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IN THE COMMONWEALTH COURT OF PENNSYLVANIA

In Re: Penn Treaty Network America Insurance Company in Rehabilitation	DOCKET NO. 1 PEN 2009
In Re: American Network Insurance Company in Rehabilitation	DOCKET NO. 1 ANI 2009

VERIFIED JOINT APPLICATION OF THE COMMISSIONER, PENN TREATY AMERICAN CORPORATION, EUGENE WOZNICKI, AND BROADBILL PARTNERS LP FOR APPROVAL OF SETTLEMENT AGREEMENT

Pursuant to Rules 123 and 3776 of the Pennsylvania Rules of Appellate Procedure, Teresa D. Miller, in her capacities as Statutory Rehabilitator and/or future Liquidator (the

"**Commissioner**") of Penn Treaty Network America Insurance Co. ("**PTNA**") and American Network Insurance Co. ("**ANIC**," and together with PTNA, the "**Companies**"), jointly with Penn Treaty American Corp. ("**PTAC**"), Eugene Woznicki ("**Woznicki**"), and Broadbill Partners LP ("**Broadbill**," and together with PTAC and Woznicki, the "**PTAC Intervenors**"; the Commissioner and the PTAC Intervenors are the "**Settling Parties**"), hereby request approval of their proposed Memorandum of Understanding ("**MOU**") dated June 14, 2016, and any Definitive Agreement(s) entered into pursuant thereto (collectively the "**Settlement Agreement**").[1]

I. BACKGROUND AND KEY PROVISIONS OF THE SETTLEMENT AGREEMENT

1. Subject to this Court's approval, on June 14, 2016, the Settling Parties signed a Memorandum of Understanding that memorializes the terms of their proposed Settlement Agreement, which is incorporated herein by reference and attached hereto as Exhibit A.

2. The Settling Parties reached the Settlement Agreement after many months of good-faith, arm's length negotiations between them, including multiple in-person settlement conferences with the Court.

3. The Settlement Agreement should be approved because the settlement would provide multiple benefits to the Companies' estates, policyholders, creditors, and the public, including, but not limited to, ensuring that certain tax benefits remain available, if needed, to the Companies in the course of their respective rehabilitation and/or liquidation, obtaining cooperation and assistance from the PTAC Intervenors in requesting

[1]The Commissioner and the PTAC Intervenors are collectively referred to herein as the "**Settling Parties**."

a Private Letter Ruling ("**PLR**") from the United States Internal Revenue Service ("**IRS**"), and resolving ongoing costly litigation.

4. The Settlement Agreement provides for Ten Millions Dollars ($10,000,000) in consideration (the "**Cash Payment**") to be paid to PTAC as actual and necessary costs of preserving and recovering assets of the Companies, which shall be entitled to priority level (a) status pursuant to 40 P.S. § 221.44(a) in any liquidation proceedings and shall be irrevocably and immediately payable in cash, as and when due, as first priority costs and expenses of the administration of receivership. The Settlement Agreement additionally provides tax benefits to PTAC, including allocating up to Four Hundred Million Dollars ($400,000,000)[1] of the Companies' operations losses/net operating losses ("**NOLs**") to PTAC in the event a PLR is issued, and other tax benefits (with the NOLs, collectively, the "**Other PTAC Consideration**").

5. The multiple benefits to the Companies' estates, policyholders, creditors, and the public constitute reasonably fair and equivalent value in exchange for the Cash Payment and the Other PTAC Consideration. The benefits to the Companies' estates, policyholders, creditors, and the public include:

[1] Such tax benefits will equal the lesser of PTAC's permitted basis in the PTNA stock or Four Hundred Million Dollars ($400,000,000).

a. ***Preservation of Tax Benefits.*** The settlement will ensure that certain tax benefits, including in excess of $1 billion NOLs, shall be and remain available, if needed, to the Companies in the course of their respective rehabilitation and/or liquidation, thereby preserving estate assets, particularly in the event that the IRS does not fully grant all of the rulings sought in a PLR, as described below.

b. ***Joint Submission of the PLR Request to the IRS.*** PTAC—the ultimate parent company of both PTNA and ANIC and common parent of the consolidated tax group that includes the Companies—will execute documents required under IRS regulations, allowing the Commissioner to request a PLR regarding certain tax issues material to the Companies and their policyholders. If granted by the IRS, a PLR will provide security and certainty for the Companies and their policyholders by confirming that neither will incur additional tax obligations as a result of liquidation.

In particular, a PLR would benefit the Companies' estates by confirming that the Companies will not be required to recognize taxable income—and that the IRS will not assess tax liability—as a result of discharging liabilities for benefits that the Companies cannot pay. Without a PLR, there is a risk that the IRS could assess tax liability on income presumed to arise from a discharge of the Companies' indebtedness, which the Court is expected to provide in the course of liquidation.

Additionally, a PLR would benefit policyholders by confirming that they are not required to recognize taxable income as a result of any purported "restructuring" of their policies or assumption of those policies or obligations

thereunder by a different insurer or state guaranty associations, that their policies do not lose any tax qualified status, and that their tax basis in their policies remains unchanged. Without a PLR, there is a risk that the IRS could later take a position that would result in adverse tax consequences for individual policyholders.

The Settlement Agreement therefore benefits both the Companies' estates and individual policyholders by requiring the Settling Parties to submit a PLR request that, if granted, would remove the risk of those possible adverse tax consequences.

c. ***Resolution of All PTAC Intervenors' Objections, Consent to Liquidation, and Expedited Proceedings.*** Upon the "Effective Date" of the Settlement Agreement as defined in the MOU, the PTAC Intervenors will consent to entry of liquidation orders with regard to both Companies, and will not object to any evidence establishing that the Companies are insolvent or that the Commissioner has reasonable cause to believe that further attempts to rehabilitate the Companies would substantially increase the risk of loss to creditors, policy and certificate holders, and the public, or would be futile. The PTAC Intervenors' consent to liquidation will remove the prospect of extensive pre-hearing discovery, reduce the length of a hearing on conversion petitions, and obviate an appeal by the PTAC Intervenors that otherwise could be taken if the conversion petition is granted without the settlement. The Settlement Agreement thus stands to avert substantial legal fees that the Companies' estates otherwise would incur, which will instead be used to pay policyholder claims and estate expenses. It will also expedite entry of a liquidation order, thereby ensuring that present claims are not

paid in full at the expense of future claimants, that both present and future claimants receive a pro rata share of the assets available to pay their claims, and that state guaranty associations are triggered for the further benefit of policyholders. Each of these benefits serves the overriding need for "enhanced efficiency and economy of liquidation . . . to minimize legal uncertainty and litigation." 40 P.S. § 221.1(c).

d. ***Elimination of the Cost of Agent Commissions and Premium Taxes.*** Once the Court enters liquidation orders and they become effective, the Companies will cease paying both agent commissions and premium taxes. Currently, those expenses are approximately $11.4 million and $2.7 million, respectively, for a total of $ 14 million annually. By facilitating unopposed liquidation conversion petitions, the Settlement Agreement will help preserve funds that would otherwise have been used to cover those and other expenses.

e. ***Reduction of the Burden on State Insurance Guaranty Associations ("GAs").*** Once the Court enters liquidation orders and they become effective, state GAs will become responsible for the majority of policyholder benefits, and receive an allocation of the Companies' assets to help cover the cost of benefits provided. GAs would assess members insurers for any costs that cannot be recovered from the estates, and member insurers are generally entitled to a tax deduction or credit for those assessments against their premium taxes. *See, e.g.*, 40 P.S. §§ 991.1707(b)(2), 991.1711(a).[2] Entry of a prompt liquidation order as contemplated by the Settlement Agreement prior to exhaustion of estate assets is

[2] In some states, GAs may add surcharges to future premiums to recover assessments. In a limited number of states, assessments are not recoverable.

likely to reduce both the assessments for which member insurers will be liable and the extent of tax credits and deductions that the public will ultimately incur as a result.

f. ***Mutual Releases for All Settling Parties.*** The MOU includes mutual releases which effectively ensure that the Settlement Agreement represents a conclusion of litigation on all contested issues between the Commissioner and the PTAC Intervenors that currently exist and that could arise in the future.

6. As provided in Settlement Agreement § I.C.3, the Settling Parties respectfully request that the Court not cause or effect any dissolution of PTNA or ANIC, discharge of the Companies' Unfunded Benefit Liability (as defined in the Second Amended Plan) and/or incurrence of cancellation of debt income before the later of (i) twenty four (24) months after entry of the respective liquidation orders, or (ii) thirteen (13) months after the IRS' disposition, or the Commissioner's withdrawal, of the requested PLR. Such deferral preserves CNOL-related tax benefits that are an essential part of the Settlement Agreement.

7. As further provided in Settlement Agreement § I.C.6, all terms and conditions of the Settlement Agreement and the Order Approving Agreement (the "**Order**") sought by this Joint Application shall remain fully enforceable notwithstanding the filing of a liquidation conversion petitions or the entry of liquidation orders against the Companies. Without limiting the generality of the foregoing, all payments including the Cash Payment due under the Settlement Agreement shall constitute and be made as costs and expenses of administration and shall be entitled to priority level (a) status pursuant to 40 P.S. § 221.44(a), to be irrevocably and immediately paid in cash, as and when due under

the Settlement Agreement, pursuant to its terms, which are incorporated herein and would be incorporated in the Order. The Settling Parties request that the Cash Payment be paid to PTAC pursuant to the Settlement Agreement without the need for any of the Settling Parties to apply for any further Order of the Court pursuant to 40 P.S. § 221.36 or any other section of Article V, and without the need for PTAC to file a proof of claim or for the Commissioner to issue a notice of determination. The Settling Parties further request any liquidation orders and actions taken thereunder shall be consistent with the Settlement Agreement.

8. As further provided in Settlement Agreement § I.I.5, the PTAC Intervenors shall be solely responsible for all of their expenses incurred in connection with the Settlement and the underlying proceedings (including, all attorneys' and expert witness or consultant fees incurred by O'Melveny and Myers LLP or any other service firm or professional). However, subject to Court approval and objection by the Commissioner, Ballard Spahr LLP retains the right to petition for payment by the Companies (or from their estates) of (i) its reasonable attorneys' fees and expenses in connection with the Settlement and the underlying proceedings, as well as (ii) the reasonable fees and expenses of Grant Thornton LLP incurred no later than March 31, 2016 in providing expert witness and other professional services to or in support of the PTAC Parties.

II. GROUNDS FOR APPROVING THE SETTLEMENT AGREEMENT

9. Pursuant to 15 U.S.C. § 1012, the "business of insurance … shall be subject to the laws of the several States," and federal law shall not invalidate or supersede any state law enacted "for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(a), (b). These insolvency proceedings are governed by Article V of the Pennsylvania Insurance Department Act of 1921, 40 P.S. § 221.1 to 221.63, and by Pennsylvania

substantive law. Article V governs insurance receivership proceedings was enacted to "protect[] ... the interests of insureds, creditors, and the public generally" when an insurer becomes unable to meet its financial obligations to policyholders. 40 P.S. § 221.1(c).

10. This Court has exclusive jurisdiction to consider the Application and the relief requested pursuant to Section 504 of Article V, 40 P.S. § 221.4.

11. In this case, the Pennsylvania Supreme Court has ruled that "judicial review [of the rehabilitation plan] should proceed subject to a more deferential overlay relative to the new acting Commissioner." *In re Penn Treaty Network Am. Ins. Co.*, 119 A.3d 313, 323 (Pa. 2015). With respect to a settlement, New York state courts have ruled that "the Court must give great weight and deference to the Rehabilitator's judgment that the Settlement Agreement is in the best interests of [the insurer] and its policyholders considered as a whole." In re Rehab. of Fin. Guar. Ins. Co., No. 401265/12, 2013 WL 4405157, at *2 (N.Y. Sup. Ct. Aug. 16, 2013) (citing Corcoran v. Hall & Co., 149 A.D.2d 165, 171 (N.Y. Sup. Ct. App. Div. 1989))); *see also In re Exec. Life Ins. Co.*, 32 Cal. App. 4th 344, 3358 (Cal. Ct. App. 1995) ("The trial court reviews the Commissioner's actions under the abuse of discretion standard.").

12. A receivership court has authority to approve a settlement agreement upon a finding that it "overall [is] reasonable and to the benefit of the insolvency estate" and is in the best interests of the insolvent insurer's policyholders, claimants, and the public. *In re Exec. Life Ins. Co.*, 32 Cal. App. 4th at 399 (holding that payment of attorneys' fees under a settlement agreement may be approved under the same standard as substantive settlement provisions); *accord In re Liquidation of Int'l Underwriters Ins. Co.*, No. 12892, 1998 WL

928383, at *6 (Del. Ch. Ct. Dec. 30, 1998) (approving a settlement agreement upon a finding that it was "fair to the [insurer's] estate and to ... policyholders").

13. Here, the proposed Settlement Agreement is fair and reasonable, and is in the best interests of policyholders, claimants, and the public for at least the reasons set forth in Paragraph 5 above.

14. By analogy, a federal bankruptcy court supervising a reorganization proceeding may approve a settlement upon a finding that is "fair and equitable" to the interested parties. *In re Jevic Holding Corp.*, 787 F.3d 173, 180 (3d Cir. 2015). In making that determination, the court should weigh the following factors: "(1) the probability of success in litigation, (2) the likely difficulties in collection, (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors." *In re RFE Indus.*, 283 F.3d 159, 165 (3d Cir. 2002).[3]

15. Review of the proposed settlement under those factors confirms that the settlement is fair and equitable:

a. As to the probability of success through continued litigation, the proposed settlement represents a compromise of disputed claims, including with respect to liquidation and tax attributes, with potentially uncertain outcomes had litigation continued. In particular, the PTAC Intervenors raised issues regarding PTAC's right (if any) to control the Companies'

[3] Although bankruptcy courts do not have jurisdiction over insurer receiverships or their estate assets, state courts may look to bankruptcy law for guidance. *Koken v. Fidelity Mut. Life Ins. Co.*, 803 A.2d 807, 817 (Pa. Commw. Ct. 2002) (noting that "we would be unwise not to look to bankruptcy cases for guidance" when Article V and bankruptcy law address similar topics).

operating loss carryforwards under provisions of the applicable tax sharing agreement that no court had previously interpreted (and should not now). Until now, the propriety of liquidation has been a highly disputed matter. The settlement agreement, therefore, represents a reasonable compromise of disputed issues. The first factor thus favors approval of the settlement.

b. The second factor, regarding collectability of funds, is at least neutral, in that the purpose of the settlement is to resolve unsettled legal issues, not to ensure collectability of a judgment. In this instance, however, the Settling Parties submit that "collectability" has a broader meaning, and includes both the marshaling of estate assets and their preservation; the proposed settlement serves both.

c. As to the third factor, the Settlement Agreement represents a resolution of multiple complex tax issues, and, more importantly, ensures that scarce estate resources will be directed to paying policyholder claims rather than litigation costs, agent commissions, premium taxes, and other administration expenses. It also maximizes the assets available to GAs to pay policyholder claims and reduces assessment burdens on the GAs' member insurers and the burden on the public that tax credits and deductions associated with GA assessments otherwise produce. The third factor, therefore, favors approval of a settlement.

d. Lastly, the interest of policyholders and creditors favors approval of the settlement because the Settlement Agreement is designed to ensure that the greatest possible share of assets and other financial resources (including

GA funds) is directed to claims in accordance with the priority statute contained in Article V, 40 P.S. § 221.44.

Application of analogous federal bankruptcy law principles, therefore, confirms that the Settlement Agreement is fair and equitable to the interested parties; *i.e.*, policyholders, creditors, and the general public, by preserving the Companies' estate assets.

16. The proposed Settlement Agreement will likewise benefit the public by conserving estate assets that would otherwise be used to fund both litigation expenses and possible tax liabilities. Those assets will instead be available to pay policyholder claims, including those made by state GAs, thereby reducing assessments to member insurers and, in turn, the costs borne by the public in the form of premium tax credits and deductions. *See* 40 P.S. § 221.1(c) (stating that the purpose of insurance receivership is to "protect[] ... the interests of insureds, creditors, and the public generally").

17. The Commissioner could not easily or efficiently obtain the benefits provided in the Settlement Agreement without the PTAC Intervenors' consent, at least not without lengthy, time-consuming and expensive litigation that could well involve one or more appeals or frustration of the Commissioner's goals.

18. The Settlement Agreement is, therefore, fair and reasonable to the Companies' estates, their policyholders and creditors, and does not constitute an abuse of the Commissioner's discretion. *Penn Treaty*, 119 A.3d at 323; *Exec. Life*, 32 Cal. App. 4th at 399.

19. Moreover, the Settlement Agreement and the transactions contemplated thereunder were proposed, negotiated and entered into by and between the Commissioner, on the one hand, and the Companies' Boards and the PTAC Intervenors, on the other hand,

without collusion, in good faith and at arm's length. The Settling Parties (i) have entered into the Settlement Agreement and propose to consummate the transactions contemplated thereunder for purposes other than hindering, or delaying or defrauding the present or future creditors of the estates or of the PTAC Intervenors; and (ii) are entering into the Settlement Agreement and proposing to consummate the transactions contemplated thereunder without fraud, not for the purpose or effect of statutory or common law fraudulent conveyance and fraudulent transfer claims, whether under Article V, the Pennsylvania Uniform Fraudulent Transfer Act, the Bankruptcy Code, or any other laws substantially similar to the foregoing.

20. The consideration that the Parties are providing under the Settlement Agreement and the performance of the covenants contained in the Settlement Agreement constitute reasonably equivalent value and fair consideration exchanged under Article V, the Pennsylvania Uniform Fraudulent Transfer Act, the Bankruptcy Code, and any other substantially similar laws. The payments provided under the Settlement Agreement are made as part of a good faith, arm's length compromise of disputed issues between the Settling Parties. The contemplated payments will be made for the purpose of obtaining the benefits described in this Verified Application, which the Companies' estates and policyholders would not receive otherwise.

III. REQUEST FOR ENTRY OF JUDGMENT ON THE SETTLEMENT APPROVAL ORDER AND POSTING OF BOND ON ANY APPEAL

21. Implementation of the Settlement Agreement will entail a number of steps that will be difficult if not impossible to reverse. For that reason, the Settling Parties believe that the Court should enter an appealable Order Approving Agreement, so that any

interested party objecting to the proposed settlement is required to timely raise their concerns.

22. Pennsylvania Rule of Appellate Procedure 341(c) allows a trial court to "enter a final order as to one or more but fewer than all of the claims and parties ... upon an express determination that an immediate appeal would facilitate resolution of the entire case." Pa. R.A.P. 341(c).

23. Article V provides that:

> [a]ny receiver appointed in a proceeding under this article may at any time apply for and the Commonwealth Court may grant, such . . . orders as may be deemed necessary and proper to prevent: . . . (iii) interference with the receiver or with the proceeding; (iv) waste of the insurer's assets; . . . (vi) the institution or further prosecution of any actions or proceedings; . . . ; or (xi) any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of the proceeding.

40 P.S. § 221.5(a).

24. Here, entry of an order approving the Settlement Agreement as final would facilitate resolution of the entire case by requiring prompt disposition of any objection to its terms and by lending certainty and finality to the Settlement Agreement once the objection and appeal process deadlines pass or the associated processes terminate.

25. Prompt disposition of any objections to the Settlement Agreement (if any are filed) will therefore advance the resolution of these receiverships and ensure that the benefits of the settlement are realized.

26. The Settling Parties, therefore, request that: the Court issue an Order Approving Agreement; the terms of the Settlement Agreement be incorporated into the Court's Order; the Commissioner continue to be bound under the Settlement Agreement in her capacity as Liquidator of the Companies; the Order remain effective notwithstanding

any subsequent liquidation order as provided by the parties' Settlement Agreement; and that such order be entered as a final judgment on the dockets of these receiverships.

27. Additionally, in the event that objections to the Settlement Agreement are filed and an appeal is taken therefrom, appellate proceedings could significantly impair the Companies' estates. The Commissioner could not release the settlement consideration until any such appeal was resolved, and the inability to do so would delay the expeditious conversion of these receiverships to liquidation as envisioned by the Settlement Agreement. An immediate liquidation petition filed during the pendency of an appeal might be challenged in a contested proceeding, significantly increasing the litigation and administrative costs charged to the estates. In that event, the estates would continue to pay premium taxes and agent commissions—unless the Court were separately to order cessation of the agent commissions—further depleting resources that otherwise would be used to pay policyholder claims. In addition, policyholders currently on claim would continue to be paid in full, depleting resources available for future claim and preventing all policyholder claimants from sharing pro rata in the estate assets.

28. Although the total costs to the estates cannot be precisely quantified until they arise, the Commissioner believes that those costs likely would meet or exceed the amount of the settlement consideration.

29. Pennsylvania Rule of Appellate Procedure 1733 provides that the court "may upon its own motion or application of any party in interest, impose such terms and conditions [with regard to an appeal bond] as it deems just and will maintain the res or status quo pending final judgment or will facilitate the performance of the order if sustained." Pa. R.A.P. 1733(a). The purpose of a bond "is to maintain the status quo and

protect the [parties in interest] from injury during the appeal period." *Commonwealth v. Mayer*, 569 A.2d 415, 418 (Pa. Comm. Ct. 1990).

30. Here, the posting of a bond in the event of an appeal is appropriate to preserve the current status quo and protect against the depletion of estate assets that would occur during the pendency of an appeal.

31. Pennsylvania Rule of Appellate Procedure 1731 provides, in the context of a judgment for the payment of money, a bond equal to one hundred twenty percent (120%) of the applicable judgment must be posted to obtain a stay pending appeal. Pa. R.A.P. 1731(a). Although a settlement approval order does not itself require the payment of money, that order authorizes the Commissioner to pay sums certain out of the Companies' estates.

32. The Settling Parties request that the Court enter an order requiring that any interested person filing a notice of appeal be required to post a bond equal to one hundred twenty percent (120%) of the amount of the settlement consideration and one hundred twenty percent (120%) of the potential alternative minimum tax in order to protect the Companies' estates against unwarranted depletion of assets in the event that the appeal is unsuccessful.

33. The settlement consideration is Ten Million Dollars ($10,000,000) and the Commissioner believes that the alternative minimum tax is about Twenty Million Dollars ($20,000,000). The Settling Parties, therefore, request that the Court enter an order

requiring any interested person filing a notice of appeal to file an appeal bond of at least Thirty Six Million Dollars ($36,000,000).[4]

34. Finally, the Settling Parties request that the Order provide that this Court shall retain exclusive jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation, and/or enforcement of the Settlement Agreement, any Definitive Agreement(s) executed in accordance therewith, and the Court's Order.

WHEREFORE, the Settling Parties request that the Court enter an Order Approving Agreement and finding that the payments which shall be made under the Settlement Agreement are fair, equitable, reasonable, and in the best interests of the Companies' policyholders and creditors, the public and the Companies' estates. The Settling Parties additionally request that the Court specify that the approval order constitutes a final judgment pursuant to Pa. R.A.P. 341(c) and require any interested party to post a bond of at least Thirty Six Million Dollars ($36,000,000).

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[4] In fact, this sum not only understates the value of the applicable judgment and tax benefits, but is substantially less than the costs and expenses that the estates would incur for agents' commissions, administration and litigation during any appeal .

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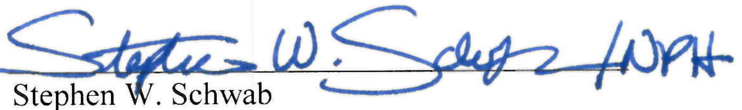
Respectfully submitted,

Dated: June 14, 2016



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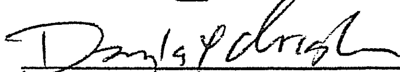

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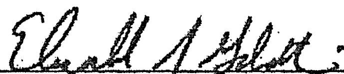

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CERTIFICATE OF SERVICE

I certify that, on June 14, 2016, I caused the foregoing Joint Application for Approval of Settlement Agreement to be served on the following counsel of record:

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