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SALE OF AN INSOLVENT INSURER'S CHARTER

By

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[Editor's Note: Mr. May is an attorney in Denver, Colo. Responses to this commentary are welcome.]

This article examines the viability of the sale of an insolvent insurer's charter under the provisions of the 1991 Insurers Rehabilitation and Liquidation Model Act ("Model Act")[1] and advocates suggested statutory language to allow the sale of insolvent insurance company charters in those states which do not already allow such sales.

THE MODEL ACT

As far as the business of insurance is concerned, it is axiomatic that in order to conduct the business of insurance, an insurer must first have an existence of some nature. Invariably, the insurer exists in the form of a corporation licensed to do business in one or more states. Once an insurer is incorporated in a state, the insurer then is required to obtain permission to transact the business of insurance by the insurance department in each of the states in which the insurer wishes to transact the business of insurance. Generally, this permission takes the form of a license which allows the insurer to transact business in various states. Together, the corporate existence and licenses to do business will hereafter be referred to as an insurance company's "charter."

COMMENTARY

In normal business practice, as well as in receiverships, insurance companies can be sold and their blocks of business can be sold. Consequently, once an insurance company enters into liquidation, the liquidator, whose responsibilities include recovery of the maximum amount of assets available for payment of the insolvent insurer's debts, could be expected to assume that the charter is one of the assets to be sold in the liquidation proceedings.[2] However, the liquidator often discovers that statutory provisions prevent the sale of a charter because of state liquidation laws which automatically dissolve the charter at the end of the liquidation. If a state's liquidation law essentially prevents sale of the charter, this limits the ability of the liquidator to recover the maximum amount of assets available for payment of the insolvent insurer's debts.

Section 20 of the Model Act provides that when an insurance company is liquidated:

> The Commissioner may petition for an order dissolving the corporate existence of a domestic insurer or the United States branch of an alien insurer domiciled in this state at the time he applies for a liquidation

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> order. The court shall order dissolution of the corporation upon petition by the Commissioner upon or after the granting of a liquidation order. If the dissolution has not previously been ordered, it shall be effected by operation of law upon the discharge of the liquidator if the insurer is insolvent but may be ordered by the court upon the discharge of the liquidator if the insurer is under a liquidation order for some other reason.[3]

Under this provision of the Model Act, unless accomplished earlier, the charter of an insolvent insurance company in liquidation is automatically dissolved by "operation of law" once its liquidator is discharged. This provision gives pause to liquidators wishing to sell the charters of insolvent insurance companies as an asset of the liquidation estate and also gives pause to prospective purchasers who are, with good cause, naturally wary of purchasing an insurance company charter which will automatically dissolve in the future.

THE "DARING" LIQUIDATOR'S ARGUMENTS

The Daring Liquidator's Statutory Construction

A "daring" liquidator may attempt to argue that an insurance company's charter or license to do business is somehow separate from its "corporate existence" and sell the charter in any event. I call this person a daring liquidator because, though this argument has a certain amount of semantic appeal, the law is fairly clear that in the absence of a statute to the contrary a charter cannot be sold or transferred and the right to be a corporation ceases when the corporate existence dissolves. See 18 Am. Jur. 2d Corporations Section 72; Couch on Insurance 2d Section 19:64.

In a state which has enacted the Model Act language, a daring liquidator may attempt to construe the statutory language in such a way that it allows for sale of a charter. The liquidator might argue that the dissolution language of the Model Act applies only when the charter has not been sold as an asset of the liquidation estate - that after a sale, the charter is no longer subject to the dissolution provision. The general purpose of the Model Act to protect the "interests of insureds, claimants, creditors, and the public generally" can be used to argue that insureds, claimants, creditors, and the general public are clearly better served when the greatest amount of assets are available for distribution from the estate. See Model Act Section 1.D.

Further, the daring liquidator would argue that because:

(1) the definition of general assets includes "all property" of an insurer;
(2) the liquidator is vested with title to all of the insurer's property;
(3) the liquidator is directed to take possession of and administer the insurer's assets;
(4) the liquidator is granted the power to conduct public and private sales of the property of the insurer; and
(5) the liquidator is entitled to sell "any property of the insurer;"

the charter, as an asset of the insurer can be legally sold by the daring liquidator. See Model Act Sections 3.I., 18.A., 21.A.(9). and 21. A.(11). The argument continues that because liquidators have the power to execute any releases necessary to effectuate any sale of the insurer's property under Section 21.A.(11)

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of the Model Act, the purchaser can be granted a release which specifically provides that the charter is transferred free and clear of all encumbrances - including future dissolutions.

From a legal standpoint, the daring liquidator's approach to statutory construction is doomed to failure because of the express provisions in the Model Act. A cardinal rule of statutory construction is that express provisions prevail over implied provisions. Because Section 20 of the Model Act expressly provides that the insolvent insurer's charter automatically dissolves at the close of the liquidation, the express provisions should control over the implied power to sell a charter.[4] Further, if the statutory drafters intended for the charter to be sold, they certainly knew how to draft Section 20 in such a way as to allow for sale of the charter.[5] Finally, the law of statutory construction which provides that a contract cannot change a statute would render void a contract for sale even if it provides that the charter does not automatically dissolve upon termination of the liquidation.

The Attempted Stamp of Court Approval

The daring liquidator may also attempt to use court approval of the sale to ratify or validate the sale of the charter. This can be done either through normal motion pleading or through an indirect approach. A motion for sale of the charter should be denied by the liquidation court for the same reasons a direct sale of the charter is not proper. Under the indirect approach, the liquidator would use other provisions of the Model Act to gain court approval of the charter's sale. Under Sections 34.A. and 44, a liquidator is allowed to disburse assets of the estate under direction of the liquidation court. Using these sections, the daring liquidator could propose a plan for distribution which includes the proceeds from the sale of the charter. Then once the liquidation court has approved the plan, the liquidator would argue the court approval ratifies and validates the sale of the charter.

However, an attempt to validate a charter's sale through court approval, given the express language of Section 20, should also fail. Legislatures are empowered to create law while courts are only authorized to enforce the law. Though court approval of a plan of disbursement may give the charter's sale a superficial stamp of approval, clearly such court approval is not able to change the law and prevent automatic dissolution of the charter at a later date.

Practical Realities Allow the Sale

From a practical standpoint, unless someone objects to the sale, a charter could conceivably be "sold" so that a liquidation estate increases its assets and the purchaser continues to operate under a company's authority. For example, the stock of a company could be sold and the purchaser could then continue to operate under the insurance company's charter. Such a sale increases the assets of the liquidation estate and therefore arguably better serves policyholders and creditors of the insolvent insurer.

However, the liquidator would then be selling something which would have a limited future life and would be of less value to the ultimate purchaser than an unencumbered charter. If the liquidator is aware of the limited life of the asset being sold, disclosure of this fact to potential purchasers will have a severe impact upon the sale price of the charter and probably make it unsalable. If the liquidator is unaware of the limited life and does not disclose it to a potential purchaser, this of course would subject the liquidator to possible suit in the future for selling an asset with a limited life which was represented as having a perpetual existence.

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In any event, the purchaser's title is always subject to attack and this constant cloud on the right to do business will lower the sale price of a charter. See Gontrum v. Union Liberty Life Ins. Co., 11 A.2d 625 (Md. App. 1940), for a case in which a charter's sale was later attacked by an insurance department which had previously approved the sale. Therefore, a sale of a charter, with a limited life under the Model Act statute, would not maximize the assets of a liquidation estate.

SOLUTION: CHANGE THE STATUTE

The most effective way to maximize the assets available to a liquidation estate, through the sale of a charter, is to change the liquidation statutes and Model Act. Beginning with Iowa, several states have changed their liquidation statutes to allow the sale of an insolvent insurer's charter. For instance, in 1993, Kansas amended K.S.A. Section 40-3624 to read:

The Commissioner may petition for an order:

(a) Dissolving the corporate existence . . .
[insert rest of Model Act language] . . .
for some other reason; *or*

(b) permitting the sale of the corporate existence of a domestic insurer, together with any of its licenses to do business, despite the entry of an order of liquidation. The court may permit the sale of such corporate existence upon or after the granting of a liquidation order. The proceeds from the sale of the corporation shall become a part of the general assets of the estate in liquidation. The corporation and its licenses shall thereafter be free and clear from the claims or interests of all claimants, creditors, policyholders and stockholders of the corporation under liquidation. If permission to sell the corporation is not granted, the court shall order dissolution of the corporation as provided in subsection (a).

(emphasis added). This statute specifically provides that the proceeds from a now permissible sale of the charter and licenses to do business become part of the general assets of the estate to be distributed according to the statutory priority scheme. Further, K.S.A. Section 40-3624(b) gives specific assurance to the purchaser of the charter that the purchaser is obtaining the corporation or its licenses free and clear from all "claims or interests of all claimants, creditors, policyholders and stockholders of the corporation under liquidation." This gives the purchaser the greatest security possible which, in turn, gives the liquidator the ability to obtain the greatest possible purchase price on the sale of the charter. This in turn maximizes the benefit to the policyholders and creditors of the insolvent insurer. Similarly, the Texas receivership code provides: "The receiver may, subject to the approval of the court and State Board of Insurance, as required by this code, sell or otherwise dispose of the charter or license of the insurer separate and apart from its outstanding liabilities." Article 21.28, Section 2(g).

POSSIBLE OBJECTIONS TO SUCH STATUTES

There are three objections which immediately spring to mind which some states may use to argue against providing for the sale of an insolvent insurer's charter. First, some states may argue the purpose behind a liquidation is to liquidate the charter of the insolvent company. This philosophy makes sense from a semantic point of view in providing a clean, straight-forward approach to the liquidation of insurance companies which says that once an insurance company has been liquidated there should be

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nothing left after the liquidation has been closed. However, this position ignores that the charter is an asset which can be sold and that just like other assets which continue to exist after the close of liquidation (i.e,. in the hands of those persons that assets were sold to) the charter of the company being liquidated can also continue to exist after the close of liquidation. This position also loses its credibility when one compares the process of liquidating an insurance company to the sale of a solvent insurance company. Solvent insurance companies can be sold; therefore, there should be no philosophical reason why an insolvent insurance company cannot sell its charter. Further, just as other assets are sold free and clear of encumbrances, the charter should be sold free and clear of encumbrances.

A second objection against enactment of a statute providing for the sale of an insolvent insurance company's charter is that persons who would not otherwise qualify to act as insurers may somehow be allowed to enter the insurance industry through a "back door." However, this is in reality a non-argument because under the Insurance Holding Company Act, enacted in the various states, a purchaser of an insurance company charter is still required to go through and meet all the requirements of the Form A process. Further, if any state is concerned that non-qualifying individuals or companies may enter the insurance industry through the purchase of an insolvent insurance company's charter, that state could specifically require the purchaser to go through a formal Form A process.

A third objection for not enacting a statute allowing for the sale of an insolvent insurer's charter is that the sale of the charter includes the name of the insolvent insurer and if the insolvent insurer's name continues to exist in the marketplace, this would erode the confidence of the consumer in the insurance industry. This may be a very valid concern in some circumstances; however, it is a concern which can be addressed either by statute or by the liquidator upon the sale of the charter. The statute or sale document can specifically provide that the purchaser is not allowed to use the corporate name for any purpose and that the name is required to be changed following the applicable state procedures as a part of the sale process. Alternatively, the statute can provide that any sale of the charter does not include the name of the insolvent company or the document of sale can specifically exclude sale of the insurance company name. By keeping the name of the insolvent insurance company off the market, consumer confidence in the insurance industry and the state insurance department should not be diminished.

SUGGESTED STATUTORY LANGUAGE

Clearly a statute which provides for the sale of the charter of an insolvent insurance company makes financial sense from a point of view which seeks to maximize the assets available to the estate to pay creditors and policyholders. Such a statute seeks to recover the greatest amount possible for the estate and should be enacted in each state's insurance company liquidation statutes. Further, a uniform model law regarding the sale of a charter is needed to give guidance to states wishing to enact such a statute and to provide uniformity of interpretation of such statutes. The Kansas statute, quoted above, is a good example of a state law which can be used as the basis for a Model Law regarding the sale of an insolvent insurer's charter. It utilizes the current Model Act language and adds to this language the necessary language to provide for sale of the charter free and clear of encumbrances.

However, under the Kansas statute, there may be a question whether some tax attributes, such as net operating loss carryovers, would remain with the liquidation estate or could be used by the purchaser who purchases the corporate existence. The intent behind these statutes should clearly be to sell only the right to do business and not the tax attributes. Further, the Kansas statute does not specifically address the further use of the company name. To address these issues, the following statutory and Model Act language is suggested:

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The Commissioner may petition for an order:

(a) Dissolving the corporate existence . . . [insert rest of Model Act language] . . . for some other reason; or

(b) permitting the sale of the corporate existence ("charter") of a domestic insurer, together with any of its licenses to do business, despite the entry of an order of liquidation. The court may permit the sale of such charter and licenses upon or after the granting of a liquidation order. The charter and licenses only shall be sold and all other attributes of the corporation shall remain part of the liquidation estate. The name of the corporation shall be used by the purchaser or seller for no purpose other than a name change. The proceeds from the sale of the charter and licenses shall become a part of the general assets of the estate in liquidation. The charter and licenses shall thereafter be free and clear from the claims or interests of all claimants, creditors, policyholders, and stockholders of the corporation under liquidation. If permission to sell the charter and licenses is not granted, the court shall order dissolution of the corporate existence as provided in subsection (a).

This language addresses all of the concerns addressed above and allows a liquidator to recover the maximum assets for the estate. The charter and licenses only are sold and there are no concerns that by selling the "corporate existence" the liquidation estate may be losing valuable tax attributes. The corporate name can only be used as part of a name change process in order to register the charter and licenses to do business in a new name and there should be no detrimental effect on consumer confidence in the insurance industry. The proceeds from the charter sale become part of the general assets of the liquidation estate - thereby maximizing the benefit to the creditors, including policyholders. The purchaser is given the assurance that it will not be responsible for any of the insolvent insurer's liabilities. And finally, if the charter is not sold, the corporate existence is automatically dissolved at the close of the liquidation.

PROCEDURE FOR SALE OF A CHARTER

Once a determination has been made that the charter of an insolvent insurance company can be sold under state law, then the work begins in trying to maximize the return to the estate on the sale of the charter. Of course the most effective way to sell the charter, and obtain the greatest benefit for the policyholders and creditors of the insolvent insurer, will vary from liquidation to liquidation and depend upon the individual facts in each situation. Generally speaking, the more states in which the company is licensed, the more valuable the charter of the insurance company. Also, not surprisingly, the more lines of business the insurer is involved in and the more unique an insurance company's charter, the more valuable the charter will be to potential purchasers. Further, the more difficult it is to obtain a charter within a given state or to obtain permission to engage in a certain type of insurance in a given state, the more valuable the charter.

For instance, in Texas, county mutual insurance companies can no longer be created and the current county mutuals have special laws which apply to them. Because of the unique character of a county mutual in Texas, a county mutual's charter recently sold for approximately $4.6 million even though the company was licensed to transact business only in Texas. Another insurance company's charter recently sold for approximately $460,000.00. This company was licensed in 30 states and was licensed to transact up to 29 different types of insurance in some states.

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As can be seen from these examples, the sale of insurance company charters can be very beneficial to insolvent insurers' estates and consequently of benefit to the policyholders and creditors of those companies. This is not to say however, that the sale of a charter is prudent in all circumstances. For example, if an insurance company is licensed in only one state for only one line of insurance which is unprofitable in that state, it is unlikely the sale of the charter would bring many assets into the estate. Further, after the sale of a charter is completed it might well be that the expense of selling the charter exceeded its sale price. Therefore, a liquidator is wise to do a careful review of the situation before undertaking the expense of selling a charter and should perhaps retain an expert who has experience in selling insolvent insurers' charters. Further, the liquidator should make sure that the proper procedures are followed to obtain the greatest recovery for the insolvent insurer's estate or the liquidator may face the possible unpleasant prospect of having the liquidation court not permit the sale, or having policyholders and creditors object that full value was not obtained on the sale of the charter.

One thing the liquidator needs to do to obtain the highest price on the sale of a charter is to be in contact with each of the states in which the company was licensed. The liquidator should attempt to have these states take actions which have the least detrimental effect on the value of the charter in the state. For instance, some states will temporarily suspend licenses until the charter can be sold, while other states fully suspend licenses which need to be reinstated by the purchaser after the sale. Yet other states will actually terminate licenses and formal applications will need to be made for a new license. Therefore, the liquidator should work with the non-domiciliary states and insurance commissioners so they do not fully suspend or terminate the licenses; but rather that they temporarily suspend the licenses pending sale of the charter. This will help maximize the charter's value. Finally, if a license has been suspended, restricted or terminated, the liquidator should make it clear to the purchaser that no assurances are being made that a suspended, restricted or terminated license will automatically be reinstated.

Clearly, even if a Model Law is enacted allowing the sale of a charter and states enact similar provisions, different states will have different procedures. In the current liquidation setting where these statutes do not exist in each state and where many states have not yet dealt with the sale of insolvent insurance companies' charters on a regular basis, the picture is even more muddled. Often a breadth of experience and involvement with the sales of charters in different states will give a liquidator different ideas and methods to use in selling a charter. However, a liquidator trying to sell a charter needs to remain flexible in solving the many intricate issues involved in the sale of a charter. What has worked in one liquidation may provide valuable experience and insight, but may not work on another liquidation. All the decisions, from changing the name to the method of sale, need to be made in light of what is being sold and the economics involved.

CONCLUSION

The charter of an insolvent insurance company should be treated as any other asset of the liquidation estate which can be sold free and clear of liens and encumbrances. By allowing the sale of a charter, a state increases the value of an insolvent insurer's estate, which in turn benefits the policyholders and creditors of the estate. Though the "daring" liquidator may attempt to sell an insolvent insurer's charter, such a sale is subject to attack and the inherent uncertainty of such a sale is sure to negatively impact the charter's selling price. Rather than taking this risky approach, each state should enact a liquidation statute which specifically gives the liquidator the power to sell an insolvent insurer's charter. The arguments against such a statute are really non-arguments or are easily addressed by statute. Further, these statutes should be uniform so as to provide uniformity of interpretation.

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Once a state has enacted a statute allowing the sale of insolvent insurers' charters, liquidators will then need to educate themselves as to the best methods to use in obtaining the greatest benefit for their liquidation estates. Experience and flexibility in responding to different factors affecting the sale of a charter in a given liquidation will be important in maximizing the benefit to a given estate.

ENDNOTES:

1. Subsequent versions of the Model Act, including the 1994 Act, contain identical provisions regarding the sale of insurance company charters.

2. In this article, sale of the charter by a liquidator contemplates a sale free and clear of all liabilities and encumbrances except possible federal tax claims and the unsettled issue of some states possibly applying the rating history of the old company to the new purchaser. Obviously, if all the liabilities of an insolvent insurer attached to the sale of a charter, buyers would be extremely scarce and the company would be in rehabilitation as opposed to liquidation.

3. Section 23 of the 1994 Model Act contains identical language.

4. Note that technically the insurer's stock can still be sold by the liquidator; however, if the charter automatically dissolves in the future, the value of the stock is essentially worthless.

5. For example, the Model Act gives the liquidator the explicit power to "transfer policy obligations to a solvent assuming insurer," but never gives the liquidator the explicit power to sell a charter. Section 21.A.(10). ■

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