

# THE INEFFICIENCIES OF EXCLUSION: THE IMPORTANCE OF INCLUDING INSURANCE COMPANIES IN THE BANKRUPTCY CODE

## INTRODUCTION

“I think that the most important systematic defect in the present United States bankruptcy system is that it excludes the insolvencies of insurance companies. . . .”<sup>1</sup> These words, spoken by Judge Samuel Bufford, bankruptcy judge of the Central District of California, articulate the deficiencies in the state-by-state insolvency process for insurance companies.<sup>2</sup> Since 1898, domestic insurance companies have been excluded from federal bankruptcy law.<sup>3</sup> As a result, insurance company insolvencies take place in individual state courts under a patchwork of state laws.<sup>4</sup> In contrast to the state-based insurer insolvency process, insurance companies have evolved into national companies.<sup>5</sup> Additionally, while in the past small, regional insurance companies were at the greatest risk of insolvency, in the last two decades, insolvencies have plagued much larger companies.<sup>6</sup> For example, at the time of its failure in 1991, Mutual Benefit Life had policyholders in all fifty states<sup>7</sup> and \$14 billion in assets.<sup>8</sup> Because insurers have become national companies

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<sup>1</sup> Hon. Samuel L. Bufford, *Increasing Scope of Bankruptcy Code*, 4 AM. BANKR. INST. L. REV. 500, 500 (1996). Judge Bufford encountered state insolvency laws when he presided over the federal bankruptcy proceedings of First Capital’s holding company. In his suggestion to the Bankruptcy Review Commission, Judge Bufford asserted that the Bankruptcy Code should be modified to include insurance companies as well as other currently excluded financial institutions. *Id.*

<sup>2</sup> William Goddard, Note, *In Between the Trenches: The Jurisdictional Conflict Between a Bankruptcy Court and a State Insurance Receivership Court*, 9 CONN. INS. L.J. 567, 570 (2003).

<sup>3</sup> *Sims v. Fid. Assurance Ass’n*, 129 F.2d 442, 448 (4th Cir. 1942), *aff’d*, 318 U.S. 608 (1943). Section 109(b) of the current Bankruptcy Code states that “a person may be a debtor under chapter 7 of this title only if such person is not (1) a railroad; (2) a domestic insurance company . . . cooperative bank, savings and loan association.” 11 U.S.C. § 109(b) (2000).

<sup>4</sup> See generally 11 ERIC MILLS HOLMES, HOLMES’ APPLEMAN ON INSURANCE ¶ 76.2 (1996).

<sup>5</sup> See Stephen W. Schwab et al., *Onset of an Offset Revolution: The Application of Set-Offs in Insurance Insolvencies*, 95 DICK. L. REV. 449, 452 (1991).

<sup>6</sup> See *id.*

<sup>7</sup> Eric N. Berg, *Mutual Benefit Life Plans to Reduce Its Home-Office Staff*, N.Y. TIMES, July 9, 1991, at D2.

<sup>8</sup> Francine L. Semaya, *Insurer Insolvencies: Looking Back and Forging Ahead*, in REINSURANCE LAW & PRACTICE 2006: NEW LEGAL AND BUSINESS DEVELOPMENTS IN A CHANGING GLOBAL ENVIRONMENT, at 207, 224 (PLI Com. Law & Practice, Course Handbook Series No. 8712, 2006).

with affiliates in multiple states and policyholders nationwide, the current state-by-state insolvency laws and piecemeal administration of the insolvencies have led to inefficient, duplicative proceedings that result in the inconsistent treatment of interested parties.<sup>9</sup>

This Comment will argue that because of the inefficiencies and inconsistencies of regulating insurance insolvencies under state law, insurance insolvencies should instead be administered by federal bankruptcy courts and according to the United States Bankruptcy Code (“Code”). Section I will describe the current state law insolvency process. Section II will examine the history of the exclusion of insurance companies from the Code and the lack of historical support for the exception. Section III will outline the problems that state-by-state insolvencies cause and how inclusion in the Code could remedy such defects. Finally, Section IV will discuss changes that should be made to the Code in order to accommodate the inclusion of insurance companies.

## I. THE STATE INSOLVENCY PROCESS

In order to examine the benefits gained from regulating insurer insolvency under the Code and how to accomplish the incorporation into the Code, it is important to understand how state insurance laws currently operate.<sup>10</sup> All insurance companies are regulated under state law.<sup>11</sup> Each state has its own insurance regulator<sup>12</sup> whose role is to monitor the life of an insurance company from beginning to end.<sup>13</sup> Regulators supervise the financial health of a

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<sup>9</sup> See generally 11 HOLMES, *supra* note 4, ¶ 75.3; Mark Ellenberg & Christopher Dove, *A Modest Proposal to Eliminate the Headache of Rehabilitating or Liquidating an Insurance Company*, 13 A.B.I. NORTHEAST BANKRUPTCY CONFERENCE AND NORTHEAST CONSUMER FORUM 129 (2006), available at WESTLAW, 060713 ABI-CLE 129; Francine L. Semaya & Lenore S. Marema, *An Overview of the State Insurance Receivership System*, 27 THE BRIEF, Fall 1997, at 12, 12.

<sup>10</sup> Because insurance insolvencies are governed by state law, the insolvency procedures vary slightly from state to state. Karl L. Rubinstein, *The Legal Standing of an Insurance Insolvency Receiver: When the Shoe Doesn't Fit*, 10 CONN. INS. L.J. 309, 317 (2004). However, the basic rehabilitation and liquidation procedures are the same among the states. *Id.*

<sup>11</sup> 15 U.S.C. § 1012(a) (2000).

<sup>12</sup> Most states have an Insurance Commissioner who monitors the insurance company. Rubinstein, *supra* note 10, at 311. However, once insolvency proceedings are commenced, the Insurance Commissioner becomes the “regulator” or the “receiver.” *Id.* For the purposes of this paper, I will use the term “regulator” to encompass all such terms.

<sup>13</sup> Ellenberg & Dove, *supra* note 9, at 129. Insurance companies are required to submit various financial statements to their state’s regulator. Philip A. O’Connell, Jr. et al., *Insurance Insolvency: A Guide for the Perplexed*, 27 INS. LITIG. REP. 669, 672 (2005). If the regulator determines that an insurer is financially unstable, stricter regulation will result. *Insurance Regulation: The Failures of Four Large Life Insurers: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 102nd Cong. 2 (1992) [hereinafter

company and require chief executive officers of insurance companies to “notify the state’s insurance regulator if the insurer is ‘impaired.’”<sup>14</sup> CEOs who do not alert their regulator of impairment face criminal charges.<sup>15</sup>

If a regulator finds that an insurance company is impaired, the regulator will petition the state court to place the company in receivership.<sup>16</sup> Only the insurance regulator in the state where the insurance company is domiciled can petition the court for receivership.<sup>17</sup> Thus, the regulator, not the company’s management or its creditors, initiates receivership proceedings.<sup>18</sup>

Each state has its own insurer insolvency statutes that govern the insolvency proceedings for insurance companies.<sup>19</sup> Most state insolvency statutes are based upon two model acts: the Uniform Insurers Liquidation Act (“UILA”), created by the National Conference of Commissioners, or the Rehabilitation and Liquidation Model Act (“Model Act”), created by the National Association of Insurance Commissioners.<sup>20</sup> Although the goal of the model acts was to encourage uniformity among the states, the existence of two different acts has impeded this goal.<sup>21</sup> Furthermore, states modify the model acts before adopting them as state law.<sup>22</sup> As a result, even if two states borrow

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*Insurance Regulation*] (statement of Richard L. Fogel, Assistant Comptroller General, General Government Programs).

<sup>14</sup> O’Connell, Jr. et al., *supra* note 13, at 672. An insurer is “impaired” if “the assets of the insurer are less than the sum of the insurer’s minimum required capital, minimum required surplus and all liabilities as determined in accordance with the requirements for the preparation and filing of the annual statement of the insurer.” *Id.* (quoting CAL. INS. CODE § 988 (2005)).

<sup>15</sup> *Id.* Although the main goal of state monitoring is to avoid major insolvencies that would have a devastating affect on thousands of policyholders, such a goal often has not been realized. Rubinstein, *supra* note 10, at 315. In 1992, the United States General Accounting Office (“GAO”) investigated the insolvencies of four large insurance companies. *Insurance Regulation*, *supra* note 13, at 1. The GAO attributed the insolvencies to the failure of the regulators of each state’s subsidiary in keeping “each other informed about solvency problems, despite their interdependence in monitoring the troubled insurers.” *Id.* at 10. Such a finding emphasizes the importance of maintaining a national perspective in regards to insurance companies. *See id.*

<sup>16</sup> *See, e.g.*, DEL. CODE ANN. tit. 18, § 5903 (1999). The regulator will petition the state court and, if the company wishes to avoid receivership, the insurance company must advocate why it should not go into receivership. *Id.*

<sup>17</sup> *Oil & Gas Co. v. Duryee*, 9 F.3d 771, 773 (9th Cir. 1993).

<sup>18</sup> O’Connell, Jr. et al., *supra* note 13, at 672. Although regulators are the formal and the primary initiators of insurer insolvency proceedings, managers are able to negotiate with regulators regarding the initiation and direction of the insolvency process. David A. Skeel, Jr., *The Law and Finance of Bank and Insurance Insolvency Regulation*, 76 TEX. L. REV. 723, 745 n.85 (1998).

<sup>19</sup> Frank P. Darr, *Federal Claims in Insurance Insolvencies*, 25 TORT & INS. L.J. 601, 616 (1990).

<sup>20</sup> Ellenberg & Dove, *supra* note 9, at 129.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

from the same model act, their modifications of the act could result in two very different statutes.<sup>23</sup> However, despite the differences between the various state insolvency statutes, the basic structure of the state insolvency process remains the same.<sup>24</sup>

When a company is placed in receivership, the regulator must determine whether rehabilitation<sup>25</sup> or liquidation is more appropriate and then petition the court accordingly.<sup>26</sup> An insurance company does not need to be insolvent for it to be liquidated or rehabilitated.<sup>27</sup> Most state statutes allow for many other justifications, ranging from evidence that the company “[h]as concealed or removed records or assets” to willful violation of the company’s charter.<sup>28</sup> As a result of such broad standards, regulators have great discretion on how to conduct insolvency proceedings.<sup>29</sup>

If a state insurance regulator places a company in receivership, the presiding state court *may* issue injunctions to halt actions that thwart the regulator’s efforts to rehabilitate or liquidate the company.<sup>30</sup> However, such injunctions may prove ineffective if courts in other jurisdictions refuse to acknowledge the injunction.<sup>31</sup>

Once the court orders a company to be either liquidated or rehabilitated, the regulator takes title over the company’s “property, contracts . . . rights of action and all . . . books and records.”<sup>32</sup> During the insolvency process, the regulator may take whatever steps deemed necessary to effectuate liquidation or rehabilitation.<sup>33</sup> Although the regulator’s actions are subject to court

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<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> Rehabilitation is the state insolvency counterpart to reorganization and attempts to return the insurer to full operation. O’Connell, Jr. et al., *supra* note 13, at 676.

<sup>26</sup> *See, e.g.,* DEL. CODE ANN. tit. 18, §§ 5905–5906 (1999). *See also* J. David Leslie et al., *State Insurance Company Insolvency Proceedings: Looks Like a Bankruptcy, Walks Like a Bankruptcy*, 13 A.B.I. NORTHEAST BANKRUPTCY CONFERENCE AND NORTHEAST CONSUMER FORUM 129 (2006), available at WESTLAW, 060713 ABI-CLE 129. The decision to place a company in rehabilitation or liquidation is usually determined by whether its surplus falls below a certain statutory level. *Id.* Because of the nature of insurance claims, both liquidation and rehabilitation can last for many years since some claims, such as asbestos claims, do not arise until after the policy term has expired. *Id.*

<sup>27</sup> O’Connell, Jr. et al., *supra* note 13, at 669.

<sup>28</sup> tit. 18, §§ 5905–5906.

<sup>29</sup> *See generally* Skeel, Jr., *supra* note 18.

<sup>30</sup> Ellenberg & Dove, *supra* note 9, at 129. *See, e.g.,* tit. 18, § 5904 (1999). Although the presiding state court may order a stay, the order might not apply to claims in other states. *See infra* part IVB.

<sup>31</sup> Ellenberg & Dove, *supra* note 9, at 129.

<sup>32</sup> tit. 18, § 5913(b) (1999). *See also* Rubinstein, *supra* note 10, at 311.

<sup>33</sup> tit. 18, §§ 5910–5911 (1999).

approval, the court “must affirm the actions of the [regulator] . . . unless they constitute an abuse of discretion,” thereby giving the regulator wide discretion.<sup>34</sup> Throughout the entire insolvency proceeding, the regulator’s primary goal is to protect policyholders and maximize their distribution.<sup>35</sup>

#### A. *The Process of Rehabilitation*

Upon an order of rehabilitation, the regulator “assumes all of the powers of the directors, officers, and managers of the insurer, whose authority is suspended.”<sup>36</sup> The regulator’s discretion over the company’s rehabilitation is subject only to the approval of the court.<sup>37</sup> Within a year of the rehabilitation order, the rehabilitator must file an “equitable” plan, such that every claim receives treatment that is the same or better than it would receive in liquidation.<sup>38</sup> Most rehabilitations ultimately lead to liquidations, and as a practical matter, “a regulator will [often] invoke rehabilitation in order to gain control of an insurer and prepare for the orderly transition to [liquidation].”<sup>39</sup> Thus, much like in federal bankruptcy, rehabilitation is often a stop on the way to liquidation.<sup>40</sup>

#### B. *The Process of Liquidation*

If the regulator determines that rehabilitation will not be successful, the company will be liquidated.<sup>41</sup> Upon the date of the liquidation order, the rights and liabilities of the insurer, its creditors, and its policyholders become fixed, and all policies are terminated within thirty days.<sup>42</sup> Once liquidation is ordered, a claimant has ninety days to file a claim.<sup>43</sup> Because an insured may

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<sup>34</sup> Garamendi v. Golden Eagle Ins. Co., 27 Cal. Rptr. 3d 239, 249 (Cal. Ct. App. 2005).

<sup>35</sup> O’Connell, Jr. et al., *supra* note 13, at 669. “[T]he proceedings . . . are an extension of the regulator’s primary mission of protecting policyholders and the corollary mission of monitoring insurer solvency.” Ellenberg & Dove, *supra* note 9, at 129.

<sup>36</sup> Leslie et al., *supra* note 26, at 129.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Kent M. Forney, *Insurer Insolvencies and Guaranty Associations*, 43 DRAKE L. REV. 813, 820 (1995).

<sup>40</sup> Davis J. Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level Approach to Defining the “Business of Insurance” Under the McCarran-Ferguson Act*, 25 WILLAMETTE L. REV. 1, 9 (1989).

<sup>41</sup> Leslie et al., *supra* note 26, at 129.

<sup>42</sup> *Id.* The thirty day termination does not apply to life insurance and health insurance policies. *Id.*

<sup>43</sup> *Id.*

need more than ninety days to file a claim, policyholders can also file an omnibus claim that reserves the right to make a claim in the future.<sup>44</sup>

Each state's guaranty fund plays an important role in the liquidation of an insurance company. Guaranty funds operate by paying the outstanding claims of an insolvent insurer's policyholders.<sup>45</sup> Policyholders are then "deemed to have assigned [their] rights of recovery against the insolvent insurer's estate to the guaranty fund."<sup>46</sup> As a result, guaranty funds are typically "the largest policyholder-level creditors of the insolvent insurer."<sup>47</sup> Because guaranty funds limit the amount of a claim they will cover, any policyholder with a claim in excess of that amount becomes a general creditor of the insurance company's estate.<sup>48</sup> All states have adopted some form of guaranty fund,<sup>49</sup> and "[e]ach state's guaranty fund is responsible for the policyholders" in that state, regardless of the domicile of the policyholder's insurer.<sup>50</sup> State guaranty funds are funded through contributions from solvent insurers licensed to do business in that state. In addition, they are not governed by state regulators<sup>51</sup> but are instead controlled by a board of directors comprised mostly of representatives from licensed insurance companies in that state.<sup>52</sup>

Although each state has its own priority statutes, many of them follow a similar order.<sup>53</sup> Most statutes give administrative claims top priority.<sup>54</sup> Claims for wages and claims for taxes and debts due to the government receive second and third priority respectively.<sup>55</sup> Fourth priority is usually assigned to policyholders' claims and guaranty associations' claims.<sup>56</sup> All other claims fall under the fifth priority.<sup>57</sup> The state priority statutes begin to diverge following

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<sup>44</sup> *Id.* Whether or not a policyholder files a claim within the ninety day period is very important for purposes of priority. *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> Semaya & Marema, *supra* note 9, at 15.

<sup>49</sup> Leslie et al., *supra* note 26, at 129.

<sup>50</sup> Skeel, Jr., *supra* note 18, at 743.

<sup>51</sup> J. Ernest Hartz, Jr., *State Guaranty Associations: The Time Has Come to Establish Uniform Ground Rules—Or Prepare for Federal Involvement in Insurance Insolvency*, 22 THE BRIEF, Fall 1992, at 20, 20.

<sup>52</sup> Semaya & Marema, *supra* note 9, at 14.

<sup>53</sup> Darr, *supra* note 19, at 602.

<sup>54</sup> 1 LEE R. RUSS, COUCH ON INSURANCE § 6:8 (3d ed. 2007).

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

the first five classes as they designate priorities for late filed claims, premium refunds, and shareholders.<sup>58</sup>

## II. THE LACK OF HISTORICAL SUPPORT FOR EXCLUDING INSURANCE COMPANIES FROM THE CODE

Two statutes are responsible for the exclusion of insurance companies from the United States Bankruptcy Code: § 109 of the Code<sup>59</sup> and the McCarran-Ferguson Act.<sup>60</sup> However, an examination of the history surrounding these statutes reveals very few practical or policy reasons for the exclusion.

Sections 109(b) and 109(d) of the Code currently exclude domestic insurance companies from qualifying as debtors under chapter 7 and chapter 11.<sup>61</sup>

However, insurance companies have not always been excluded from federal bankruptcy law. The Bankruptcy Act of 1867, which was “applicable to moneyed business and commercial corporations,” was interpreted to apply to insurance companies.<sup>62</sup> However, the inclusion of insurance companies changed in 1898 when the Bankruptcy Act limited the application of federal bankruptcy law to corporations “engaged principally in manufacturing, trading, printing, publishing, mining, or mercantile pursuits.”<sup>63</sup> The list did *not* include domestic insurance companies.<sup>64</sup> In 1910, Congress amended the Bankruptcy

<sup>58</sup> Darr, *supra* note 19, at 619 nn.150, 152.

<sup>59</sup> 11 U.S.C. § 109 (2000).

<sup>60</sup> 15 U.S.C. §§ 1011–1015 (2000). Insurer exclusion is based completely in statute. Raymond A. Guenter, *Rediscovering the McCarran-Ferguson Act’s Commerce Clause Limitation*, 6 CONN. INS. L.J. 253, 275 (2000). There are no constitutional barriers to the inclusion of insurers in the Code. *Id.*

<sup>61</sup> 11 U.S.C. § 109(b) (2000) (“A person may be a debtor under chapter 7 of this title only if such person is not (1) a railroad; (2) a domestic insurance company, . . . cooperative bank, savings and loan association . . .”). 11 U.S.C. § 109(d) states:

Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

*Id.* § 109(d).

<sup>62</sup> *Sims v. Fid. Assurance Ass’n*, 129 F.2d 442, 448 (4th Cir. 1942), *aff’d*, 318 U.S. 608 (1943).

<sup>63</sup> *Id.* Federal bankruptcy law in the nineteenth century was very volatile. DAVID A. SKEEL, JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 23 (Princeton University Press 2001). Bankruptcy laws were created during financial turmoil and fell by the wayside when the crisis subsided. *Id.* at 24. This led to a variety of different bankruptcy laws during those years. *Id.*

<sup>64</sup> *In re Supreme Lodge of the Masons Annuity*, 286 F. 180, 184 (N.D. Ga. 1923).

Act, returning to the original language of the 1867 Act.<sup>65</sup> However, while the 1867 language had been interpreted to include domestic insurance companies, Congress specifically excluded domestic insurance companies in the 1910 Amendment.<sup>66</sup>

There are few explanations for why the exclusion from federal bankruptcy law initially occurred.<sup>67</sup> The legislative history of the 1978 Bankruptcy Code Amendment provides the only express reason for the exclusion.<sup>68</sup> Congress stated that “banking institutions and insurance companies are excluded from liquidation under the bankruptcy laws because they are bodies for which alternate provision is made for their liquidation under various regulatory laws.”<sup>69</sup> When one considers the previous history of the exclusion of insurers from federal bankruptcy law, this reasoning by Congress is not persuasive. Before the enactment of the Bankruptcy Act of 1867, which applied to insurance companies, state law governed all insolvencies.<sup>70</sup> As a result, when the Bankruptcy Act of 1867 was created, it governed insurer insolvencies even though alternative state law existed. Thus, the existence of alternative state law regarding insurer insolvency did not prevent Congress from applying federal insolvency law to insurance companies in 1867. Furthermore, Congress’s 1978 legislative history does not give a practical reason for why federal bankruptcy law does not apply to insurer insolvencies today. Instead, Congress’s primary reason for the exclusion seems to be tradition—this is how it has always been done.<sup>71</sup>

Confronted with legislative silence on the policy reasons for the exclusion of insurance companies from § 109, courts have extrapolated reasons based on the similarities between the entities listed in § 109.<sup>72</sup> However, these reasons also fail to adequately explain why insurance companies were initially excluded and continue to be excluded from the Code. In *In re Supreme Lodge of the Masons Annuity*, the court explained that insurance companies are

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<sup>65</sup> *Sims*, 129 F.2d at 448. The language of the Act was amended because the 1898 language led to difficulty in classifying entities for the purpose of their inclusion or exclusion under the bankruptcy law. *See id.*

<sup>66</sup> *In re Supreme Lodge*, 286 F. at 184.

<sup>67</sup> Darr, *supra* note 19, at 616–17.

<sup>68</sup> H.R. REP. NO. 95-595, at 318–19 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963, 6275.

<sup>69</sup> *Id.*

<sup>70</sup> SKEEL, JR., *supra* note 63, at 23.

<sup>71</sup> Darr, *supra* note 19, at 616.

<sup>72</sup> *Union Guarantee & Mortgage Co. v. Van Schaick (In re Union Guarantee & Mortgage Co.)*, 75 F.2d 984, 984 (2d Cir. 1935). *See* Darr, *supra* note 19, at 615–17, for further discussion of the reasons for the exclusion of insurance companies from the Code.

excluded from the Code because of their public nature and the diversity of interests, beyond creditors' interests, that are implicated by their insolvency.<sup>73</sup> In *In re Equity Funding Corporation of America*,<sup>74</sup> the court proposed that the state regulatory scheme balances the interests of policyholders and creditors, protecting the public interest affected by insurance companies.<sup>75</sup> Although insurance companies greatly affect the public, a characteristic that state regulations attempt to protect,<sup>76</sup> the Code is similarly equipped to protect such policy interests. In fact, most state insolvency laws, which history has deemed to be superior in monitoring public interest, were closely modeled after already existing federal bankruptcy law.<sup>77</sup>

Courts' interpretation of the McCarran-Ferguson Act also prevents insurers from utilizing the Code during insolvencies,<sup>78</sup> but an examination of the Act's legislative history indicates that excluding insurers from federal bankruptcy law was not the intention of the Act's drafters. The McCarran-Ferguson Act declares that "[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States"<sup>79</sup> and that Congress is precluded from "impairing any law enacted by a state for the business of insurance unless such congressional action specifically relates to the business of insurance."<sup>80</sup> Courts have concluded that the insolvency proceedings of an insurance company constitute the "business of insurance" and that federal bankruptcy law does not specifically relate to the business of insurance.<sup>81</sup> As a result, insurance insolvencies are governed by state law.<sup>82</sup> Although courts, in interpreting the McCarran-Ferguson Act, have concluded that insurer insolvency proceedings constitute the business of insurance, an examination of the Act's history indicates that Congress did not intend to place insurer

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<sup>73</sup> *In re Supreme Lodge of Masons Annuity*, 286 F. 180, 184 (N.D. Ga. 1923).

<sup>74</sup> 396 F. Supp. 1266 (D. Cal. 1975).

<sup>75</sup> *Id.* at 1275. This reasoning is also supported by the language of the McCarran-Ferguson Act which states that the "continued regulation . . . by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011 (2000).

<sup>76</sup> Rubinstein, *supra* note 10, at 315.

<sup>77</sup> O'Connell, Jr. et al., *supra* note 13, at 670.

<sup>78</sup> See *Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1279–80 (10th Cir. 1998); *Levy v. Lewis*, 635 F.2d 960, 963 (2d Cir. 1980); *Selcke v. Medicare HMO*, 147 B.R. 895, 902 (N.D. Ill. 1992), *aff'd sub nom. In re Estate of Medicare HMO*, 998 F.2d 436 (7th Cir. 1993); *In re Grouphealth P'ship, Inc.*, 137 B.R. 593, 599 (Bankr. E.D. Pa. 1992).

<sup>79</sup> 15 U.S.C. § 1012(a) (2000).

<sup>80</sup> *Baldwin-United Corp. v. Garner*, 678 S.W.2d 754, 758 (Ark. 1984).

<sup>81</sup> *U.S. Dep't of the Treasury v. Fabe*, 508 U.S. 491, 505–06 (1993).

<sup>82</sup> *Id.*

insolvencies under the control of state law.<sup>83</sup> Rather, Congress intended to shield the insurance industry from potential anti-trust violations, which would have arisen if federal law was applied to insurance rate-making.<sup>84</sup>

In 1868, the United States Supreme Court, in *Paul v. Virginia*,<sup>85</sup> held that the business of insurance was not interstate commerce and thus not subject to the Commerce Clause.<sup>86</sup> As a result of the holding, states developed a system of insurance regulation that could only be upheld if the Commerce Clause did not apply.<sup>87</sup> These regulations included state laws that allowed insurers to set their own rates.<sup>88</sup> However, in 1944, state policy allowing collective rate-making came in direct conflict with the Sherman Act when, in *United States v. South-Eastern Underwriters Association* (“*SEUA*”),<sup>89</sup> the Supreme Court reversed *Paul* and held that the business of insurance was interstate commerce and thus subject to the Commerce Clause.<sup>90</sup> This decision subjected the insurance industry to the Sherman Act and “sustained criminal indictments against nearly 200 stock fire insurance companies and twenty-seven individuals”<sup>91</sup> for collective ratemaking.<sup>92</sup> In addition, the *SEUA* decision challenged the constitutionality of states’ taxation of insurance companies—a practice that brought \$123 million in tax revenue to the states in 1943.<sup>93</sup>

These effects of the *SEUA* decision prompted swift legislative action.<sup>94</sup> In creating the McCarran-Ferguson Act, Congress’s objective was to limit the application of the Commerce Clause to the insurance industry in order to protect state taxation of insurance companies and to shield industry leaders

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<sup>83</sup> Guenter, *supra* note 60, at 286–87.

<sup>84</sup> *Id.* at 287–88.

<sup>85</sup> 75 U.S. 168 (1868), *overruled in part by* United States v. South-Eastern Underwriters Ass’n, 322 U.S. 533 (1944).

<sup>86</sup> *Id.* at 183. During the mid-1800s, state laws regulated insurance and most states had expensive requirements that companies had to meet before they could distribute insurance in that state. Guenter, *supra* note 60, at 258. In *Paul*, insurance companies wanted to escape state law by placing the business of insurance under federal law. *Id.*

<sup>87</sup> *Id.* at 255.

<sup>88</sup> *Id.* at 284.

<sup>89</sup> 322 U.S. 533 (1944).

<sup>90</sup> *Id.* at 562.

<sup>91</sup> Guenter, *supra* note 60, at 287.

<sup>92</sup> Spencer L. Kimball & Ronald N. Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 MICH. L. REV. 545, 553–54 (1958).

<sup>93</sup> Guenter, *supra* note 60, at 285 n.173. Application of the Commerce Clause to the insurance industry did not prevent states from taxing insurance companies, but it did prevent states from doing so in a way that caused an undue burden. *Id.* at 288.

<sup>94</sup> *Id.* at 297.

from anti-trust violations for collective rate-making.<sup>95</sup> Thus, in calling for “the continued regulation and taxation by the several States of the business of insurance,” Congress did not have insolvency proceedings in the forefront of its concerns.<sup>96</sup> This contention is further supported by the fact that the Commerce Clause does not affect the application of federal bankruptcy law to an entity.<sup>97</sup> Thus, the drafters’ focus on limiting the application of the Commerce Clause to insurance companies would not have been motivated by any desire to have insurer insolvencies addressed by state law.

Additionally, the drafters, in order to achieve their objective, designed the McCarran-Ferguson Act so as to restore the *Paul*-era regulatory structure.<sup>98</sup> However, for thirty years during the *Paul*-era, insurer insolvencies were governed by federal law.<sup>99</sup> The fact that Congress, by drafting the McCarran-Ferguson Act, attempted to return to an era in which federal law governed insurer insolvencies further demonstrates that the drafters’ intention was not to place insurer insolvencies in the hands of state law.

### III. PROBLEMS CREATED BY THE STATE-BASED INSOLVENCY SYSTEM

In addition to the lack of historical support for the exclusion of insurance companies from the Code, there is also a lack of practical support considering the many problems that the exclusion creates. Such problems have not gone unnoticed, even causing one judge to apologize to litigants for the exclusion:

[i]t is with regret that I refuse to take jurisdiction . . . because it is apparent that future administration could be more readily carried on under one control than under the limited jurisdiction of several state courts. It seems almost a travesty to have to deny to this company the benefits of . . . the Bankruptcy Act.<sup>100</sup>

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<sup>95</sup> See Kimball & Boyce, *supra* note 92, at 555. The emphasis on these objectives is evidenced by the two major parties involved in the drafting process, the fire insurance industry and the National Association of Insurance Commissioners. Guenter, *supra* note 60, at 290. The Sherman Act still applies to insurance companies but only to the extent that it does not conflict with state law. 43 AM. JUR. 2D *Insurance* § 30 (2003). Through the McCarran-Ferguson Act, the insurance industry continues to have control over regulating rates. *Id.* at §§ 30, 40.

<sup>96</sup> 15 U.S.C. § 1011 (2000).

<sup>97</sup> Guenter, *supra* note 60, at 281.

<sup>98</sup> *Id.* at 296.

<sup>99</sup> See *Sims v. Fid. Assurance Ass’n*, 129 F.2d 442, 448 (4th Cir. 1942). The Bankruptcy Act of 1867 was interpreted to include insurance companies. *Id.* This interpretation applied until the Bankruptcy Act of 1898. *Id.* Thus, during the *Paul*-era, between 1867 and 1898, insurance companies were liquidated under federal law. See *id.*

<sup>100</sup> *In re Nat’l Sur. Co.*, 7 F. Supp. 959, 961 (N.D.N.Y. 1934).

These words were spoken in 1934 by Judge Bryant, who, even then, realized the inefficiencies that arise from a state-by-state insolvency process.<sup>101</sup> The perceived problems in 1934 continue and are amplified by the national character of many insurance companies.<sup>102</sup> The absence of a nationwide automatic stay within state courts, inconsistent classification of insurance companies, inconsistent treatment of policyholders, and jurisdictional inconsistencies cause the state-by-state insurance insolvency process to be ill-fit for an insurance industry that extends nationally.

A. *Jurisdictional Constraints in State-by-State Insolvency Proceedings: The Difficulty in Reclaiming Out-of-State Assets*

One of the problems with the current insurer insolvency process is the difficulty in litigating over and acquiring the debtor's assets.<sup>103</sup> One of the causes of this problem is the limited jurisdiction of state courts over the insolvency proceedings.<sup>104</sup> Unlike bankruptcy courts, which have nationwide jurisdiction, state courts only have jurisdiction over persons that have sufficient minimum contacts.<sup>105</sup> Thus, "if the holder [of the property] is not subject to suit in [the] jurisdiction, then [state statutes] may require suit elsewhere."<sup>106</sup> As a result, in order to reclaim out-of-state property that is subject to an ownership dispute, regulators must commence suit against the assets' current holders; but if the state insolvency court does not have in personam jurisdiction over the holder, regulators must resolve the dispute in an out-of-state court.<sup>107</sup>

*In re National Heritage Life Insurance Co.* demonstrates the limited jurisdiction state courts have over out-of-state assets.<sup>108</sup> In this case, a Delaware insurer, National Heritage Life Insurance ("National Heritage"), entered into numerous contracts with another company, TPM Holdings, Inc. ("TPM"), a Nevada corporation.<sup>109</sup> In accordance with these contracts,

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<sup>101</sup> *See id.*

<sup>102</sup> James A. Smallenberger, *Restructuring Mutual Life Insurance Companies: A Practical Guide Through the Process*, 49 DRAKE L. REV. 513, 518 (2001).

<sup>103</sup> *See generally In re Rehabilitation of Nat'l Heritage Life Ins. Co.*, 656 A.2d 252 (Del. Ch. 1994).

<sup>104</sup> *See generally id.*

<sup>105</sup> *Id.* at 256.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* A court is only required to give full faith and credit to an order rendered by an out-of-state court if that court had jurisdiction over the parties. *Tenn. ex rel. Sizemore v. Sur. Bank*, 200 F.3d 373, 377 (5th Cir. 2000). Thus, if the state court does not have personal jurisdiction over the holder of the asset, than the state court where the asset resides need not respect the out-of-state court's order. *See id.*

<sup>108</sup> *See generally In re Rehabilitation of Nat'l Heritage Life Ins. Co.*, 656 A.2d 252.

<sup>109</sup> *Id.* at 254.

National Heritage paid TPM for certain rights that TPM had in outstanding mortgage notes.<sup>110</sup> TPM continued to service these mortgages in exchange for a fee and kept possession of the books and records relating to the mortgages.<sup>111</sup> During National Heritage's rehabilitation, the court ordered TPM to turn over the mortgages and the related documents to the regulator.<sup>112</sup> However, a dispute arose as to which company, National Heritage or TPM, had possessory rights to the assets.<sup>113</sup> Additionally, TPM asserted that the Delaware court did not have in personam jurisdiction over TPM, and thus could not issue binding orders to TPM.<sup>114</sup> After much debate, the Delaware court concluded that it did not have in personam jurisdiction over TPM and therefore could not compel TPM to turn over assets or appear in court to dispute their ownership.<sup>115</sup> The Court held that in order for National Heritage to reclaim the assets, it "may sue in . . . Nevada where TPM holds the books and records."<sup>116</sup>

These court proceedings, though necessary to determine the state insolvency court's jurisdiction over collateral matters related to the insurer's bankruptcy, can take valuable time away from the insolvency proceeding. For example, in *Tennessee ex. rel Sizemore v. Surety Bank*, the parties litigated for five years before the United States Court of Appeals for the Fifth Circuit held that the state insolvency court did not have jurisdiction to reclaim out-of-state assets.<sup>117</sup> By spending time litigating over the jurisdiction of the state court, insurers prolong the insolvency proceedings, which not only delays the eventual distribution to creditors but also takes away estate assets that would have contributed to the creditors' distribution.

Additionally, the out-of-state proceedings that are required to reclaim the insurer's assets result in the duplicated efforts of the regulators. Instead of

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<sup>110</sup> *Id.* Under the agreement, National Heritage purchased "100% of the loan's aggregate outstanding principal balance," and, for a certain fee, TPM agreed to service the mortgage loans. *Id.* at 254 n.2.

<sup>111</sup> *Id.* at 254.

<sup>112</sup> *Id.* at 255. The documents requested included:

all collateral documents and loan files in any way related to the mortgages being serviced or real estate owned . . . all blank check stock and any work in progress in the cashiering area; all escrow deposits; all cash obtained in collection of principal and interest; and a copy of all computer records maintained on these loan portfolios.

*Id.*

<sup>113</sup> *Id.* at 254.

<sup>114</sup> *Id.* at 256.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 261.

<sup>117</sup> *See* *Tenn. ex. rel. Sizemore v. Sur. Bank*, 200 F.3d 373, 380 (5th Cir. 2000). In *Sizemore*, the assets at issue were deposits the insurance company had with a bank. *Id.* at 376.

litigating the issues in the state court already familiar with the parties and the intricate facts of the case, regulators waste time and resources informing an out-of-state judge, who is unfamiliar with the insurer, the creditors, and the insurer's pending insolvency. Such additional out-of-state proceedings are inefficient and diminish estate assets that otherwise would have gone to the creditors.

One of the main benefits of including insurance companies in the Code is the broad jurisdictional powers of the bankruptcy court.<sup>118</sup> Although 28 U.S.C. § 1334 does not explicitly discuss personal jurisdiction in bankruptcy cases, bankruptcy courts have held that their reach is nationwide.<sup>119</sup> As one commentator stated, “[the] provision for pervasive federal bankruptcy jurisdiction . . . was designed to be as broad as the Constitution permits.”<sup>120</sup> Additionally, 28 U.S.C. § 1334(e) states that upon the commencement of a bankruptcy case, all of the property of the debtor and estate, regardless of location, are automatically under the jurisdiction and control of the presiding district court.<sup>121</sup> Also, 28 U.S.C. § 1334(b) not only grants jurisdiction to the bankruptcy court over “cases arising under” a bankruptcy case but also to proceedings that are “related” to the bankruptcy.<sup>122</sup> This broad jurisdiction allows most suits regarding the debtor, including suits over disputed assets, to be handled in one venue: the bankruptcy court presiding over the insolvent entity.<sup>123</sup> This result is much more efficient than the current state insolvency system because the matters are handled by a court that is already familiar with the case, which saves time and money otherwise spent on informing out-of-state judges of the basics of the case. As a result, the money saved can remain

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<sup>118</sup> See 28 U.S.C. § 1334 (2000).

<sup>119</sup> *B.W. Dev. Co. v. John B. Pike & Son, Inc. (In re B.W. Dev. Co.)*, 49 B.R. 129, 131 (Bankr. W.D. Ky. 1985).

<sup>120</sup> Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 748 (2000).

<sup>121</sup> 28 U.S.C. § 1334(e).

<sup>122</sup> *Id.* § 1334(b).

<sup>123</sup> [28 U.S.C. § 1334(e)] gives the Bankruptcy Court the exclusive jurisdiction to determine the parameters of the property of the estate. Identifying, administering and resolving competing claims to property of the estate is an essential function of a Bankruptcy Court. Even though the Bankruptcy Court must utilize state law in determining the nature and extent of the debtor's interest in property, the ultimate identification of property of the estate is exclusively within the jurisdiction of the Bankruptcy Court.

*In re Catholic Bishop of Spokane*, 329 B.R. 304, 315 (Bankr. E.D. Wash. 2005), *aff'd sub nom.* *Comm. of Tort Litigants v. Catholic Diocese of Spokane*, No. CV-05-0274-JLQ, 2006 WL 211792 (E.D. Wash. Jan. 24, 2006), *rev'd in part*, 364 B.R. 81 (E.D. Wash. 2006).

in the insurer's estate and can contribute to a more successful liquidation or rehabilitation.

*B. Absence of an Automatic Stay Provision in State Insurer Insolvency Statutes*

One drawback to the current state insolvency laws is the absence of an automatic stay provision that would provide nationwide protection against the collection efforts of creditors.<sup>124</sup> In place of a nationwide automatic stay, state courts issue individual injunctions to halt actions against the insurer's property.<sup>125</sup> However, because of the jurisdictional limitations on state courts, injunctions are an imperfect tool for stopping collection efforts.<sup>126</sup> In order for a state insolvency court's injunction to halt an out-of-state collection effort, the state insolvency court must have personal jurisdiction over the collecting party.<sup>127</sup> Because policyholders and creditors are usually not parties to the insolvency proceeding and do not have sufficient minimum contacts with the forum, the state insolvency court often lacks personal jurisdiction over the parties that the injunction is meant to enjoin.<sup>128</sup>

In addition, even when the rehabilitation court does have personal jurisdiction over the collecting party, the process of making that determination wastes time and does not promote judicial economy. For example, in *In re Mutual Benefit Life Insurance Co.*, three out-of-state bondholders, attempting to collect on their bonds, challenged the rehabilitation court's injunction barring their collection.<sup>129</sup> As a result of the challenge, the rehabilitation court spent seven months determining whether the injunction was binding on the out-of-state collectors.<sup>130</sup> Because insurance companies today are national and have many out-of-state assets, it is common for out-of-state parties attempting to collect on the company's out-of-state assets to challenge injunctions issued

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<sup>124</sup> Ellenberg & Dove, *supra* note 9, at 129.

<sup>125</sup> See, e.g., *In re Nat'l Heritage Life Ins. Co.*, 656 A.2d 252 (Del. Ch. 1994).

<sup>126</sup> Eric P. Berg, Note, *Injunctions Barring Suit Against Insolvent Insurance Companies: State Cooperation Through Tit-For-Tat Strategy*, 57 RUTGERS L. REV. 1377, 1378–81 (2005).

<sup>127</sup> *In re Mut. Benefit Life Ins. Co.*, 609 A.2d 768, 775–76 (N.J. Super. Ct. App. Div. 1992).

<sup>128</sup> Berg, *supra* note 126, at 1401.

<sup>129</sup> *In re Mut. Benefit*, 609 A.2d at 770. In this case, Mutual Benefit Life ("MBL") had assets in the form of real estate projects. *Id.* at 771. To fund the projects, the insurance company issued bonds to various investors. *Id.* MBL's rehabilitation triggered default provisions in many of the bonds, and the bondholders attempted to foreclose on the out-of-state properties their bonds had been used to fund. *Id.* at 771–72. It was these foreclosures that the injunction attempted to stop. *Id.* at 770.

<sup>130</sup> See *id.*

by the rehabilitating court.<sup>131</sup> The result is that for every challenge the rehabilitation court must oversee time-consuming proceedings to determine its personal jurisdiction over the collectors. Such frequent proceedings burden not only the rehabilitation court, but also the company's insolvency proceedings as a whole.

In the absence of the state insolvency court's personal jurisdiction over collecting parties, some out-of-state courts will enforce the insolvency court's injunction if both states have adopted the same model insolvency statute, such as the UILA.<sup>132</sup> However, this is not a complete remedy because no statutory model has been adopted nationwide.<sup>133</sup> Additionally, even if two states have adopted the same model act, they often significantly amend the statutes,<sup>134</sup> such that courts will find the statutes too dissimilar to merit reciprocity and adherence to the out-of-state injunction.<sup>135</sup> As a result, state court injunctions seldomly apply to out-of-state collection efforts, thus forcing insurers to defend themselves in out-of-state court proceedings.

In *Alabama National Life Insurance Co. v. Gammill*,<sup>136</sup> Alabama National Life Insurance Company ("Alabama Life"), an Alabama corporation, was placed in receivership in Alabama.<sup>137</sup> Prior to its receivership, Alabama Life deposited 240,638 shares of stock that it owned in an Arizona bank as collateral for a loan.<sup>138</sup> During Alabama Life's receivership, an Alabama court issued an injunction to halt garnishment proceedings by a former attorney for Alabama Life against the stock that was deposited in the Arizona bank.<sup>139</sup> However, the Arizona court did not enforce the injunction because it found the Arizona and Alabama insurer insolvency statutes too dissimilar.<sup>140</sup> Because the court held that Alabama and Arizona were not reciprocal states, it did not honor the Alabama court's injunction, thus allowing Alabama Life's attorney to continue his collection efforts on Alabama Life's assets.<sup>141</sup>

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<sup>131</sup> See generally Schwab et al., *supra* note 5, at 452.

<sup>132</sup> Berg, *supra* note 126, at 1389. See *infra* Part II for a discussion of the model acts.

<sup>133</sup> Berg, *supra* note 126, at 1384–85.

<sup>134</sup> Ellenberg & Dove, *supra* note 9, at 129.

<sup>135</sup> Berg, *supra* note 126, at 1391.

<sup>136</sup> 504 P.2d 516 (Ariz. Ct. App. 1972).

<sup>137</sup> *Id.* at 516–17.

<sup>138</sup> *Id.* at 517.

<sup>139</sup> *Id.* at 518.

<sup>140</sup> *Id.* at 520.

<sup>141</sup> See *id.*

Even more problematic is the fact that some courts have failed to honor injunctions even when they are issued by a court in a reciprocal state. In *Reliance Insurance Co. v. Plum Creek Timber Co.*,<sup>142</sup> a Pennsylvania court had issued an injunction to stay all lawsuits against the insurer.<sup>143</sup> A third party in Delaware filed suit against the insurer to determine its current insurance coverage.<sup>144</sup> Although Delaware was a state with reciprocal provisions, the Delaware court held that the Pennsylvania court's stay did not apply because the version of the model act that Delaware had adopted did not provide for the type of stay issued by the Pennsylvania court.<sup>145</sup> As a result, the Pennsylvania court could not stop the Delaware lawsuit, forcing the insurer to litigate the out-of-state proceeding.<sup>146</sup>

The cases above demonstrate how the limited jurisdiction of state courts to issue binding injunctions can cause an insurance company rehabilitating in one state to defend itself from multiple creditors simultaneously in other states.<sup>147</sup> This result undermines the equitable distribution to creditors during liquidation because the creditors to whom the injunction does not reach can recover the full value of their assets while other creditors who are affected by the injunction are limited to their diminished distribution upon liquidation.<sup>148</sup> Additionally, out-of-state collection actions make the insolvency proceedings less efficient because the insurer is forced to defend multiple out-of-state actions simultaneously.<sup>149</sup> Such out-of-state actions take away valuable time from the insolvency proceedings and cost money, which reduces the insurer's estate and the ultimate distribution to creditors upon liquidation.

If insurance companies were included in the Code, the Code's automatic stay provision would prevent insurers from defending against out-of-state collection efforts during their insolvency proceeding.<sup>150</sup> The automatic stay provision in the Code operates as a nationwide injunction against all legal actions aimed at obtaining the debtor's property.<sup>151</sup> The goal of the automatic stay is to promote efficiency and cost effectiveness by protecting the debtor

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<sup>142</sup> No. 99C-11-263, 2001 WL 1222090 (Del. Super. Ct. Sept. 26, 2001).

<sup>143</sup> *Id.* at \*1.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *See id.*

<sup>147</sup> Ellenberg & Dove, *supra* note 9, at 129.

<sup>148</sup> *See* Berg, *supra* note 126, at 1382–83.

<sup>149</sup> *See id.* at 1379.

<sup>150</sup> *See* 11 U.S.C. § 362 (2000).

<sup>151</sup> *See id.*

from having to undergo costly litigation in other venues in order to protect its assets.<sup>152</sup> The automatic stay also allows the debtor to focus on the insolvency proceeding as opposed to devoting time to distracting lawsuits.<sup>153</sup> Additionally, because the stay is automatic, it takes effect the moment the petition is filed “without any request or order.”<sup>154</sup> Thus, not only would insurance companies be relieved from spending valuable time defending out-of-state collection efforts, they would receive the benefit without having to petition the court, as currently required in state court proceedings.<sup>155</sup>

### *C. Inefficiencies in the Insolvency Proceedings of Holding Companies and their Subsidiaries*

While the state-by-state insolvency process is a complicated “patchwork” with regard to insurance companies, it becomes even more complicated when the insurance holding companies are involved as well.<sup>156</sup> Although holding companies and their subsidiaries are legally separate entities, oftentimes their finances, and thus their insolvencies, are inextricably linked.<sup>157</sup> For example, in *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*, a holding company and its insurance company subsidiary both became insolvent after the subsidiary guaranteed a large amount of debt for its holding company.<sup>158</sup> Thus, the insolvencies of both companies resulted from the same debt. Despite the commonality of their finances and debt, holding companies and their insurance subsidiaries will always undergo insolvency proceedings in different courts. This is because holding companies are not considered insurance companies and are thus addressed under the Code by the bankruptcy court, while their insurance subsidiaries must utilize state courts.<sup>159</sup> Such separate proceedings are inefficient because they require adjudication of many of the same issues in two different courts. Additionally, because the survival of each of the companies is often dependent on the other, the decision made by one court can impair the proceedings in the other court. Based on his experience as

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<sup>152</sup> DAVID G. EPSTEIN ET AL., *BANKRUPTCY* 60 (West 1993).

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> *See generally* Ala. Nat’l Life Ins. Co. v. Gammill, 504 P.2d 516, 518 (Ariz. Ct. App. 1972).

<sup>156</sup> 11 HOLMES, *supra* note 4, ¶ 75.3. “The effect of state dominance has been to create in this country a patchwork quilt of gigantic proportions when it comes to insurance regulation. . . . National and regional concerns find coping with the diverse state insurance departments to be tremendous work, and not the easiest.” *Id.*

<sup>157</sup> *See* *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 181–83 (Del. Ch. 2006).

<sup>158</sup> *Id.* at 178.

<sup>159</sup> *See* Goddard, *supra* note 2, at 569.

presiding judge over the insolvency of a national holding company, Judge Samuel Bufford deemed the Code's exclusion of insurance companies to be "the most important systematic defect in the present United States bankruptcy system."<sup>160</sup>

Because holding companies and their subsidiaries undergo separate insolvency proceedings, oftentimes the proceedings of one can interfere with the proceedings of the other. Such interference was the result in *In re Madison Mortgage Corp.*<sup>161</sup> In *In re Madison Mortgage Corp.*, Madison Mortgage Corporation ("Madison") was the holding company of a New York insurance company.<sup>162</sup> The insurance company was Madison's principal asset and Madison held all of the insurer's shares.<sup>163</sup> Both companies initiated their rehabilitation and reorganization proceedings on the same day—Madison in bankruptcy court and the insurance subsidiary in state court.<sup>164</sup> The bankruptcy court confirmed Madison's reorganization plan, which included the sale of its stock in the insurance company.<sup>165</sup> However, in the state insolvency proceedings, the insurance regulator demanded the liquidation of the insurance subsidiary.<sup>166</sup> Although the bankruptcy court recognized that the "liquidation of the subsidiary would wreck [the] reorganization" of Madison, the court held that it could not prevent the state court from ordering the liquidation.<sup>167</sup>

Including insurance companies in the Code would remedy the inefficiencies that occur when holding companies and their insurance subsidiaries undergo insolvency proceedings in different courts. Under sections 1014 and 1015 of the Federal Rules of Bankruptcy Procedure, the insolvency of holding companies and their subsidiaries can be jointly administered in the same court, a procedural alternative not available in the current state insolvency scheme.<sup>168</sup> The purpose of joint administration is to "promote administrative convenience and cost efficiencies by avoiding the duplication of effort which results when cases involving related debtors

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<sup>160</sup> Bufford, *supra* note 1, at 500.

<sup>161</sup> See *In re Madison Mortgage Corp.*, 22 F. Supp. 99 (S.D.N.Y. 1937).

<sup>162</sup> *Id.* at 100.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> FED. R. BANK. P. 1014–15. These sections allow the joint administration of debtors and their affiliates. The definition of "affiliate" in § 101(2) includes entities as a corporation where "20 percent or more of the outstanding voting securities are . . . owned, controlled, or held . . . by the debtor." 11 U.S.C. § 101(2) (2000). This definition would include most holding companies. *Id.*

proceed entirely separately.”<sup>169</sup> Thus, the goals and results of joint administration provide effective remedies to the precise problems and inefficiencies that occur when the insolvency proceedings of insurance holding companies and their subsidiaries take place in two separate courts. By consolidating the insolvencies of insurance holding companies and their subsidiaries in one court and before one judge, the estate can save money by avoiding duplicated efforts. Furthermore, the court can create a comprehensive insolvency plan that takes into consideration the interdependence of the two companies.

### *D. What is a Domestic Insurance Company?: Inconsistencies in the Federal Definition*

One of the problems with excluding insurance companies from the Code is the difficulty in determining what exactly constitutes an insurance company.<sup>170</sup> Today, more than ever, companies are merging and adding to the types of services they perform.<sup>171</sup> Some companies (“hybrid entities”) may act like insurance companies by taking on risk-allocating functions, but they may also provide other services outside the scope of those traditionally offered by insurance companies.<sup>172</sup> For example, Health Maintenance Organizations (“HMOs”) not only allocate risk among enrollees, but they also provide medical services to enrollees through contracted providers.<sup>173</sup> Upon insolvency, the classification of these hybrid entities causes confusion for litigants, courts, and policyholders.

The confusion over the classification of these entities results in costly litigation that would not be necessary if all insurance companies were included in the Code. Before commencing “a bankruptcy case, health care providers first must determine whether [or not they are an insurance company and thus]

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<sup>169</sup> 2 WILLIAM L. NORTON, JR., *NORTON BANKRUPTCY LAW AND PRACTICE* 2D § 20.1 (West 1994).

<sup>170</sup> 11 HOLMES, *supra* note 4, at ¶ 1.3.

<sup>171</sup> Goddard, *supra* note 2, at 568. For example, the healthcare industry has responded to harsh market forces by developing “new organizational forms for healthcare delivery” that include Health Maintenance Organizations and preferred provider organizations, which combine healthcare services with insurance services. Other new organizational forms include integrated delivery systems, independent practice associations, and physician hospital organizations, all of which combine patient care with managed care plans. *ABI HEALTH CARE INSOLVENCY MANUAL: THE BASICS OF BUSINESS BANKRUPTCY FOR THE HEALTH CARE PROFESSIONAL AND THE BASICS OF HEALTH CARE LAW FOR THE BANKRUPTCY PROFESSIONAL* 12 (David C. Hillman & William W. Kannel eds., 2d ed. 2005).

<sup>172</sup> Craig P. Druehl, Note, *HMO and Insurance Insolvency: The Benefits and Detriments of a Federal System*, 23 *AM. J.L. & MED.* 487, 489 (1997).

<sup>173</sup> *Id.*

eligible for relief under” the Code.<sup>174</sup> Because state insurance regulators often disagree with the debtor on how they should be classified, hybrid entities must undergo time-consuming litigation regarding their classification before courts can address the substantive issues of the insolvency.<sup>175</sup> Such litigation takes away valuable dollars from the bankruptcy estate, thereby adversely affecting the success of the insolvency proceedings. For example, in the case of the insolvency of Maxicare, a Los Angeles-based, nationwide HMO, it took the bankruptcy court three and a half years to determine that its Wisconsin subsidiary qualified as an insurance company and should be handled according to state law and not by the bankruptcy court.<sup>176</sup> Such costly and lengthy litigation will continue to diminish the estate as companies continue to merge different types of services into their operations.<sup>177</sup>

This litigation can also result in the inconsistent treatment of policyholders.<sup>178</sup> When classifying these entities for the purpose of insolvency proceedings, courts have mainly employed the “state classification test.”<sup>179</sup> Under this test, courts look at whether state law classifies the entity as an insurance company in order to determine if the insolvency should be addressed under state or federal law.<sup>180</sup> When this test is applied to a company that has almost identical subsidiaries incorporated in different states, depending on how the state classifies such entities, some subsidiaries will be handled under state law while others will be addressed under the Code.<sup>181</sup> As a result, “policyholders in the same company purchasing what is essentially the same product, may receive widely disparate remedies in the event of an insolvency.”<sup>182</sup> This result occurred in the insolvency of Maxicare.<sup>183</sup> In those

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<sup>174</sup> ABI HEALTH CARE INSOLVENCY MANUAL, *supra* note 171, at 33.

<sup>175</sup> Colette B. Resnik, Comment, *Maxicare as a Guide for Health Maintenance Organizations (HMOs) in Bankruptcy*, 8 BANKR. DEV. J. 271, 274 (1991).

<sup>176</sup> See *In re Family Health Servs., Inc.*, 143 B.R. 232 (C.D. Cal. 1992). In this case, Maxicare filed for chapter 11 in March of 1989. *Id.* at 234. The court handed down the decision in July 1992, stating that Maxicare’s Wisconsin subsidiary qualified as an insurance company and should be handled by state law. *Id.* at 236.

<sup>177</sup> See generally Goddard, *supra* note 2, at 568.

<sup>178</sup> Adam Hodkin, Note, *Insurer Insolvency: Problems & Solutions*, 20 HOFSTRA L. REV. 727, 740–41 (1992).

<sup>179</sup> *In re Estate of Medicare HMO*, 998 F.2d 436, 442 (7th Cir. 1997). Prior to *Medicare*, courts used three different tests. *Id.* However, *Medicare* determined that the “state classification test” was sufficient. *Id.* Most commentators believe that *Medicare*’s precedence will be followed. See Lisa DeMoss et al., *Bankruptcy Issues in Health Care*, in HEALTH CARE CONTRACTING 2000, at 109, 129 (PLI Corp. Law & Practice, Course Handbook Series No. 1118, 1999).

<sup>180</sup> *Medicare*, 998 F.2d at 442.

<sup>181</sup> Hodkin, *supra* note 178, at 740–41.

<sup>182</sup> *Id.* See also *In re Family Health Servs., Inc.*, 143 B.R. 232, 234 (C.D. Cal. 1992).

proceedings, forty-seven of the HMO's affiliates were addressed under the Code, while its Wisconsin subsidiary was addressed under Wisconsin law at the behest of the Wisconsin regulator.<sup>184</sup> The court recognized this discordant result and expressed "concern about [the] confusion and lack of consistency [created] through [the] piecemeal administration of a multi-state business reorganization."<sup>185</sup>

In addition to the complications the exclusion creates for policyholders and litigants, courts' deference to the state classification test in effect allows states to determine which entities have access to federal bankruptcy law and federal bankruptcy courts.<sup>186</sup> In response to courts' deference to the state classification test, states have expanded their classifications in order to retain control over these entities during the insolvency process.<sup>187</sup> While it is not uncommon for state law to determine rights under the Code, giving states the power to act as gatekeepers to the bankruptcy court was not likely the intent of Congress when it drafted § 109(b).<sup>188</sup>

Including insurance companies in the Code would completely eliminate the initial costly and dilatory litigation that is required when hybrid entities become insolvent. Hybrid entities such as Maxicare, which spent three years litigating the classification of its Wisconsin subsidiary, could instead devote that time and money to creating a successful reorganization/liquidation scheme and to paying creditors. This would also provide more protection for policyholders because the estate would have more money with which to pay them. Additionally, including all hybrid entities in the Code would ensure more uniform treatment of policyholders. If all hybrid entities were included in the Code, then all policyholders would be subject to the same federal

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<sup>183</sup> *In re Family Health*, 143 B.R. at 234.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* at 236. The court acknowledged the inconsistency between its holding and the general state-by-state insolvency proceedings of insurance companies. *Id.* However, the court noted that its hands were tied by § 109 and that "[i]t [was] for Congress, not the courts, to make any changes in the bankruptcy law that uniform administration requires." *Id.*

<sup>186</sup> Patrick Collins, Note, *HMO Eligibility for Bankruptcy: The Case for Federal Definitions of 109(b)(2) Entities*, 2 AM. BANKR. INST. L. REV. 425, 450 (1994).

<sup>187</sup> See *In re Family Health*, 143 B.R. at 236.

<sup>188</sup> *In re Colo. Indus. Bank of Fort Collins*, 84 B.R. 735, 738-40 (Bankr. D. Colo. 1988) ("[T]he court is convinced that the 'state classification test' is inappropriate for determining jurisdiction because its utilization would result in an abdication of a federal court's responsibility to interpret federal law. No state scheme can override Congress's own intention as to who should be eligible for bankruptcy relief. . . ."). Although this case deals with the state classification test with regard to banks, the test is the same for insurance companies and has the same effect of allowing states to determine which entities have access to the Code. *Id.* at 740.

priority statute. This would eliminate the different payouts to policyholders with essentially the same policy but subject to different state priority statutes. Such uniform treatment of policyholders is one of the benefits provided by the Code.

### *E. The Inadequacies of Regulator Management*

Another drawback to the current state insolvency system is that upon initiation the regulator, who has only limited information about the company, takes control of the insurer from the company's managers who have been intimately involved with the company.<sup>189</sup> While insurance insolvencies were relatively simply due to the smaller size of insurance companies, today, as insurance companies have become larger and more national, insurer insolvencies have greatly increased in complexity, sometimes taking more than a decade to be resolved.<sup>190</sup> Additionally, insurance companies today invest in highly complex financial products that require a certain level of expertise if they are to be managed properly.<sup>191</sup> However, the regulators appointed to manage the company do not always have the requisite business experience to manage these ever-evolving companies adequately.<sup>192</sup> For example, in *Gross v. Weingarten*,<sup>193</sup> it was argued that the insurance regulator in charge of the insurer "lacked the expertise needed to manage a [financial] portfolio as large as" the insurance company's, and that as a result of this inexperience, the regulator sold the insurer's junk bonds at a loss when there were indications of an upturn in the junk bond market.<sup>194</sup> As a result of this inexperience, insolvency proceedings can be unnecessarily delayed, and unfortunately, regulators have little incentive to hasten closure because doing so might leave them unemployed.<sup>195</sup>

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<sup>189</sup> 43 AM. JUR. 2D *Insurance* § 103 (2003).

<sup>190</sup> Semaya & Marema, *supra* note 9, at 12–13.

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> 217 F.3d 208 (4th Cir. 2000).

<sup>194</sup> *Id.* at 217.

<sup>195</sup> Semaya & Marema, *supra* note 9, at 16. In *Serio v. Hevesi*, 831 N.Y.S.2d 160 (N.Y. App. Div. 2007), *rev'd sub nom.* Dinallo v. DiNapoli, No. 1,111, slip op. (N.Y. Oct. 11, 2007), *available at* 2007 WL 2947397, the Comptroller of the state of New York argued over his ability to audit the New York State Insurance Department Liquidation Bureau in order to determine "whether the financial management and operating practices of the Liquidation Bureau [were] effective in fulfilling its responsibility to liquidate and settle the affairs of insolvent insurance companies." *Id.* at 163. Although such an audit indicates suspicion about the regulator's abilities, it should also be noted that there were possible political motivations behind the audit as the regulator was a Republican ally and the Comptroller was an elected Democrat. Law Office of Thomas M. Bower, Old Coverage News, [http://thomasbower.com/new\\_page\\_4.htm](http://thomasbower.com/new_page_4.htm) (last visited Oct. 1, 2007).

To compound the effects of their inexperience, regulators often have a demanding workload that can limit the time they are able to devote to individual insolvency proceedings.<sup>196</sup> For example, just one month after he was appointed regulator to Executive Life, an insurance company with approximately 245,000 policyholders,<sup>197</sup> the California Insurance Commissioner was also appointed regulator to First Capital, which had assets two years prior to receivership of \$4.7 billion.<sup>198</sup> In order to alleviate this workload, most state insolvency statutes permit head regulators to appoint another staff member in the insurance commissioner's office to perform the daily operations of the receivership.<sup>199</sup> However, the appointment of the staff member may exacerbate the problem because they often also have little insurance expertise.<sup>200</sup> While regulators may retain outside experts, such as lawyers or financial consultants, this can add great costs to the insolvency proceedings.<sup>201</sup> Although court supervision may ameliorate some of these problems, the effect is limited because the state judges that oversee these insolvencies are not experts in the field of insolvency, unlike bankruptcy judges.<sup>202</sup>

In contrast to state insolvency laws, the Bankruptcy Code contemplates that the company's existing management will continue to control the company in the form of the debtor in possession ("DIP").<sup>203</sup> The benefit of allowing management to remain in control of the company during insolvency proceedings is that it allows "those who are familiar with the business . . . [to] utiliz[e] their experience and contacts," which increases the "effectiveness" of an insolvency proceeding.<sup>204</sup>

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<sup>196</sup> See Semaya & Marema, *supra* note 9, at 13.

<sup>197</sup> Vincent J. Vitkowsky & John L. Ingersoll, *Survey of 1992 Developments in the Public Regulation of Insurance*, 28 TORT & INS. L.J. 408, 418 (1993).

<sup>198</sup> *Insurance Regulation*, *supra* note 13, at 1-3.

<sup>199</sup> Semaya & Marema, *supra* note 9, at 13.

<sup>200</sup> *Id.* at 16.

<sup>201</sup> *Id.* at 13.

<sup>202</sup> See Bufford, *supra* note 1, at 500. See also Semaya & Marema, *supra* note 9, at 16.

<sup>203</sup> EPSTEIN ET AL., *supra* note 152, at 8.

<sup>204</sup> Barry L. Zaretsky, *Trustees and Examiners in Chapter 11*, 44 S.C. L. REV. 907, 908 (1993).

Additionally, retaining the existing managers, as opposed to appointing a third party regulator, is more cost effective.<sup>205</sup> Although the regulator is somewhat familiar with the company, his knowledge of the company is usually based on written reports as opposed to thorough internal monitoring.<sup>206</sup> As a result, a regulator does not have the necessary expertise about the company, its business, or its clients that the existing managers would possess.<sup>207</sup> To compensate for their lack of expertise, regulators will often hire costly advisors, which would be unnecessary if management was able to continue its control of the insurer.<sup>208</sup>

#### IV. NECESSARY CHANGES TO THE BANKRUPTCY CODE TO ACCOMMODATE INSURANCE COMPANIES

In order to include insurance companies in the Code, some changes must be made to its provisions. In making these changes, it is important to maintain the policy behind current insurer insolvency laws of protecting policyholders.<sup>209</sup> More so than other industries, “the business of insurance is one that is affected with a public interest.”<sup>210</sup> With some types of insurance, such as health insurance, the failure of insurance coverage can be a matter of life and death for a policyholder. As a result, it is important that whatever changes that are made to the Code provide policyholders heightened protection.

One important aspect of state insolvency law that provides the greatest protection for policyholders, and is thus important to incorporate into the Code, is the role of the guaranty fund. Guaranty funds benefit policyholders because policyholders do not have to wait for the completion of the insolvency process to have their claims paid; instead they are immediately compensated by the guaranty fund.<sup>211</sup> However, the current Code does not have any mechanism for reimbursing guaranty funds during insolvency. In order to include guaranty funds in the Code, the priority section of the Code would need to be amended.<sup>212</sup> In current state statutes, guaranty funds are given fourth

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<sup>205</sup> EPSTEIN ET AL., *supra* note 152, at 19.

<sup>206</sup> *Insurance Regulation*, *supra* note 13, at 4.

<sup>207</sup> O’Connell, Jr. et al., *supra* note 13, at 669

<sup>208</sup> Leslie et al., *supra* note 26, at 129.

<sup>209</sup> See *Koken v. Legions Ins. Co.*, 831 A.2d 1196, 1232–33 (Pa. Commw. Ct. 2003), *aff’d sub nom. Koken v. Villanova Ins. Co.*, 878 A.2d 51 (Pa. 2005).

<sup>210</sup> 43 AM. JUR. 2D *Insurance* § 24 (2003).

<sup>211</sup> Leslie et al., *supra* note 26, at 129.

<sup>212</sup> See generally 11 U.S.C. § 508 (2000).

priority.<sup>213</sup> This level of priority should be incorporated into the Code because it provides some assurance of reimbursement to guaranty funds, which gives insurance companies an incentive to continue their operation. One way to accomplish this would be to place administrative expenses of the guaranty fund as the third priority in the Code and guaranty fund claims as the fourth priority. Because this alteration would only affect insurance companies, the change would provide top priority for guaranty funds without altering the priority of creditors of non-insurance companies under the Code.<sup>214</sup>

Another necessary modification to the Code is to create some mechanism for regulatory supervision over an insurer's insolvency proceeding. Although existing managers are the most appropriate party to control a company during an insolvency proceeding, the profound effect that insurance companies have on the public interest necessitates some input from the regulator.<sup>215</sup> One way to incorporate regulator input is to create a position for the regulator similar to the patient-care ombudsmen that are appointed for healthcare businesses that enter insolvency proceedings.<sup>216</sup> Such a change would allow the court to appoint the regulator as the insurance ombudsman. Once appointed, the regulator would continue to monitor the insurance company to ensure that the interests of policyholders are being protected during the proceedings.<sup>217</sup> The insurance ombudsman would also have the ability to petition the court throughout the insolvency proceeding if the interests of policyholders are jeopardized. However, while the patient-care ombudsman is required to report to the court every sixty days,<sup>218</sup> an insurance ombudsman should not report to the court as frequently due to the long duration of most insurance insolvencies.<sup>219</sup>

Finally, some modifications of the initiation procedures would also be necessary in order to incorporate insurance companies into the Code. One of the primary changes would be to ensure that § 303, the provision for creditor initiation, is interpreted to include guaranty funds since they are usually "the largest policyholder-level creditors of the insolvent insurer."<sup>220</sup> Inclusion of

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<sup>213</sup> See, e.g., DEL. CODE ANN. tit. 18, § 5918 (1999).

<sup>214</sup> See generally 11 U.S.C. § 507 (2000).

<sup>215</sup> 43 AM. JUR. 2D *Insurance* § 24 (2003).

<sup>216</sup> 11 U.S.C.A. § 333 (West 2007).

<sup>217</sup> This would be similar to the patient-care ombudsman who monitors "the quality of patient care provided to patients of the debtor." 9 AM. JUR. 2D *Bankruptcy* § 697 (2007).

<sup>218</sup> *Id.*

<sup>219</sup> See generally Semaya & Marema, *supra* note 9, at 12.

<sup>220</sup> Leslie et al., *supra* note 26, at 129.

guaranty funds in creditor initiation could be accomplished by modifying the definition of “creditor” under § 101(10) to specifically include guaranty funds<sup>221</sup> or by amending § 303 to explicitly allow guaranty funds to initiate.<sup>222</sup>

Another important change in the current initiation provisions is to allow regulators to initiate insolvency proceedings against a troubled insurer. Although this change would arguably not expedite the initiation of insolvency proceedings,<sup>223</sup> it would maintain the importance of the regulator’s role in monitoring the solvency of insurers. Without the ability to place a distressed insurer into receivership, the regulator’s monitoring power would be greatly decreased. In order to incorporate regulator initiation, § 303 of the Code should be modified to allow regulators, in addition to creditors, to initiate insolvency proceedings.<sup>224</sup> The result of this change would be that creditors, debtors, and regulators would be permitted to initiate insurer insolvency proceedings. To balance the initiation capabilities of all three interested parties, the Code should also include more judicial oversight regarding initiation. Such oversight is necessary due to the profound and detrimental effects an insurer’s insolvency can have on the public. This oversight could be achieved by amending both the voluntary and involuntary petition sections of the Code to require court approval through a hearing in the cases of insurance company initiation.<sup>225</sup> This would allow for input from all interested parties, as well as the court, in order to ensure that an insolvency proceeding is in the best interest of the public.

## CONCLUSION

In 2005 a catastrophic hurricane season was responsible for record damages with Hurricane Katrina creating \$50 billion in damages alone.<sup>226</sup> The insurance claims that resulted from the damage lead to the insolvency of two

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<sup>221</sup> See generally 11 U.S.C. § 101(10) (2000).

<sup>222</sup> See generally *id.* § 303.

<sup>223</sup> In an investigation of the failures of four large insurance companies, the GAO determined that one major problem was that regulators were prone to delay initiation of a struggling insurer. *Insurance Regulation*, *supra* note 13, at 10.

<sup>224</sup> See generally 11 U.S.C. § 303(b).

<sup>225</sup> See *id.* §§ 301, 303.

<sup>226</sup> Elliott C. McLaughlin, *No More Hurricane Katrinas*, CNN, May 19, 2006, <http://edition.cnn.com/2006/WEATHER/04/06/hurricane.names/index.html>

large insurers, Poe Financial Group and Vesta Fire Insurance Company.<sup>227</sup> A catastrophe of this size and the resulting damage illustrates the real possibility of large, national insurer insolvencies. In 2006, Senators Sununu and Johnson introduced the National Insurance Act which, among other things, attempted to modify current insurer insolvency laws by creating a more national insolvency scheme.<sup>228</sup> This Act is only one of several proposed changes that Congress has considered with regard to insurer insolvency.<sup>229</sup> The reality of national insurer insolvencies and the several attempts to modify current insurer insolvency laws demonstrates the importance of having one nationwide insolvency law that is applicable to insurance companies and that is administered by one court.<sup>230</sup>

By incorporating insurance companies into the Code, insurers would no longer have to spend time on out-of-state litigation to recover the company's own assets or to halt the collection efforts of others. Additionally, the national jurisdiction of the Code and its accompanying court system could accommodate insurers and their holding companies more efficiently than the current state-by-state system, which administers these intertwined entities in completely separate proceedings. Incorporation into the Code would also ensure that management, who is already informed about the industry and the company, controls the insolvency proceedings. Such a result saves both time and money, which would contribute to more successful reorganizations and better distribution to creditors and policyholders in liquidation. Lastly, incorporation in the Code would increase the efficiency of the insolvency proceedings by placing them in the control of bankruptcy judges who are already experts in the field. In his experience presiding over the insolvency proceedings of an insurance holding company, one bankruptcy judge observed that the state court judges overseeing the insolvencies of the insurance subsidiaries were less knowledgeable about bankruptcy law, and as a result, more time and money were spent on determining "the respective rights and entitlements than would be required in bankruptcy court."<sup>231</sup> By excluding insurer insolvencies from the purview of the McCarran-Ferguson Act and

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<sup>227</sup> Insurance Information Institute, Hot Topics and Issues Updates, <http://www.iii.org/media/hottopics/insurance/insolvencies/> (last visited Oct. 1, 2007). Poe Financial Group was Florida's third largest insurance group and Vesta was Texas's sixth largest homeowners' insurance company. *Id.*

<sup>228</sup> National Insurance Act of 2006, S. 2509, 109th Cong. § 2 (2006).

<sup>229</sup> The proposed Federal Insolvency Act of 1992 is another recent act that has attempted to stream-line and federalize the insurance insolvency process. Vitkowsky & Ingersoll, *supra* note 197, at 409.

<sup>230</sup> This need was also expressed in Judge Bufford's suggestion to the National Bankruptcy Review Commission and Congress where he explained that "these problems would be greatly reduced if an insurance insolvency case is all in one court, which could only be a federal court." Bufford, *supra* note 1, at 500.

<sup>231</sup> *Id.*

including them in the Code, many of these inefficiencies in the current state-by-state insolvency system would be avoided and insurance companies, like so many other companies, would have access to the overwhelming benefits of the Code.

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