Insurance Receiverships: A Primer

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Introduction

We're all familiar with Juliet Capulet's injunction that "a rose by any other name would smell as sweet." Shakespeare, *Romeo and Juliet*, Act II, Sc. 2, l. 43. It's a seemingly self-evident statement. But is it true?

Perhaps that's a bit too metaphysical for us – who are here to discuss insurance receiverships – to answer today. But we will see that an insurance receivership – which many consider to be a bankruptcy by another name – is akin to, but not identical with, the creature found in the federal bankruptcy code.

Some businesses succeed. Others fail. In a free society, with a free economy, success and failure are both ways of life. There is nothing inherently malicious or suspicious about the failure of a business, even in the insurance industry.

However, when an insurer fails, the state's Insurance Commissioner is authorized to commence delinquency proceedings. The receivership action, launched under state law in state court, involves special rules and procedures. This paper briefly introduces some of the peculiarities of an Oklahoma insurance receivership action.[1]

McCarran-Ferguson

The starting place for contemporary insurance law is the McCarran-Ferguson Act.

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[1] For the most part, this paper only discusses receiverships involving the liquidation of an Oklahoma domestic insurer.

15 U.S.C. §§ 1011 *et seq.* McCarran-Ferguson is sort of a reverse Supremacy Clause. The Supremacy Clause of the United States Constitution states:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the authority of the United States, shall be Supreme Law of the land; and the Judges in every state shall be bound thereby, any thing in the Constitution or Laws of any state to the contrary notwithstanding.

U.S. Const. Art. VI, ¶ 2. Supremacy Clause jurisprudence is abundant. See, e.g., *McCulloch v. Maryland*, 4 Wheat. (17 U.S.) 316, 427 (1819) (state law that conflicts with federal law is "without effect"); *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984) (whether federal law regulating nuclear energy safety preempts punitive damages); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992) (the Federal Cigarette Labeling and Advertising Act of 1965, as amended by the Public Health Cigarette Smoking Act of 1969, 15 U.S.C. §§ 1331 *et seq.*, preempts some state law cigarette smoking damage claims).

McCarran-Ferguson, by contrast, reverses the standard rule. In the area of insurance law, instead of federal law being supreme over state law, precisely the opposite is true: state law reigns supreme.

When it enacted McCarran-Ferguson, Congress made clear its policy of leaving the business and regulation of insurance to the states. As the United States Supreme Court has stated:

> In the McCarran-Ferguson Act, Congress provided that the "business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."

FMC Corp. v. Holliday, 498 U.S. 52, 62 (1990). According to the Court:

> Congress was concerned [in the McCarran-Ferguson Act] with the type of

> state regulation that centers around [*sic*] the contract of insurance…. The relationship between insurer and insured, the type of policy which could be issued, its reliability, its interpretation, and enforcement-these were the core of the 'business of insurance.' [T]he focus [of the statutory term] was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the 'business of insurance.'

Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 743-4 (1985), quoting *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969) (internal quotation marks omitted).

So the place to look for insurance law is, in the first instance, the law the appropriate state. In Oklahoma, the practitioner must become familiar with Title 36 of the Oklahoma Statutes.

The Oklahoma Uniform Insurance Liquidation Act.

The Oklahoma Statutes detail what the practitioner needs to know about receiverships. The place to look is Article 19 of Title 36. Let's review the Oklahoma Uniform Insurers Liquidation Act ("OUILA") and other provisions of Article 19.

The procedures of the OUILA are comprehensive. Reviewing courts have described the OUILA as a "comprehensive scheme" for oversight of the liquidation of insolvent insurers. *Munich American Reinsurance Co. v. Crawford*, 141 F.3d 585, 593 (5th Cir.), *cert. denied*, 525 U.S. 1016 (1998); *Davister Corp. v. United Republic Life Ins. Co*., 152 F.3d 1277, 1280 (10th Cir. 1998); *Grimes v. Crown Life Ins. Co*., 857 F.2d 699, 705 (10th Cir. 1988); *Grimes v. Okla. Prop. & Cas. Ins. Guar. Ass'n*, 1990 OK CIV APP 61, 796 P.2d 352.

Section 1901 – Definitions.

First are the definitions. Two are of especial importance. 1. What constitutes an "impairment?" According to 36 O.S. § 1901(1):

> "Impairment" or "insolvency." The capital of a stock insurer, or limited stock life, accident and health insurer, the net assets of a Lloyds association, or the surplus of a mutual or reciprocal insurer, shall be deemed to be impaired and the insurer shall be deemed to be insolvent, when such insurer shall not be possessed of assets at least equal to all liabilities and required reserves together with its total issued and outstanding capital stock if a stock insurer, the net assets if a Lloyds association, or the minimum surplus if a mutual or reciprocal insurer required by this code to be maintained for the kind or kinds of insurance it is then authorized to transact.

2. Who is an insurer?

> "Insurer" means any person, firm, corporation, health maintenance organizations, association or aggregation of persons doing an insurance business and subject to the insurance supervisory authority of, or to liquidation, rehabilitation, reorganization or conservation by the Insurance Commissioner or the equivalent insurance supervisory official of another state.

36 O.S. § 1901(2).

Now we know that when an insurer is impaired or insolvent something under Article 19 can happen. What is it?

Section 1902 – Delinquency Proceedings Procedure

Section 1902 creates the procedure for delinquency proceedings. Here we see something unusual. According to this provision, "[t]he district court is vested with *exclusive original jurisdiction* of delinquency proceedings pursuant to the provisions of this article, and is authorized to make all necessary and proper orders to carry out the purposes of this article." 36 O.S. § 1902(A) (emphasis added). Note the broad jurisdiction the statute grants: agents, policy holders, directors, officers, others in control of the insurer, even third party administrators and persons who merely "maintain[] information for an insurer," are all subject to the court's jurisdiction 36 O.S. § 1902(C).

This broad power, apparently conferred on all district courts in Oklahoma, is narrowed quickly by subparagraphs F and G. According to 36 O.S. § 1902(F), venue "of delinquency proceedings against any insurer" is limited to Oklahoma County. And only the Insurance Commissioner, by herself or through her attorney, may seek appointment of a receiver of an insurer. 36 O.S. § 1902(G).

Section 1903 – Commencement of Delinquency Proceedings

If section 1902(G) is not clear enough, the Legislature reiterated its limitations in 36 O.S. § 1903. Only the Insurance Commissioner, her attorney, or the Attorney General on behalf of the Commissioner, may "commence any such proceeding." Note how the Commissioner or her counsel starts the action and on whom the burden rests.

The Commissioner initiates the proceeding:

> by an application to the court for an order directing the insurer to show cause why the Insurance Commissioner should not have the relief prayed for. On the return of such order to show cause, and after a full hearing, the court shall either deny the application or grant the application, together with such other relief as the nature of the case and the interests of policyholders, creditors, stockholders, members, subscribers, or the public may require.

Section 1903 is a jurisdictional statute, *State ex rel. Hunt v. Green*, 1973 OK 29, 508 P.2d 639, that creates a special proceeding, cf. *State ex rel. Crawford v. Indemnity Underwriters Ins. Co.*, 1997 OK CIV APP 37, ¶ 7, 943 P.2d 1102, 1104. As such, the court's powers are circumscribed by statute and, to some extent, differ from the usual powers generally associated with typical civil procedure. Cf. *Matter of Estate of Speake*, 1987 OK 61, 743 P.2d 648 (explaining, in context of post-probate will contest, procedural differences between normal actions and special proceedings).

Section 1904 – Injunctions

Typically, the Commissioner seeks an injunction. The court may issue the injunction without notice. 36 O.S. § 1904. The injunction generally "restrain[s] the insurer, its officers, directors, stockholders, members, subscribers, agents and all other persons for [*sic*] the transaction of its business or the waste or disposition of its property until the further order of the court." 36 O.S. § 1904(B).

The injunction is somewhat akin to the injunction that occurs in a federal bankruptcy proceeding. In addition to the obvious, the court enjoins affected persons from concealing, destroying, disbursing, disposing of or assigning any assets, records, correspondence, documents, or other property which may have any conceivable relevance to the delinquency proceedings. Additionally, the court restrains them from paying any claims, debts, or obligations of the company. The court affirmatively orders them to transfer company property to the receiver; all persons are restrained from interfering with the receiver's rights in the property. 36 O.S. § 1904(B).

Finally, all persons, including creditors, are prohibited from transferring the assets and property of the company. The order typically bans people from commencing or prosecuting actions against the company, or from otherwise obtaining any preferences, judgments, attachments, or other liens against the company, or from making any levy against the company or its assets. *Id.*

Rehabilitation or Liquidation

The receivership can result in two outcomes. The insurer can be rehabilitated or it can be liquidated. The bases for each possibility are listed in Title 36 in sections 1905 and 1906, respectively. Requirements of the orders of rehabilitation and liquidation are contained in sections 1910 and 1911, respectively.

Section 1914 – Delinquency Proceedings

How does a delinquency proceeding work? Assuming the court agrees with the petition, it will name the Insurance Commissioner as receiver and will order her "forthwith to take possession of the assets of the insurer and to administer the same under the orders of the court." 36 O.S. § 1914(A).

A review of section 1914 shows the broad powers the Insurance Commissioner exercises, under court supervision, upon appointment as receiver. Essentially, the Commissioner takes over the company. She is "vested … with the title to all of the property, contracts, and rights of action and all of the books and records of the insurer … as of the date of entry of the order … to rehabilitate or liquidate [the insurer]." 36 O.S. § 1914(B). The receiver then "conduct[s] the business of the insurer," 36 O.S. § 1914(E), and is otherwise "responsible for the proper administration of all assets coming into [her] possession or control." 36 O.S. § 1914(D). By recording a certified copy of the order with the Oklahoma County clerk, the public is given the same notice as if a deed or bill of sale for the property of the company had been filed. 36 O.S. § 1914(C).

Priority of Claims

The statutes provide a specific priority for distribution of the assets of an insurer in receivership. Potential claimants must be mindful of where their claims stand in the order of distribution. Starting with Class 1, the statutes provide that "[b]efore the members of the next class receive any payment, every claim in each class shall be: 1. Paid in full; or 2. Protected by adequate funds retained for such payment." 36 O.S. § 1927.1(A).

Class 1 claims essentially encompass the costs to administer the receivership.

Class 2 claims are certain administrative expenses of guaranty associations.[2] The statute appears to allow Class 2 claimants to get early access to distributions under certain circumstances. Class 3 claims concern "[a]ll claims under policies," 36 O.S. 1927.1(B)(3), which includes "all claims of a guaranty association for payment of covered claims or covered obligations of the insurer and … for reasonable expenses other than those included in Class 2." *Id.* There is no provision for early access for Class 3 or later claims. Under the age old doctrine of *expressio unius est exclusio alterius*, there is a strong argument that early access cannot be allowed for such claims. *Patterson v. Beall*, 2000 OK 92, ¶ 24, 19 P.3d 839, 845 ("the mention of one thing in a statute impliedly excludes another thing"); *Manning v. State ex rel. Dep't. of Public Safety*, 2003 OK CIV APP 57, ¶ 11, 71 P.3d 527, 529 (calls the maxim a "rule of interpretation"); *State v. One 1965 Red Chevrolet Pickup*, 2001 OK 82, ¶ 12, n. 34, 37 P.3d 815, 820 (referring to doctrine as "*inclusio unius est exclusio alterius*" (emphasis added), states that "to express or imply one thing implies the exclusion of the other").

Back to McCarran-Ferguson: How Exclusive is Exclusive Jurisdiction?

As we've seen, the Oklahoma County District Court "is vested with exclusive original jurisdiction of delinquency proceedings pursuant to the provisions of this article." 36 O.S. § 1902. But how exclusive is that exclusive jurisdiction?

Lawyers are used to the notion that, although state courts are courts of general jurisdiction, and federal courts are courts of limited jurisdiction, a party against whom a claim is filed in state court may, under appropriate circumstances, remove a case to

[2] For the law applicable to guaranty associations, see 36 O.S. §§ 2001 *et seq.* (property and casualty insurance guaranty association) and 36 O.S. §§ 2021 *et seq.* (life and health insurance guaranty association).

federal court. See 28 U.S.C. §§ 1441 *et seq.* (removal jurisdiction and procedure). Is removal proper where the claim involves the receiver of an Oklahoma insurer?

The knee-jerk answer – that federal law is supreme, and preempts state law, and therefore removal is proper – is not necessarily true. And this is so because of McCarran-Ferguson.

Section 1012 of the McCarran-Ferguson Act provides:

> (a) State regulation
> The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
> (b) Federal regulation
> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance ... unless such Act specifically relates to the business of insurance.

15 U.S.C. § 1012. This "anti-exemption" provision of the Act exempts certain state laws from preemption, reversing the ordinary rule that federal law supersedes inconsistent state law. *United States v. Fabe*, 508 U.S. 491, 493, 498 n. 3, 507 (1993).

This "reverse preemption" doctrine applies if: (1) the federal statute at issue does not specifically relate to the business of insurance; (2) the state statute was enacted for the purpose regulating the business of insurance; and (3) application of the federal statute would "invalidate, impair or supersede" the state law. 15 U.S.C. § 1012(b); see also *Munich American Reinsurance Co. v. Crawford*, 141 F.3d at 590, adopted by *Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277 (10th Cir. 1998). While federal law ordinarily preempts conflicting state law by virtue of the Supremacy Clause, the "McCarran-Ferguson Act reverses that effect in the narrow range of cases involving state regulation of the insurance industry." *Munich American*, 141 F.3d at 590. Thus, where state laws regulating the insurance industry conflict with federal law, the federal law is "reverse preempted."

In *Munich American*, the Fifth Circuit discussed the relationship between the McCarran-Ferguson Act and the Oklahoma Uniform Insurers Liquidation Act. It held that, pursuant to McCarran-Ferguson, the Federal Arbitration Act ("FAA") is "reverse preempted" to the extent it conflicts with OUILA.

In *Munich American*, two reinsurance companies sued an insolvent insurer in a Texas federal district court. They sought to recover funds from a settlement they claimed the insolvent insurer owed them under the reinsurance agreements.

Relying on the FAA, the reinsurers asked the federal court enforce the arbitration provision of the reinsurance agreement. The Fifth Circuit affirmed the dismissal of the action, concluding that the liquidation court, not the federal district court, had jurisdiction, and that the FAA was not enforceable against the receiver. The Tenth Circuit in *Davister* adopted the *Munich American* holding *in toto*.

Statutes that directly or indirectly protect or regulate the relationship between insurance companies and their policyholders are laws "regulating the business of insurance." *Fabe*, 508 U.S. at 501. This category of law is broad. It includes those "that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance." 508 U.S. at 505 (quoting *Black's Law Dictionary*, 1236, 1286 (6th ed. 1990)).

The provisions of the OUILA, including specifically the provisions placing exclusive jurisdiction in the District Court of Oklahoma County over matters involving an insolvent insurer, have the intention or aim of managing or controlling the business of insurance and protecting the relationship between the insured and insurer. Thus, these statutes were enacted for the purpose of regulating insurance.

As we have seen, under OUILA, the Oklahoma County District Court "is vested with exclusive original jurisdiction" over all delinquency proceedings. 36 O.S. § 1902(A). Only the Insurance Commissioner can place an Oklahoma insurer into liquidation or rehabilitation proceedings. 36 O.S. § 1903. Only the Commissioner can be named as receiver. 36 O.S. § 1914(A). As receiver, the Commissioner is vested with title to all property, contracts and rights of action of the insurer. 36 O.S. § 1914(B). Upon taking possession of the assets, including rights of action, the receiver must immediately take steps to conserve the assets of the insurer. 36 O.S. § 1914(E). OUILA authorizes the liquidation court to issue an injunction to prevent waste of the insurer's assets and the "commencement or prosecution of any actions." 36 O.S. § 1904(B). Additionally, OUILA provides the Oklahoma County District Court with extensive general power "to make all necessary and proper orders to carry out the purposes of [the Act]." 36 O.S. § 1902(A).

OUILA is a "complex and comprehensive scheme of insurance regulation ... for the liquidation of an insolvent insurer." *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699, 705 (10th Cir. 1988) (holding *Burford*[3] abstention required in a federal action against an insurance company subject to delinquency proceedings in Oklahoma state court). As the Tenth Circuit stated:

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[3] *Burford v. Sun Oil, Co.*, 319 U.S. 350 (1943). *Burford* held a federal court may dismiss a case if it presents "difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar," or if its adjudication in a federal forum "would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." In *Quackenbush v. Allstate Ins. Co.,* 517 U.S. 706, 731 (1996), the Court held a federal court is allowed to dismiss a case or remand it to state court under *Burford* abstention only if the relief being sought is equitable or otherwise discretionary.

> Oklahoma has not only adopted a comprehensive scheme to oversee the liquidation of insolvent insurers, it has provided a particular court ... to oversee liquidation proceedings. The effect of this provision grants the Oklahoma County District Court a special relationship of cooperation, technical oversight and concentrated review with the Oklahoma Commissioner of Insurance in the process of liquidating insurers.

Grimes, 857 F.2d at 705.[4]

The court in *Munich American* held that "this comprehensive regulatory scheme, viewed in its entirety, regulates the business of insurance." 141 F.3d at 592. More specifically, the court concluded that the provisions of OUILA requiring consolidation of all claims related to delinquency proceedings and vesting exclusive jurisdiction of such proceedings in the Oklahoma state court were enacted for the purpose of regulating the business of insurance. *Id.* 593-94.

The special relationship between the liquidation court and the Oklahoma Insurance Commissioner contributes to the orderly liquidation of an insurance company. *Munich American*, 141 F.3d at 593. The policy under OUILA "of placing ultimate control over all issues relating to the insolvency proceedings in a single court is aimed at protecting the relationship between the insurance company and its policyholders." *Id.* Consolidation in one court "eliminates the risk of conflicting rulings, piecemeal litigation of claims, and unequal treatment of claimants, all of which are of particular interest to insurance companies and policyholders as well as other creditors." *Id.* A single forum protects receivers from litigating in multiple forums, which might deplete the assets of the insolvent insurance company. See *U.S. Financial Corp. v. Warfield*, 839 F. Supp. 684, 689 (D. Ariz. 1993); *Covington v. Sun Life of Canada (U.S.) Holdings, Inc.,* 2000

[4] Although *Grimes* discussed McCarran-Ferguson in *dicta*, its holding addressed only abstention.

WL 33964592 (S.D. Ohio).

In discussing the purpose of OUILA, the Oklahoma Supreme Court has explicitly recognized the state Legislature's intent to ensure uniformity:

> [W]ide distribution of assets and liabilities [of insolvent insurers] creates a formidable array of problems when liquidation, rehabilitation, or reorganization proceedings become necessary, and the equitable and expeditious solution of those problems is rendered the more difficult by wide differences in the provisions of the statutes of the several states regarding such matters as special deposits, preferred claims, securities, setoff, and the administrative and judicial procedures to be followed.

Professional Const. Consultants, Inc. v. Grimes, 1982 OK 61, 646 P.2d 1262, 1266. OUILA was designed to eliminate these difficulties. *Id.* The "breadth [of OUILA] reflects the need to fully protect the insolvent insurer's policyholders[.] In reflecting such an important and overwhelming public policy, the Act confines any proceeding involving an insolvent insurer to the domiciliary state if liquidation proceedings have commenced." *Motor Club of America v. Weatherford*, 841 F. Supp. 610, 618 (D.N.J. 1994).

Davister interpreted Utah receivership laws similar to those in Oklahoma. In *Davister*, the Tenth Circuit fully adopted *Munich American's* reasoning and holding as to Oklahoma law. Like *Munich American*, *Davister* involved an insolvent insurer's creditor who sought to avoid the receivership court's stay of all actions against the insurer and force arbitration to determine its claim. The court noted the Utah statute requiring a stay of all proceedings against the delinquent insurer in courts other than the receivership court makes it clear the policy is to "consolidate in one forum all matters" related to the liquidation and "manifests a purpose of protecting policyholders." *Davister*, 152 F.3d at 1281. It concluded the Utah statute, like the Oklahoma statutes, was "enacted for the purpose of regulating the business of insurance." *Id.*

Some courts have specifically held federal jurisdictional statutes invalidate, impair, or supersede state laws regulating insurance, and are therefore reverse preempted pursuant to McCarran-Ferguson. *Omaha Life Ins. Co. v. Udisky*, 2001 WL 102670 (S.D. Ohio); *Covington v. Sun Life of Canada (U.S.) Holdings, Inc.,* 2000 WL 33964592 (S.D. Ohio); *U.S. Financial Corp. v. Warfield*, 839 F. Supp. 684 (D. Ariz. 1993). In particular, those courts addressed the effect of jurisdictional statutes on provisions of state liquidation laws requiring exclusive jurisdiction in the liquidation court over matters related to an insolvent insurer.

In *Covington*, the liquidator of an insurance company brought an action in Ohio state court seeking to recover alleged preferential and fraudulent transfers. Defendants removed the case to federal court on the basis of diversity. The liquidator contended the state's liquidation act, by virtue of McCarran-Ferguson, reverse preempted the federal removal statute. Defendants asserted the jurisdictional provisions of the liquidation act did not fall within the reverse preemption principles of McCarran-Ferguson.

First, the court determined the removal and jurisdiction statutes did not specifically relate to the business of insurance. 2000 WL 33965492 at *3. Next, it concluded the exclusive jurisdiction provisions of the state liquidation law were enacted for the purpose of regulating insurance, relying on the reasoning in *Munich American* for that conclusion. 2000 WL 33965492 *4-8. Having determined the first two criteria of the reverse preemption test were met, the court examined whether the federal statutory authority governing removal of an action based on diversity jurisdiction, 28 U.S.C. §§ 1332 and 1441, "invalidates, impairs or supersedes" the provisions of the liquidation act vesting exclusive jurisdiction in the Franklin County Court of Common Pleas. 2000 WL

33964592 at *9.

The defendants maintained it would not impair the Ohio statutes if the federal district court retained jurisdiction because the federal court was as capable as the Franklin County Court of applying the provisions of the liquidation act to the fraudulent transfer and preferential transfer claims. The court, however, noted: "The issue is not whether the Court is capable of applying [state] law to the claims brought by the Liquidator but whether the federal statutory authority governing removal ... invalidates, impairs or supersedes the provisions of the Liquidation Act vesting exclusive jurisdiction in" one court. *Id.* The court concluded if it retained jurisdiction on the basis of diversity jurisdiction, it would prevent the consolidation of all liquidation proceedings related to the insolvent insurer in one forum, and, thus, would invalidate, impair or supersede the state statutes requiring consolidation.

In *Udisky*, an interpleader action related to *Covington*, the court held the interpleader statute, 28 U.S.C. § 1335, also impairs the Ohio Liquidation Act by placing jurisdiction in federal court when the Act places jurisdiction in only the Franklin County Court of Common Pleas. 2001 WL 102670 at *5. The court stated:

> The Act provides an efficient and equitable process to collect and distribute assets of insolvent insurers. It does so by consolidating all of the assets and claims into a single forum, the Franklin County Court of Common Pleas. A ruling by the Court on this matter could be inconsistent with the determinations of the Court of Common Pleas and would thereby impair the purpose of the Liquidation Act.

Id. Accordingly, the court found it was without subject matter jurisdiction based on the McCarran-Ferguson reverse preemption doctrine and dismissed the action.

U.S. Financial Corp. v. Warfield arose from a transaction involving the purchase of preferred stock from an insurance company later placed in receivership. 839 F. Supp.

at 687. USF brought an action against the receiver, seeking a declaratory judgment and compensatory damages. *Id.* The court concluded the supplemental jurisdiction statute, 28 U.S.C. § 1367, would impair the operation and effect of the provisions of the Arizona liquidation act vesting exclusive jurisdiction over insurer liquidation proceedings in state courts and permitting them to issue injunctions from bringing actions involving the assets of the insurer in any forum other than the receivership court. 839 F. Supp. at 689. Although the court noted that it was "somewhat hesitant" to conclude that state law could divest the federal court of jurisdiction, it nevertheless concluded it did not have jurisdiction over the matter. *Id.* The court found that exempting jurisdictional statutes from the reach of McCarran-Ferguson is inconsistent with the Act's terms, and held it did not have subject matter jurisdiction. 839 F. Supp. at 690.

According to *AmSouth Bank v. Dale*, 386 F.3d 763, 783 (6th Cir. 2004), a federal court may be divested of diversity jurisdiction pursuant to McCarran-Ferguson even when it originally had jurisdiction. The Sixth Circuit ultimately decided the reverse preemption doctrine did not apply to the declaratory judgment action before it because it had a minimal connection to regulating the business of insurance. Nonetheless, the court made clear that the doctrine would apply in a proper case. *Id.*

In concluding *Burford* abstention also did not apply, the court in *AmSouth* discussed *Gonzalez v. Media Elements, Inc.*, 946 F.2d 157 (1st Cir. 1991), a case involving a dispute over coverage with an insurer that became insolvent while the case was on appeal:

> A coverage claim against a now-insolvent insurer that arose prior to the insolvency is of course exactly the sort of claim that must be heard in the liquidation proceedings; although dismissal under *Burford* abstention is no

> longer appropriate under *Quackenbush* in damages actions,[5] presumably McCarran-Ferguson protection would extend to this kind of claim.

386 F.3d at 784.

Claims the Receiver May Pursue.

Note that the Receiver owns the insurer's "rights of action." Two questions concerning the Receiver's handling of the insurers rights of action arise: What may she do? What must she do?

In asserting these rights of action, "the [receiver of an insurer subject to delinquency proceedings] is performing a traditionally non-governmental function, *the primary purpose of which is to protect insureds and creditors.*" *Farrimond v. Fisher*, 2000 OK 52, ¶ 16, 8 P.3d 872, quoting *Kentucky Cent. Life Ins. Co., By and Through Stephens v. Park Broadcasting of Kentucky, Inc.*, 913 S.W.2d 330 (Ky.App.1996) (emphasis added). The rights of action the receiver may bring include obvious ones, such as breach of contract and other claims that management would have brought even without the delinquency proceedings. But they may also include less obvious claims, including claims management would not have brought.

Potential claims could include actions based in tort against third parties whose conduct is alleged to have damaged the insurer, its policyholders and other creditors. *Farrimond*; 36 O.S. § 1914(B). In a proper setting, this may include actions against the former officers, directors, employees, accountants, actuaries, attorneys, and others whose conduct has wrongfully contributed to the insolvency of the insurer.

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[5] *Gonzalez* was based on the pre-*Quackenbush Burford* abstention doctrine. After *Quackenbush*, *Burford* abstention is inapplicable to damages actions, except in rare circumstances pending the resolution by the state courts of a disputed question of state law. *Quackenbush*, 517 U.S. at 730-31.

This right is important. It is also exclusive. The Receiver is vested with exclusive standing to assert and settle common claims on behalf of the company, its creditors and policyholders. *Four Star Ins. Agency, Inc. v. Hawaiian Elec. Indus., Inc.*, 974 P.2d 1017, 1025 (Haw. 1999) (Receiver has exclusive standing to assert policyholder and creditor claims); *In re American Mutual Liability Ins. Co.*, 632 N.E.2d 1209, 1213 (Mass. 1994) (Receiver may settle claims on behalf of policyholders where injury involves harm to insurer that decreases amount of funds available to satisfy policyholder claims); *Arthur Andersen LLP v. Superior Court of Los Angeles County*, 67 Cal. App. 4th 1481, 1497 (Cal. Ct. App. 1998) (Receiver may recover damages for benefit of policyholders); *Federal Signal Corp. v. Stewart*, 1998 W.L. 1144558 (E.D. Pa. 1998) (only Receiver has standing to pursue claims common to policyholders); *Cordial v. Ernst & Young*, 483 S.E.2d 248, 257 (W.Va. 1996) ("[T]he Insurance Commissioner, while acting as Receiver for an insurer, acts as the representative of interested parties, such as the defunct insurer, its policyholders, creditors, shareholders, and other affected members of the public[.]"); *Foster v. Peat Marwick Main & Co.,* 587 A.2d 382, 385 (Pa. Commw. Ct. 1991) (Receiver may maintain suit on behalf of policyholders); *Corcoran v. Frank B. Hall & Co., Inc.*, 545 N.Y.S.2d 278, 280, 149 A.D.2d 165 (N.Y. App. Div. 1989) ("[T]he [Receiver] had paramount and exclusive standing to assert claims not only on behalf of [the insurer], but also on behalf of its policyholders and creditors").

The Receiver has the exclusive ability to assert common claims on behalf of policyholders because (i) the receiver is charged with the duty to ensure the most equitable distribution of the insurer's assets; and (ii) the purpose of the statutory framework is to avoid multiple lawsuits by various policyholders and creditors.

Corcoran, 545 N.Y.S.2d at 281 ("[P]aramount purpose of [rehabilitation and liquidation act] 'is the preservation and enhancement of [the estate's] assets to the end that the interests of all its creditors, policyholders, stockholders and the public will be subserved'"); *Four Star Ins. Agency, Inc*., 974 P.2d at 1024 (adopting *Corcoran* reasoning in a rehabilitation proceeding).

Courts addressing the question of a Receiver's authority hold that the Receiver has the capacity to bring lawsuits on behalf of the insurer's policyholders and creditors when the Receiver is prosecuting or settling "common claims." As a general rule, a Receiver has a right to maintain a suit that is necessary to preserve the corporation's assets and to recover assets of which the impaired insurer has been wrongfully deprived. It is the policyholder's interest in the assets of the impaired insurer the Receiver is prosecuting. *Liquidation of American Mutual Liability Ins. Co*., *supra*.

In *Liquidation of Integrity Ins. Co*., 240 N.J. Super. 480, 495, 573 A.2d 928, 936 (1990), the Court determined:

> [T]he issue here necessarily turns on whether the Liquidator is suing to increase Integrity's assets, so that all of its policyholders, creditors, etc., may benefit thereby or whether the Liquidator is simply asserting personal claims which really belong to the individual creditors, policyholders, and the like.

See also *Foster v. Peat Marwick Main & Co*., *supra* (Rehabilitator had authority to bring suit against accounting firm on policyholders' behalf; if damage asserted in litigation is common to a policyholder class, and recovery constitutes assets to which that class will ultimately look for distribution or payment from the estate, claim should be asserted by Receiver, not policyholders); *Corcoran v. Frank B. Hall & Co., Inc*., *supra* (insurer's liquidator had exclusive standing to assert claims against the insolvent company's former directors and officers and former auditor, for operating company for sole benefit of other businesses and causing insolvency, because recovery would inure to benefit of all policyholders of estate).

In *Insurance Commissioner of Michigan v. Arcilio*, 221 Mich. App. 54, 561 N.W.2d 412 (1997), policyholders of the insolvent insurance company filed a class action against former officers and directors seeking damages for, among other things, common law fraud and misrepresentation. In determining that the Receiver, not the policyholders, had the requisite standing to prosecute the action, the Michigan Court of Appeals stated:

> Hence, the general assets of the insurer clearly include causes of action based in tort against a third party whose breach of the appropriate standard of care is alleged to have defrauded the insurer and its policyholders.

Id., at 418. The *Arcilio* Court went on to state:

> Here, [policyholders'] federal claims allege the type of personal injury, that can be pursued by the rehabilitator on behalf of the rehabilitation estate. Moreover, we note that [rehabilitator] has commenced a suit on behalf of all policyholders against most of the same parties, named in [policyholders'] federal actions in Georgia. Accordingly, continuation of [policyholders'] common law claims would result in wasteful and duplicative litigation that would run the risk of potentially conflicting outcomes. Consequently, we affirm the circuit court's order enjoining [policyholders] from pursuing their common law claims for fraud and misrepresentation in the federal court.

Id., at 419.

As the *Arcilio* Court noted, the litigation itself constitutes an asset of the estate, because the lawsuit generates proceeds that are available for the use and protection of all policyholders rather than a select few. The Court also was aware of the likelihood of piecemeal litigation and unequal treatment of interested persons if separate policyholder "factions" were allowed to personally attempt to vindicate the rights of the policyholder class.

A Brief Word on Deepening Insolvency

Sometimes, the failure of a business is caused by tortious or even criminal mismanagement of the business. When that happens in the insurance industry, as we have seen, the Insurance Commissioner, who has had to commence delinquency proceedings, may determine that suit would be appropriate against some person or people who controlled, directed or assisted the control or direction of the insurer.

There are several traditional claims one can file. Misfeasance, malfeasance, negligence, theft, malpractice – all of these claims and more should be considered.

One of the hottest causes of action[6] today involves a claim that someone – a director, an officer, an auditor, an attorney – caused or exacerbated the failure of the business. Sometimes, the claim is referred to as one for "deepening insolvency."

The name for the claim comes from an opinion written by Judge Richard Posner of the Seventh Circuit. In *Schacht v. Brown*, 711 F.2d 1343 (7th Cir. 1983), the court stated:

> [T]he corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability. Indeed, in most cases, it would be crucial that the insolvency of the corporation be disclosed, so that shareholders may exercise their right to dissolve the corporation in order to cut their losses. Thus, acceptance of a rule which would bar a corporation from recovering damages due to the hiding of information concerning its insolvency would create perverse incentives for wrong-doing officers and directors to conceal the true financial condition of the corporation from the corporate body as long as possible.

711 F.2d at 1350. Because insurers have a duty to report their assets and liabilities not only to their shareholders, but also to their regulators (and thereby to the public), the "perverse incentives" to which Judge Posner refers would be even more perverse.

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[6] There is substantial debate concerning whether "deepening insolvency" is a separate cause of action or merely a theory of damages.

There are plenty of opportunities for an insurer, or those representing the insurer, to deepen the company's insolvency. It's not just in the typical "lender liability" situation – where a lender improperly extends credit to an insolvent company, thereby allowing it to spend itself into deeper insolvency. Mismanagement, fraud, misreporting of assets or liabilities – any of these acts can have a highly deleterious impact on the solvency of the business. When the facts support doing so, a receiver should consider pursuing a deepening insolvency theory against responsible parties, whether as a claim for relief or merely as a measure of damages.

Receiverships – A Bankruptcy By Another Name

There is nothing mysterious about an insurance receivership. Insurance receiverships are like bankruptcy actions, but they are filed in state court under state procedures pursuant to state rules. The statutes lay out how an insurance receivership action works. Where should you start? Where you always should, by reading the appropriate statutes – here, Article 19 of Title 36 of the Oklahoma Statutes.