

# A Bankruptcy and Regulatory Primer for Insurance Company In-house Counsel

May 13, 2020



- For those of you who require CLE credits please note the following states have been approved for CLE in AZ, CA, NJ, NY, PA and TX. CLE is pending in Ohio.
- Please write down the following affirmation code [KEYP513]
- A couple business days after today's session you will receive an email with a link to the ***uniform certificate of attendance*** and ***program evaluation*** to complete and SUBMIT to my colleague, Robin Hallagan at [robin.hallagan@squirepb.com](mailto:robin.hallagan@squirepb.com).

- **Welcome**
- **Bankruptcy Basics**
- **Automatic Stay and Implications for Insurers**
- **Insurers and Executory Contracts with Debtor in Bankruptcy**
- **Red Flags, Due Diligence for Bankruptcy Risks and Monitoring for Pre-Bankruptcy Distress**
- **Communicating with Regulators about Bankruptcy Issues**
- **Questions**

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"Not scared yet? Just wait until I  
get to Chapter 11!"

# Bankruptcy Has Two Fundamental Goals

- **Fundamental Goal #1: Fresh Start for the Debtor**

The modern day Bankruptcy Code is designed to relieve the honest but unfortunate debtor of its indebtedness so that the debtor can make an economic fresh start and emerge as a viable productive entity.

# Bankruptcy Has Two Fundamental Goals

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## ▪ Fundamental Goal #2: Equitable Distribution

The Bankruptcy Code is designed to place all of the debtor's property under the control of the court for equal distribution among all creditors.

# Bankruptcy Courts are Courts of Equity



- Unlike traditional courts, Bankruptcy Courts are not Courts of Law.
- While Bankruptcy Courts reside in the Federal Judicial System, they are Courts of Equity which provides both flexibility and uncertainty.



# The Automatic Stay – Section 362

- **Purpose**

- Provide the debtor with a “breathing spell” in which it can attempt to reorganize and achieve a fresh start.

- **The Stay prevents:**

- The commencement or continuation of any action or proceeding against the debtor.
- The enforcement of a judgment against the debtor or its property.
- Any act to obtain possession of property of the estate or demand for payment of pre-bankruptcy debts.
- **The unilateral termination of an executory contract with the debtor.**





# The Stay Protects Property of the Estate

## What is “Property of the Estate”? Almost Everything!

- The commencement of a bankruptcy case creates an “estate.”
  - What is considered “property of estate” is expansive and includes, among, other things, all the debtor’s legal and equitable interests in:
    - All tangible property (such as personal property, real estate, financial accounts,, etc.);
    - Property that is in someone else’s possession;
    - Funds that the debtor is entitled to receive, but has not yet received; and
    - Intangible assets (such as licenses, accounts receivable, tax refunds, **contract rights**).
- What is not – property separately held in trust, escrowed funds held for benefit of another, letters of credit.
- Undisbursed and comingled premiums, expirations, customer lists, books of business and computer systems and related items are likely property of the estate .

## Warning: Do Not Violate Automatic Stay!



- The automatic stay is broadly construed.
  - Any action that harms a debtor in bankruptcy or has an adverse impact on its property can be a violation.
- The automatic stay is strictly applied.
  - There is no such thing as an “innocent violation” of the automatic stay.
- Violations of the automatic stay can carry heavy sanctions and penalties.
  - Any violation can result in sanctions, including actual damages and attorneys’ fees and costs.
- A willful violation of the automatic stay can result in an award of punitive damages.
  - Simply knowing that someone is a debtor can make an act willful

# Automatic Stay – Implications for Insurers

- Automatic Stay will prevent insurance companies from taking any actions to recover property controlled by the debtor agent/broker/administrator without relief from the Bankruptcy Court, including
  - Policyholder Information
  - Claim Information
  - Underwriting Data
  - Policy Premiums not held in a trust account
- Look at the terms of the agreement.
  - Who owns what? Is the other party complying? Are necessary documents filed, like UCC statements? Are premiums held in trust?

# Executory Contracts – Section 365

- Defined – a contract under which performance remains outstanding for both parties, which failure to perform would result in a material breach of the contract.
- Executory contracts are property of the bankruptcy estate, therefore, the automatic stay prevents the non-debtor parties from terminating or adversely affecting the debtor's rights under the contract.
- *Ipsso Facto* Clauses – clauses in contracts that provide for termination upon a bankruptcy filing, insolvency, or the appointment of a trustee in bankruptcy – are unenforceable.



**We will come back to this!**

# How Does This Effect Insurance Companies?

- **Types of Agreements Within Insurance Industry**
  - Third-party Administration Agreement
  - Managing General Agency Agreement
  - Vendor Outsourcing Agreement (e.g., Finance, IT)
  - General Agency Agreement or IMO Agreement
- Because these arrangements call for continuous obligations on behalf of both parties, they would be considered “executory contracts.” Therefore, they cannot be unilaterally terminated.

# Executory Contracts - A Debtor's Obligations

- A debtor has ability to pick and choose what contracts it wants.
  - A debtor may “**assume**” the contract and continue performance.
  - A debtor may “**reject**” the contract, or terminate it.
  - A debtor may **assign** a contract to third party.
    - Note that a contract must be assumed or rejected in full – a debtor cannot pick and choose valuable provisions.
- There is not time limit other than upon confirmation of plan (end of the case) for the debtor to assume or reject a contract.
- Prior to assumption, a debtor is not necessarily required to perform under the contract. But the other party has rights!

# What Happens When...

- **A TPA, MGA, IMO, agent or key vendor files for bankruptcy and moves to assume its Agreement with an Insurance Company?**
  - The debtor must cure any existing monetary defaults, *i.e.*, pay in full all outstanding amounts.
  - The debtor must continue to perform under the contract or provide “adequate assurance” that the debtor will and is able to perform under the contract.
  - Contract can be assigned in bankruptcy despite contract provisions to the contrary, unless non-bankruptcy law prevents it, such as intellectual property licenses or state MGA/TPA or insurance agent licenses.



# What Happens When...

- **A TPA, MGA, IMO, agent or vendor files for bankruptcy and moves to reject its contract?**
  - The debtor is relieved of its obligations under the contract.
  - Rejection constitutes a breach as of the day the bankruptcy case was filed.
  - Rejection entitles the non-debtor party (Insurance Company) to a general unsecured claim for damages for breach.

- A non-debtor party may not legally terminate an executory contract without obtaining the Bankruptcy Court's permission.
  - A non-debtor may force the debtor to make a decision to assume or reject.
  - If you move for an early determination, the court will look at, among other things:
    - The damage the non-debtor will suffer beyond the compensation available under the Bankruptcy Code
    - The importance of the contract to the debtor's business and reorganization
    - Whether the debtor had sufficient time to evaluate its financial situation and potential value of its assets
    - The complexity of the case

- **Offset and Recoupment:** The Bankruptcy Code recognizes state law rights you may have to offset any mutual debts with your customer. Initially hold all payments you owe to the debtor. Offset requires relief from the stay, but recoupment does not. Does your agreement provide for it?
- **Relief From Automatic Stay:** If the debtor is not performing under the contract or if continuing to work with the debtor is substantially detrimental to your company, you can request relief from the automatic stay to terminate the contract.
  - Creditor bears a heavy burden. Be prepared to substantiate your request with evidence of postpetition defaults, failure to cure, harm to insureds, consumer complaints, regulatory compliance obligations, state insurance law requirements, evidence of harm to creditor, etc.
- **Security Interests:** An insurer can assert a properly perfected security interest in customer and policy data, IP, underwriting processes, premiums.

# Discharge in Bankruptcy

## ■ What is it and how does it Effect Insurance Companies?

- The Bankruptcy Code provides a debtor relief from debt to enable a “fresh start.”
- Not all debt is dischargeable. Claims for certain fraud are non-dischargeable as are claims for fraud and misappropriation of funds while acting as a fiduciary.
- Considerations:
  - Does your contract make the debtor a fiduciary?
  - Does state law make the debtor a fiduciary?
  - Are funds required to be held in trust under contract or state law?
  - Are funds separately held in escrow?



# Actions Before Bankruptcy – Red Flags

- Before trouble arises, closely examine contract terms to determine fiduciary duties, property to be held in trust, segregation of funds, ownership rights and security interests.
  - Is the contractor complying?
  - If not, correct now and perfect security interest asap.
  - Check contract audit status or delivery of financials, and consider exercising audit rights and demanding delivery of financials.
- For agents, are they running significant or persistent debt balances?
- For TPAs, MGA/MGUs and other vendors:
  - Are regulatory and contractual deadlines being met?
  - Are consumer complaints on the rise?
  - Is the vendor responsive to data requests?
  - Is reporting timely?
  - Are payments current?
  - Have there been changes in reporting and payment trends?

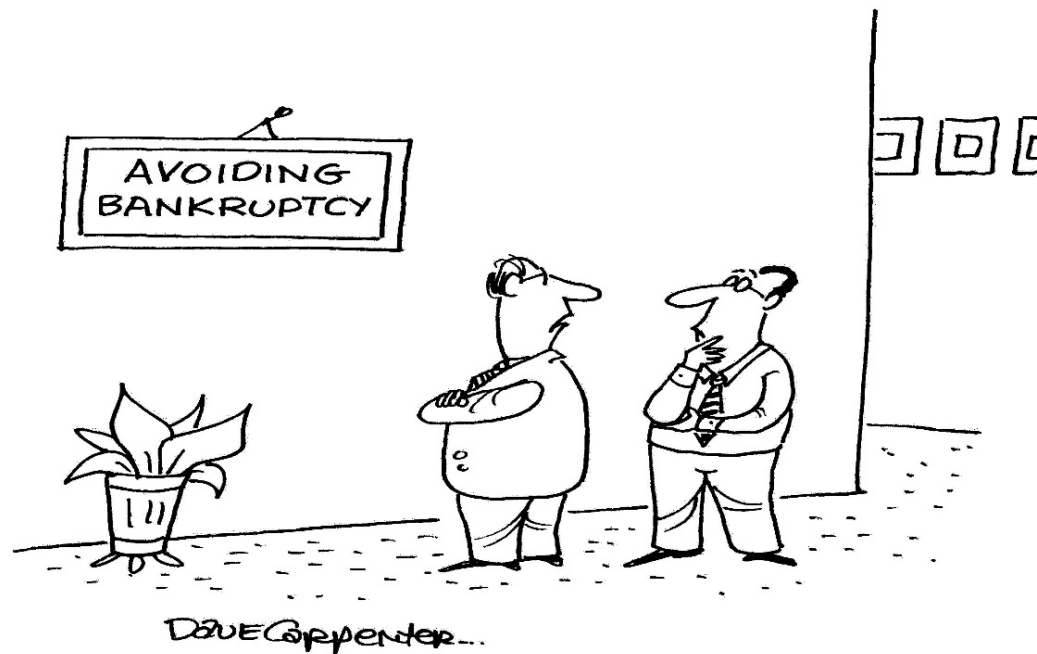
- **Accessing More Data & Signs of Trouble and Reaction**
  - In addition to staying abreast of news and facts that are readily accessible to a company through both public and internal sources, outside counsel can provide valuable information.
  - Squire Patton Boggs subscribes to and monitors data providers regarding legal developments, debt markets, restructurings and bankruptcy filings. These resources can provide vital clues and insights on current conditions and anticipated future developments.
  - After becoming aware of a business partner's financial troubles, a quick and strategic response can put a company in a strong position to protect its rights and interests.

# Working with Insurance Regulators

- If key contractor or vendor files for bankruptcy, evaluate potential impact on delivery of services to insureds and claimants, on company's compliance, and regulatory reporting obligations.
  - Consider advising domiciliary regulator of situation and transition plan, including bankruptcy court hurdles.
  - If consumers in multiple states may be impacted, prepare a communications plan with a dedicated team to respond to questions or concerns, and advise the regulators how they or consumers can reach the team.
  - If the vendor has a license or appointments, then be certain to understand any notice or revocation requirements.



Please Do Not Hesitate to Contact Us With Any Questions



" I WAS LOOKING FOR A LITTLE STRONGER  
MISSION STATEMENT THAN THAT. "

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# Speakers



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Chris concentrates in the areas of bankruptcy and creditors' rights, as well as litigation, representing secured and unsecured creditors, vendors and committees. His clients benefit from his extensive industry experience in the enforcement of a broad spectrum of creditors' rights.

He represents investors seeking to acquire distressed debt and assets of bankrupt and insolvent businesses, as well as the contractual interest of publicly and privately held companies in bankruptcy proceedings. His experience in the bankruptcy context includes real estate, lending, telecommunications, automotive and retail. His active bankruptcy litigation practice includes complex valuation and avoidance action litigation.



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Maura's restructuring and insolvency activity has focused on representing indenture trustees, corporate debtors and secured lenders in various industries.

Maura's litigation experience is bankruptcy-focused and centered on representing mortgage servicers in chapter 13 proceedings.

Prior to joining Squire Patton Boggs, Maura worked for an international law firm and focused her practice on representing indenture trustees in matters involving defaulted securities and chapter 11 debtors.



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Mary Jo is a former Insurance Commissioner for the State of Ohio. She represents insurance companies and similar financial service enterprises in matters involving transactional matters, regulatory examinations, operational and governance matters, product and rate filings, policy issues and solvency regulation issues.

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Sue is a former insurance regulator and seasoned adviser to clients in the insurance industry. She supports her clients with advice and guidance on compliance, particularly marketing and distribution, licensing, products, and managing a company's relationship with regulators.

Sue spent 15 years as a regulator with the Ohio Department of Insurance, serving as staff lawyer and Assistant Director for Market Conduct, Fraud & Enforcement and Agent Licensing. Prior to entering the regulatory space, she was an insurance defense attorney for several years.