiff may plead inconsistent causes of action in the alternative, such as breach of contract and, alternatively, promissory estoppel, the promissory estoppel claim will fail where, as here, the former officers incorporate their allegations that a valid contract exists into the promissory estoppel count. *Id* (dismissing promissory estoppel claim because a plaintiff “may not allege the existence of an express contract in its claim for promissory estoppel” and plaintiff “specifically incorporate[d] its prior allegations of express and valid contracts into its promissory estoppel claim.”)

Finally, a claim of promissory estoppel requires proof that there is a “definite and clear” promise upon which the former officers “reasonably relied.” *Id*. The former officers do not plead any facts that would establish that there was a definite and clear promise that the former officers would be paid their change of control agreements if they continued working while the company was run into receivership proceedings. Further, in light of the express provisions in the statute disallowing the claim asserted, the former officers can never establish that their reliance

was reasonable. *Northern Warehousing, Inc v State of Mich*, 475 Mich 859; 714 NW2d 287 (2006)(“Promissory estopped requires reasonable reliance on the part of the party asserting estoppel.”)

In light of these obvious flaws in the claims of the former officers, their claims must be denied.

**C. The Court Should Interpret Chapter 81 As Written For The Additional Reason The It Will Promote Uniformity In The Administration Of Insolvent Insurance Estates And Promote Surplus Note Investments.**

The disallowance of the former officers’ claims because of the plainly worded provisions of Chapter 81 is further reinforced by the need for relative uniformity in the application and interpretation of the model insolvency laws on a nationwide basis. Chapter 81 is based on a model law promulgated by the NAIC, which originally developed the NAIC Insurers Rehabilitation and Liquidation Model Act following the Great Depression, when it became clear that the states needed better mechanisms to handle insurance insolvencies. A 1935 Report of the Special Committee on Interstate Liquidation and Reorganization resolved, in pertinent part:

WHEREAS, Although the institution of insurance is rapidly approaching a state of stabilization and there is ample reason to believe that the period of extensive liquidation and rehabilitation has been passed, it is desirable to have available adequate machinery to meet the emergencies that may arise in the future;

NOW THEREFORE, BE IT RESOLVED, THAT the [NAIC] urges the enactment into law of the necessary statute or statutes whereby such unitary control of liquidations or rehabilitations may be effected by extending the authority and control of the appropriate Insurance Commissioner .. and the appropriate court. ...

1 Proceedings of the Nat’l Ass’n of Ins. Comm’rs 97 (1935).

The Model Act, which was amended several times throughout the decades, thereafter served as a guide for state legislatures to use when regulating this complex area of the law. Since 1936, virtually every state has at some point adopted the Model Act in one of its various

forms.<sup>2</sup> Because every state has some version of the Model Act, courts frequently look to decisions of other states interpreting the act for guidance and uniformity. *See e.g., Oxendine v Comm'r of Ins of NC*, 494 SE2d 545 (Ga Ct App 1997); *Four Stars Ins Agency v Hawaiian Elec Indus*, 974 P2d 1017 (Haw 1999); *State ex rel Sizemore v United Physicians Ins Risk Retention Group*, 56 SW3d 557 (Tenn Ct App 2001).

The implications for this Court's decision thus extend beyond just this case. Interpreting the statute to permit claims of the former officers, when those claims are expressly barred by statute, will take Michigan out of sync with other jurisdictions, and will interfere with the ability to coordinate Michigan receiverships with those of other states.

Furthermore, permitting the claims of the former officers to have a higher priority than surplus notes in the distribution of an insolvent insurer's estate makes surplus note investments even less attractive to potential investors. Given that surplus notes are one of the very few ways for a mutual insurance company to raise capital, this potential implication also militates against the invocation of some sort of equitable exception to the plain language of the statute. As between a valid creditor who will receive the return of only a portion of its investment, and the former management of the now defunct company, the creditor who provided money for the company to survive while it attempted to improve its financial situation should be given the statutory preference to which it is entitled.

### CONCLUSION

The claims of the former officers must be denied under the unambiguous language of Chapter 81. Distributions to the surplus note holders have priority and must be honored to the extent possible based on the remaining assets in the estate.

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<sup>2</sup> Attached as Exhibit 6 is a table published by the NAIC which tabulates the status of implementation of the Model Acts by the States.

Respectfully submitted,

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# Tab 1

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

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

Petitioner,

Case No. 10-397 -CR

v

Hon. WILLIAM E. COLLETTE

AMERICAN COMMUNITY MUTUAL  
INSURANCE COMPANY,

Respondent.

---

STIPULATED PETITION OF THE COMMISSIONER OF THE OFFICE OF FINANCIAL  
AND INSURANCE REGULATION FOR AN ORDER PLACING AMERICAN  
COMMUNITY MUTUAL INSURANCE COMPANY INTO REHABILITATION,  
APPROVING APPOINTMENT AND COMPENSATION OF SPECIAL DEPUTY  
REHABILITATORS, AND PROVIDING INJUNCTIVE RELIEF

Ken Ross, Commissioner of the Office of Financial and Insurance Regulation

("Commissioner"), by and through his attorneys, Michael A. Cox, Attorney General, and David W. Silver and Christopher L. Kerr, Assistant Attorneys General, petitions the Court for an order authorizing the Commissioner to rehabilitate American Community Mutual Insurance Company, approving the appointment and compensation of Special Deputy Rehabilitators, and providing certain injunctive relief. In support of this Petition, the Commissioner states as follows:

THE PARTIES

1. American Community Mutual Insurance Company ("American Community") is a life, accident, and health insurance company authorized to transact insurance in Michigan.
2. Ken Ross is the duly appointed Commissioner of the Office of Financial and Insurance Regulation ("OFIR").

JURISDICTION

3. MCL 500.8102 provides that a proceeding under Chapter 81 of the Michigan Insurance Code of 1956, MCL 500.8101 – 500.8159 ("Chapter 81"), including a rehabilitation proceeding, may be applied to an insurer who: (a) is or has been transacting insurance business in this state and against whom claims arising from that business may exist now or in the future; or (b) who has insureds resident in this state. American Community satisfies both criteria and is therefore subject to rehabilitation or any other proceeding authorized by Chapter 81.

4. Pursuant to MCL 500.8112, the Ingham County Circuit Court is the proper court to petition for an order of rehabilitation.

REHABILITATION IS APPROPRIATE BASED ON AMERICAN COMMUNITY'S  
BOARD OF DIRECTORS CONSENTING TO REHABILITATION AND  
BASED ON THE COMPANY'S IMPAIRED FINANCIAL CONDITION

5. MCL 500.8112 authorizes the Commissioner to petition this Court for an Order authorizing the Commissioner to rehabilitate American Community based on one or more of thirteen (13) listed grounds. These grounds include:

(a) The insurer is in such condition that the further transaction of business would be hazardous financially to its policyholders, creditors, or the public.

\* \* \*

(l) The board of directors . . . request[s] or consent[s] to rehabilitation under this chapter.

6. Pursuant to MCL 500.8112(l), entry of an Order authorizing the Commissioner to rehabilitate American Community is proper because American Community's Board of Directors has consented to rehabilitation under Chapter 81.<sup>1</sup> Toward this end, American Community, by

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<sup>1</sup> Exhibit A, Certificate of Resolution of American Community Board of Directors dated March 31, 2010.

and through its legal counsel, has stipulated to the relief sought in this Rehabilitation Petition and to the entry of the Order attached hereto as Exhibit B.

7. Pursuant to MCL 500.8112(a), entry of an Order authorizing the Commissioner to rehabilitate American Community is also proper because American Community's financial condition is such that further transaction of business would be hazardous financially to its policyholders, creditors, or the public.

8. Specifically, American Community reported a 2009 net loss of \$49,135,134. This 2009 net loss resulted in a \$53,404,628 decrease in American Community's capital and surplus, or a 72% decrease, from the prior year-end. The company's year-end 2009 capital and surplus stood at \$21,101,431, down from \$74,506,058 as of year-end 2008. American Community also has surplus note obligations of \$30,000,000; however, these surplus notes are repayable only out of the surplus earnings of American Community and only with the prior written approval of OFIR.

9. As of December 31, 2009, American Community's Risk-Based Capital level was 155.5%, which represented a significant decline from its 564% Risk-Based Capital level one year earlier on December 31, 2008. Pursuant to OFIR Bulletin No. 98-02, American Community's 155.5% Risk-Based Capital level is a "Company Action Level Event" that requires the submission of an RBC Plan.<sup>2</sup>

10. American Community has reported negative cash flow from operations the last five years. The company's 2009 negative cash flow from operations was equal to 85% of its total capital and surplus.

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<sup>2</sup> Exhibit C, OFIR Bulletin No. 98-02.

11. Further, on March 8, 2010, A.M. Best Co. downgraded its financial strength rating of American Community to "D" (poor) from "C+" (marginal), and downgraded its issuer credit rating to "C" from "B-." According to A.M. Best Co., the outlook for both ratings is negative.

12. Immediate action placing American Community into rehabilitation is necessary to protect the interest of American Community's policyholders, creditors, and the public.

13. Based upon the existence of the above-described statutory grounds for rehabilitation, and based upon American Community's stipulation to the relief sought by this Petition, the Court should enter the Rehabilitation Order attached as Exhibit B.

#### APPOINTMENT OF SPECIAL DEPUTY REHABILITATORS

14. The Commissioner, as Rehabilitator, is authorized to appoint Special Deputy Rehabilitators, who shall have all the powers and responsibilities of the Rehabilitator granted under Section 8114 of the Insurance Code and shall serve at the pleasure of the Commissioner.<sup>3</sup>

15. Pursuant to MCL 500.8114(1), the compensation of Special Deputy Rehabilitators and all expenses of taking possession of the insurer and of conducting the proceedings shall be fixed by the Commissioner, with the approval of the Court, and shall be paid out of the funds or assets of the insurer.

16. The Commissioner, as Rehabilitator, seeks approval of the appointment of James Gerber, the Director of Receiverships at OFIR, as a Special Deputy Rehabilitator for American Community. The Commissioner, as Rehabilitator, also seeks approval of the appointment of Michael Hogan, the Auditor-In-Charge at OFIR, as a Special Deputy Rehabilitator for American Community, who will work under Mr. Gerber's direction and supervision. The Commissioner

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<sup>3</sup> MCL 500.8114(1).

further reserves the right to appoint other Special Deputy Rehabilitator(s) to replace and/or serve with Mr. Gerber and Mr. Hogan in the future as the need arises.

17. The Commissioner, as Rehabilitator, has fixed the compensation of Special Deputy Rehabilitators Gerber and Hogan pursuant to the terms set forth in the Order attached as Exhibit B. The Commissioner requests that the Court approve this compensation arrangement.

18. The Commissioner, as Rehabilitator, has determined that it is appropriate and necessary for the success of the rehabilitation that the services and compensation of James Gerber and Michael Hogan be approved so that this Rehabilitation may proceed effectively, efficiently, and provide the maximum protection of creditors, policyholders, and the public.

#### RELIEF REQUESTED

Based upon the foregoing, the Commissioner requests that the Court issue an Order, in the form attached as Exhibit B, that grants the Commissioner the following, nonexclusive relief:

1. Places American Community into rehabilitation pursuant to Chapter 81;
2. Grants the Commissioner, as Rehabilitator, possession, title, and control of American Community, its assets, resources, and business to the fullest extent allowed by law.
3. Approves the appointment and compensation of James Gerber and Michael Hogan as Special Deputy Rehabilitators.
4. Grants the injunctive relief necessary to protect American Community's business, assets, policyholders, creditors, the public, and the rehabilitation process
5. Grants the Commissioner such other and further relief that is necessary and appropriate for the rehabilitation of American Community.

Respectfully submitted,

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Attorney General



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P.O. Box 30755  
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(517) 373-1160

Dated: April 8, 2010

American Community Mutual Insurance Company stipulates to the facts and law recited above, to the relief sought by this Petition, and to the existence of the statutory bases for the entry of an Order placing American Community into rehabilitation. Further, American Community waives any right to a hearing on this Petition:



John D. Pirich (P23204)  
Attorney for Respondent American  
Community Mutual Insurance Company

4. 8. 10

Date

# Tab 2

STATE OF MICHIGAN

IN THE CIRCUIT COURT OF THE COUNTY OF INGHAM

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

Case No. 10-397-CR

Petitioner,

Hon. William E. Collette

vs.

AMERICAN COMMUNITY MUTUAL  
INSURANCE COMPANY,

Respondent.

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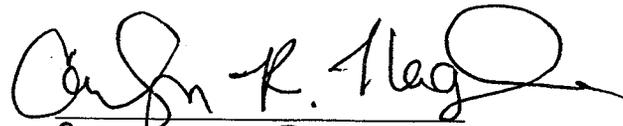
State of Alabama            )  
  )  
County of Jefferson        )

**AFFIDAVIT OF CAROLYN R. THAGARD**

Carolyn Thagard, being first duly sworn, deposes and states:

1. I have personal knowledge of the facts stated herein and am competent to so testify.
2. A true copy of the original surplus note that is at issue in this receivership proceeding is attached to this Affidavit.
3. The surplus note was originally purchased by Credit Suisse, Cayman Islands Branch.
4. Trapeza CDO IX, Ltd. and Trapeza CDO X, Ltd. are the current beneficial holders of the surplus note, the aggregate principal amount of which is ten million dollars (\$10,000,000.00). The note remains due and owing.

Further affiant sayeth not.

  
Carolyn R. Thagard  
Trapeza Capital Management, LLC

Subscribed before me this  
19 day of June, 2012.

  
Notary Public

Sara Marshall Diruscio  
MY COMMISSION EXPIRES  
AUGUST 11, 2013

## SURPLUS NOTE

THIS SURPLUS NOTE IS A GLOBAL SECURITY AND IS REGISTERED IN THE NAME OF THE DEPOSITORY TRUST COMPANY ("DTC") OR A NOMINEE OF DTC. THIS SURPLUS NOTE IS EXCHANGEABLE FOR A SURPLUS NOTE REGISTERED IN THE NAME OF A PERSON OTHER THAN DTC OR ITS NOMINEE ONLY IN THE LIMITED CIRCUMSTANCES DESCRIBED IN THE INDENTURE, AND NO TRANSFER OF THIS SURPLUS NOTE (OTHER THAN A TRANSFER OF THIS SECURITY AS A WHOLE BY DTC TO A NOMINEE OF DTC OR BY A NOMINEE OF DTC TO DTC OR ANOTHER NOMINEE OF DTC) MAY BE REGISTERED EXCEPT IN LIMITED CIRCUMSTANCES.

THE SURPLUS NOTES REPRESENTED BY THIS CERTIFICATE WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND SUCH SURPLUS NOTE, AND ANY INTEREST THEREIN, MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. EACH PURCHASER OF ANY SURPLUS NOTES IS HEREBY NOTIFIED THAT THE SELLER OF THE SURPLUS NOTES MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A UNDER THE SECURITIES ACT.

THE HOLDER OF THE SURPLUS NOTES REPRESENTED BY THIS CERTIFICATE AGREES FOR THE BENEFIT OF THE COMPANY THAT (A) SUCH SURPLUS NOTES MAY BE OFFERED, RESOLD OR OTHERWISE TRANSFERRED ONLY (I) TO THE COMPANY, (II) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (III) TO AN INSTITUTIONAL "ACCREDITED INVESTOR" WITHIN THE MEANING OF SUBPARAGRAPH (a) (1), (2), (3) OR (7) OF RULE 501 UNDER THE SECURITIES ACT THAT IS ACQUIRING THE SURPLUS NOTE FOR ITS OWN ACCOUNT, OR FOR THE ACCOUNT OF AN "ACCREDITED INVESTOR," FOR INVESTMENT PURPOSES AND NOT WITH A VIEW TO, OR FOR OFFER OR SALE IN CONNECTION WITH, ANY DISTRIBUTION IN VIOLATION OF THE SECURITIES ACT, (IV) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR (V) PURSUANT TO AN EXEMPTION FROM THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER APPLICABLE JURISDICTION AND, IN THE CASE OF (III) OR (V), SUBJECT TO THE RIGHT OF THE COMPANY TO REQUIRE AN OPINION OF COUNSEL AND OTHER INFORMATION SATISFACTORY TO IT AND (B) THE NOTE HOLDER WILL NOTIFY ANY PURCHASER OF ANY SURPLUS NOTES FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE.

THE SURPLUS NOTES WILL BE ISSUED AND MAY BE TRANSFERRED ONLY IN BLOCKS HAVING AN AGGREGATE PRINCIPAL AMOUNT OF NOT LESS THAN \$100,000. TO THE FULLEST EXTENT PERMITTED BY LAW, ANY ATTEMPTED

TRANSFER OF SURPLUS NOTES, OR ANY INTEREST THEREIN, IN A BLOCK HAVING AN AGGREGATE PRINCIPAL AMOUNT OF LESS THAN \$100,000 AND MULTIPLES OF \$1,000 IN EXCESS THEREOF SHALL BE DEEMED TO BE VOID AND OF NO LEGAL EFFECT WHATSOEVER. TO THE FULLEST EXTENT PERMITTED BY LAW, ANY SUCH PURPORTED TRANSFEREE SHALL BE DEEMED NOT TO BE THE HOLDER OF SUCH SURPLUS NOTES FOR ANY PURPOSE, INCLUDING, BUT NOT LIMITED TO, THE RECEIPT OF PRINCIPAL OF OR INTEREST ON SUCH SURPLUS NOTES, OR ANY INTEREST THEREIN, AND SUCH PURPORTED TRANSFEREE SHALL BE DEEMED TO HAVE NO INTEREST WHATSOEVER IN SUCH SURPLUS NOTES.

THE HOLDER OF THIS SURPLUS NOTE, OR ANY INTEREST THEREIN, BY ITS ACCEPTANCE HEREOF OR THEREOF ALSO AGREES, REPRESENTS AND WARRANTS THAT IT IS NOT AN EMPLOYEE BENEFIT, INDIVIDUAL RETIREMENT ACCOUNT OR OTHER PLAN OR ARRANGEMENT SUBJECT TO TITLE I OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED ("ERISA"), OR SECTION 4975 OF THE INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE") (EACH A "PLAN"), OR AN ENTITY WHOSE UNDERLYING ASSETS INCLUDE "PLAN ASSETS" BY REASON OF ANY PLAN'S INVESTMENT IN THE ENTITY, AND NO PERSON INVESTING "PLAN ASSETS" OF ANY PLAN MAY ACQUIRE OR HOLD THIS SURPLUS NOTE OR ANY INTEREST THEREIN. ANY PURCHASER OR HOLDER OF THE SURPLUS NOTES OR ANY INTEREST THEREIN WILL BE DEEMED TO HAVE REPRESENTED BY ITS PURCHASE AND HOLDING THEREOF THAT IT IS NOT AN EMPLOYEE BENEFIT PLAN WITHIN THE MEANING OF SECTION 3(3) OF ERISA, OR A PLAN TO WHICH SECTION 4975 OF THE CODE IS APPLICABLE, A TRUSTEE OR OTHER PERSON ACTING ON BEHALF OF AN EMPLOYEE BENEFIT PLAN OR PLAN, OR ANY OTHER PERSON OR ENTITY USING THE ASSETS OF ANY EMPLOYEE BENEFIT PLAN OR PLAN TO FINANCE SUCH PURCHASE.

No. 1

\$10,000,000

## SURPLUS NOTE

Issued: December 1, 2005

American Community Mutual Insurance Company, a Michigan mutual insurance company (the "Company"), for value received, hereby promises to pay to Cede & Co. or registered assigns (the "Note Holder"), the principal amount of \$10,000,000 on April 15, 2026 and to pay interest on the outstanding principal amount at the rate of 8.95% percent per annum from the date of issuance until the principal amount is paid in full. Interest which accrues between January 1 through March 31 of a calendar year shall be paid on July 15 of such calendar year; interest which accrues between April 1 and June 30 of a calendar year shall be paid on October 15 of such calendar year; interest which accrues between July 1 and September 30 of a calendar year shall be paid on January 15 of the following calendar year; interest which accrues between October 1 and December 31 of a calendar year shall be paid on April 15 of the following calendar year. Each January 15, April 15, July 15 and October 15 shall be an "Interest Payment" date. All accrued but unpaid interest on the amount of principal which is paid at maturity shall be paid on the date such principal payment is made. Payment shall be on the terms and subject to the conditions set forth in this Surplus Note. Interest shall not compound and shall be computed on the basis of a year of twelve thirty-day months. Notwithstanding the foregoing or anything to the contrary herein contained or implied, principal of and any interest on this Surplus Note shall be (i) payable solely from "surplus earnings" (as such term is defined by the Michigan Office of Financial and Insurance Services, hereinafter "OFIS"), (ii) subject to the prior approval of the Board of Directors of the Company and the OFIS therefor, and (iii) subject to any other restrictions set forth under the applicable insurance laws of the State of Michigan (the foregoing, collectively, the "Payment Restrictions"). Subject to satisfaction of the Payment Restrictions, payment of principal and any interest then due shall be made to the Trustee for the benefit of the Note Holders at the place and in the manner set forth in the Indenture.

This Surplus Note shall not be a liability or claim against the Company or any of its assets, except as provided in this Surplus Note. This Surplus Note does not confer any rights upon the Note Holder other than the right to receive payment of principal and interest on the terms and subject to the conditions set forth in this Surplus Note, including the Payment Restrictions.

This Surplus Note is one of a duly authorized issue of surplus notes of the Company (collectively, the "Surplus Notes") issued under the Indenture, dated as of December 1, 2005 (the "Indenture"), between the Company and JPMorgan Chase Bank, National Association, as Trustee (in such capacity, the "Trustee," which term includes any successor trustee under the Indenture), to which Indenture and all indentures supplemental thereto reference is hereby made for a statement of the respective rights, limitations of rights, duties and immunities thereunder of

the Company, the Trustee, the holders of Senior Obligations (as defined below) and the Note Holders and of the terms upon which the Surplus Notes are, and are to be, authenticated and delivered.

Subject to the Payment Restrictions, the Company at its option, may repay all or any part of this Surplus Note on any Interest Payment Date on or after April 15, 2016 at the outstanding principal amount plus the interest accrued thereon to the date of repayment fixed by the Company in accordance with the Indenture. All partial payments of principal and interest shall be made by the Company to the Note Holder without presentment of this Surplus Note or endorsement of such payment. The final payment of principal and interest shall be made only on surrender of this Surplus Note at the office of the Trustee. If the Company gives notice to the Note Holder setting forth a date and place for such final payment and surrender of the Surplus Note, this Surplus Note shall not bear interest after such date. All payments and notices shall be mailed to the Note Holder as provided in the Indenture.

By acceptance of this Surplus Note, the Note Holder agrees that the payment of principal and interest hereunder is expressly subordinated to claims of creditors and members of the Company and any other priority claims provided by Chapter 81 of the Insurance Code (the "Senior Obligations") which provides that surplus notes are at the eighth level of priority. If the Company is dissolved and there are insufficient assets to pay in full the principal and interest due on all outstanding Surplus Notes, then the Company shall pay on the Surplus Notes pro rata on the basis of the outstanding principal amount of each Surplus Note and the interest accrued thereon. Regardless of the issuance date of this Surplus Note or any other surplus note of the Company this Surplus Note shall be of equal rank with any other surplus note, unless such other surplus note is expressly subordinated to this Surplus Note. Each Note Holder (a) agrees to be bound by such provisions, (b) authorizes and directs the Trustee on his or her behalf to take such actions as may be necessary or appropriate to effectuate the subordination so provided and (c) appoints the Trustee his or her attorney-in-fact for any and all such purposes.

No recourse under this Surplus Note shall be had against any member, officer or director of the Company, either directly or through the Company, by virtue of any statutes, by enforcement of any assessment or otherwise. By acceptance of this Surplus Note, the Note Holder waives and releases any liability of or claims against such members, officers, and directors under this Surplus Note.

The Company, the Trustee and any agent of the Company or the Trustee may treat the person in whose name this Surplus Note is issued as the owner of this Surplus Note for all purposes including payment of principal and interest. No transfer of this Surplus Note shall be valid for any purpose until all transfer restrictions have been satisfied and such transfer shall have been recorded as provided in the Indenture.

Unless the Certificate of Authentication hereon has been executed by the Trustee by manual signature, this Surplus Note shall not be entitled to any benefit under the Indenture or be valid or obligatory for any purpose.

The Company and, by its acceptance of this Surplus Note or a beneficial interest herein, the Note Holder of, and any Person that acquires a beneficial interest in, this Surplus Note agree

that, for United States federal, state and local tax purposes, it is intended that this Surplus Note constitute indebtedness.

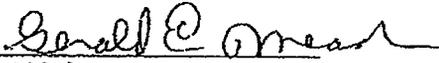
**This Surplus Note, insofar as the terms and provisions relate to the payment of principal of and any premium, if any, and interest, or any monetary remedy or collection attempt associated therewith, shall be construed and enforced in accordance with and governed by the laws of the State of Michigan, without reference to its conflict of laws provisions. All other terms shall be construed and enforced in accordance with and governed by the laws of the State of New York, without reference to its conflict of laws provisions (other than Section 5-1401 of the General Obligations Law).**

IN WITNESS WHEREOF, American Community Mutual Insurance Company has caused the Surplus Note to be executed by its duly authorized officer as of this 1<sup>st</sup> day of December, 2005.

Attest

AMERICAN COMMUNITY MUTUAL  
INSURANCE COMPANY

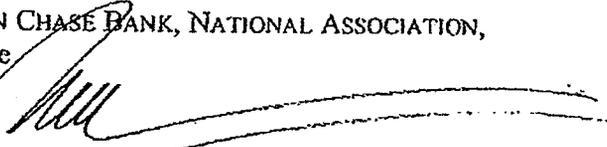
By   
Its Treasurer and Chief Financial Officer

By:   
Its: Chief Executive Officer

This is one of the Surplus Notes referred to in the within mentioned Indenture.

Dated: December 1, 2005

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION,  
as Trustee

By:   
\_\_\_\_\_

Authorized Signatory



II(A)

**AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY  
OFFICERS' CERTIFICATE**

Each of the undersigned hereby certifies that the undersigned is the President and Chief Executive Officer of American Community Mutual Insurance Company, a Michigan insurance company (the "Company"), or the Chief Financial Officer and Treasurer of the Company, and further certifies on behalf of the Company, pursuant to Section 5(b) of the Placement and Purchase Agreement, dated as of December 1, 2005 (the "Purchase Agreement"), among Cochran Caronia Securities LLC, the Company, and Credit Suisse, acting through its Cayman Islands Branch (the "Purchaser"), as follows:

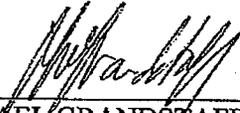
1. Since the dates as to which information is given in the most recent Financial Statements, except as disclosed in the Schedules to the Purchase Agreement, there has been no Material Adverse Effect.
2. The representations and warranties contained in Section 1 of the Purchase Agreement were true and correct when made and are true and correct with the same force and effect as though expressly made on and as of the Closing Date.
3. The Company has complied with all agreements and satisfied all conditions on its part to be performed or satisfied as contemplated by the Transaction Documents on or prior to the Closing Date.

Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Purchase Agreement.

IN WITNESS WHEREOF, each of the undersigned has executed this certificate as of this 1<sup>st</sup> day of December, 2005.



Name: GERALD MEACH  
Title: President and Chief Executive Officer



Name: MICHAEL GRANDSTAFF  
Title: Senior Vice-President, Treasurer and  
Chief Financial Officer