Case No. 07-16188

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: ANDREW D. GLOGOWER

Debtor

JANIE A. MILLER, Liquidator of National Business Association Trust And National Benefit Administrators,

Appellant

v.

ANDREW D. GLOGOWER,

Appellee

Appeal from the United States District Court For The District Of Arizona at Phoenix
Case No. CV-04-01724-RGS

BRIEF *AMICUS CURIAE* OF NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS IN SUPPORT OF APPELLANT

BARGER & WOLEN LLP
Charles R. Cohen (Arizona SBN 010190)
Michael A. S. Newman (California SBN 205299)
Chase Tower
201 N. Central Avenue, Suite 3300
Phoenix, Arizona 85004
Telephone: (602) 256-2888
Facsimile: (602) 256-2893
Attorneys for
Amicus Curiae, National Association of Insurance Commissioners

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I. IDENTITY AND INTEREST OF *AMICUS CURIAE*

A. Identity of Amicus Curiae

The National Association of Insurance Commissioners ("NAIC") is a non-profit corporation whose membership consists of the principal insurance regulatory officials of the fifty States, the District of Columbia, the territories and insular possessions of the United States. Founded in 1871, it is the nation's oldest association of state government officials. The NAIC represents the coordinated and considered views of the state government officials that regulate and enforce the insurance laws of the country.

The mission of the NAIC is:

> [t]o assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost-effective manner, consistent with the wishes of its members: protect the public interest; promote competitive markets; facilitate the fair and equitable treatment of insurance consumers; promote the reliability, solvency and financial solidity of insurance institutions; and support and improve state regulation of insurance. National Association of Insurance Commissioners, Mission Statement, *http://www.naic.org/index_about.htm* (last visited Jan. 28, 2008)

The NAIC performs numerous crucial services on behalf of state government, including: the development and publication of

model laws, regulations, bulletins and financial and accounting standards; the coordination of quarterly national meetings and interim meetings of various NAIC committees, task forces and working groups; the creation and publication of white papers, consumer guides, handbooks, periodicals and the *Proceedings of the NAIC*; the management of accreditation standards for, and coordination of, the review of state insurance departments; the maintenance of financial and regulatory databases and regulatory analysis of insurance company financial data; the offering of education and training programs for state, federal and international insurance financial regulators; and the operation of the Securities Valuation Office. The Kentucky Office of Insurance requested the filing of an amicus brief, and its request was approved by the Executive Committee of the NAIC.

B. Interest of Amicus Curiae

The interest of the NAIC in this case is twofold: the enforceability of state laws based on NAIC Models and Regulations; and the continued strength of state-based regulation of insurer insolvency. NAIC members craft and adopt model acts with an expectation that those acts will be fully enforceable once adopted by a

particular state. The outcome of this case will determine whether the Nonadmitted Insurance Model Act will be allowed to function as NAIC members and the Kentucky state legislature intended, or whether the federal courts will disregard the state mandate. Furthermore, this case is a test of a longstanding principle that state insurance regulators are best situated to preside over insurer insolvency.

Each NAIC member promotes the objective of solvent insurance institutions in the member's two distinct capacities as the chief insurance regulator in each state and as the officer charged with handling insurer receiverships for the state. Individually and collectively, the NAIC's members and the state agencies over which they preside have a wealth of experience in the regulation of insolvency. The NAIC's members understand the interests of insurance consumers and others affected by the emergencies arising from insurer insolvency, and work daily to protect those interests. The NAIC's members are uniquely qualified and situated to assist this Court by presenting the regulatory and public policy concerns involved in this case.

The NAIC endorses the brief of the Kentucky Office of Insurance and its legal arguments with respect to the liability of the Debtor. We seek to aid the Court of Appeals by offering the legal position and public policy perspectives of our association and NAIC member states.

II. STATEMENT OF THE CASE

The NAIC adopts the statement as set forth by Appellant Janie A. Miller, Liquidator of National Business Association Trust ("NBAT") and National Benefit Administrators, Inc ("NBA").

III. SUMMARY OF ARGUMENT

The District Court erred in ruling that the bonus and loan payments from NBA, as well as the unpaid claims liability from NBAT, were dischargeable in bankruptcy. The District Court's decision to discharge these debts raises several issues that are of general and national concern to the NAIC:

1. The Franklin Circuit Court of the Commonwealth of Kentucky ("Kentucky Court") has exclusive jurisdiction to entertain, hear, or determine all matters that in any way relate to any insolvency proceeding brought in Kentucky. This Kentucky Court ordered the

insolvencies of NBA and NBAT and made a final and crucial determination that the two entities operated as one. This ruling has not been given due deference by the courts in the subsequent bankruptcy proceedings.

2. The District Court's ruling contradicts and undermines Kentucky's enactment of the NAIC's Nonadmitted Insurance Model Act, which imposes liability on the debtor for unpaid claims.

3. The District Court's ruling disregards the longstanding principle that insurer insolvency is best regulated by the states.

IV. ARGUMENT

A. The Kentucky Court's Ruling Has Not Been Given Due Deference

The Debtor was the chairman of the board and chief executive officer of NBA. NBA was the administrator of NBAT. NBAT provided self-funded health insurance coverage to employers in 21 states, including Kentucky. *See* Opening Brief for Appellant at 8, *Miller v. Glogower*, No. 07-16188 (9th Cir. Jan. 25, 2008). The NAIC joins Kentucky in its characterization of NBAT as a multiple employer welfare arrangement ("MEWA") subject to state regulation. *See id.* at 36. NBAT paid NBA twenty percent of all contributions to

the trust as an administrative fee. *See id* at 9. In 1988, the Debtor approved a promissory note from NBA to himself for "accrued but unpaid salary." *See Glogower v. Miller*, No. CV 04-1724-PHX-RGS (D. AZ. May 25, 2007). NBA made loan payments on this promissory note in the total amount of $395,000 from 1989 to 1990. *See id.* The Debtor also approved a bonus payment of $362,282.70 from NBA to himself in 1989. *See id.*

On June 20, 1991, the Kentucky Court ruled that NBAT was an unauthorized insurer doing business in Kentucky. In the same ruling, the Kentucky Court found that NBAT was insolvent and ordered its liquidation. On May 10, 1995, the Kentucky Court ruled that NBAT acted through and as one with NBA. *See Wright v. National Business Association Trust*, et al. No. 90-CI-01207, (Franklin Circ. Ct. Ky. May 9, 1995 May 10, 1995). The Kentucky Court reasoned that NBA had sole control of management of NBAT; that NBAT had no offices or operations other than those provided by NBA; and that NBAT had no employees or officers other than the Debtor. *See id.* Since NBA was financially dependent on NBAT, the Kentucky Court held that NBA was also insolvent. *See id.*

A state court's order of liquidation fixes the rights and liabilities of the insurer and all interested parties in the insolvency estate. The Kentucky Court found that NBAT and NBA were being operated as a single entity and applied the appropriate remedy for policyholders and claimants. The District Court should have given greater deference to the opinion of the Kentucky Court, which is the only court in Kentucky having jurisdiction over insolvency proceedings and has the greater expertise in insolvency proceedings. *See* KY. REV. STAT. ANN. § 304.11-040(3)

The Kentucky Court ruled that there was no meaningful distinction between NBA and NBAT for purposes of applying Kentucky's insurance laws. *See Wright,* No. 90-CI-01207. The Bankruptcy Court correctly found that the payments the Debtor made to himself from NBA were not dischargeable in bankruptcy under 11 U.S.C. § 523 (a)(4), as the Debtor committed defalcation in a fiduciary capacity when he authorized the payments. *See In Re Andrew D. Glogower*, No. 00-06179-PHX-RTE, (U.S. Bank. Ct. July 9, 2004). It is well established that the defalcation exception applies only to express and technical trusts. *See* Appellant Br. at 34. The NAIC reiterates the assertion of the Kentucky Office of Insurance that

the single entity NBAT/NBA was an express trust and that the Debtor actively controlled and dominated the investment and management of plan funds. *See id.* at 38. The Debtor was clearly acting in a fiduciary capacity.

These rulings establish two crucial points in this case; that the Debtor acted in a fiduciary capacity as to the bonus and loan payments from NBA, and that any distinction between NBAT and NBA is artificial at best. The Debtor's liability under 11 U.S.C. §523 extends from the payments he made to himself from NBA to the unpaid claims owed from NBAT. Additionally, the unpaid claims liability stems from Kentucky's codification of the NAIC's Nonadmitted Insurance Model Act.

B. The Nonadmitted Insurance Model Act Is Undermined by the District Court's Ruling

Following the Kentucky Court's rulings on the insolvency of NBAT and NBA, the Kentucky Office of Insurance, acting as Liquidator, filed for damages for unpaid claims in an amount upward of $10 million. Both the Bankruptcy Court and the District Court ruled that the unpaid claims liability is dischargeable in bankruptcy. These rulings run contrary to public policy and defeat the efforts of

the NAIC, its members, and the Kentucky state legislature to regulate unauthorized insurers.

The Debtor is liable for NBAT's unpaid claims under KY. REV. STAT. ANN. § 304.11-030(3)(b), which provides:

> In the event of failure of any such unauthorized insurer to pay any claim or loss within the provisions of such insurance contract, any person who assisted or in any manner aided directly or indirectly in the procurement of such insurance contract shall be liable to the insured for the full amount of the claim or loss in the manner provided by the provisions of the insurance contract. KY. REV. STAT. ANN. § 304.11-030(3)(b).

This language is derived from Section 4D of the NAIC's Nonadmitted Insurance Model Act. *See* 1996 NAIC Proceedings, 2nd Qtr, p. 884-885. The Kentucky state legislature adopted the model act in 1970. *See* 3 NAIC *Model Laws, Regulations and Guidelines*, 870-32 (2002). The NAIC's members develop model laws and regulations to serve as standards for the promulgation of insurance laws and regulations in individual states to assist in carrying out their regulatory and receivership duties. Consistent with its mission, the NAIC helps its members and their respective insurance departments to explain the function and significance of NAIC model laws and regulations to

legislatures, courts, other divisions of the executive branch, industry, consumers and the general public.

The public policy behind Section 4D of the Nonadmitted Insurance Act is to protect the policyholders in the event of nonpayment, whether due to insolvency or some other factor. Unauthorized insurers should not be allowed to escape liability after insolvency when they have evaded state regulation and failed to maintain sufficient reserves. Another consequence of an insurer's unauthorized marketing and selling of insurance is that its policyholders are not protected under a state's guaranty funds. *See* Joseph A. Kilbourn and Jeffrey M. Winn, Excess, Surplus Lines and Reinsurance: Recent Developments, 25 Tort & Ins. L.J. 288, 305 (1990). In Kentucky, for instance, the state guaranty fund does not cover policies issued by a MEWA or even by an authorized insurer if the policy is issued at a time when that insurer was not admitted to do business in the state. *See* KY. REV. STAT. ANN. §§ 304.42-030(2)(b)(4) and 304.42-030(2)(b)(6).

The NAIC filled this gap in consumer protection by imposing personal liability on the unauthorized procurer, in this case the Debtor, through Section 4D. The provision is so central to the NAIC's view

of regulatory policy that it is referenced in Section 7 of the Prevention of Illegal Multiple Employer Welfare Arrangements (MEWAs) and Other Illegal Health Insurers Model Regulation. *See* 2 NAIC Model Laws, Regulations and Guidelines, 220-1 to 220-14 (2006). A person that violates the MEWA Model Regulation is subject to personal liability for unpaid claims under Section 4D of the Nonadmitted Insurance Model Act. *See id.*

Thirty-six states have adopted provisions similar to Section 4D[1]. This national trend demonstrates the public policy concerns that are at issue in the present case. It was certainly not intended by these states that an individual could thwart the effect of an unambiguous

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[1] ALA. CODE § 27-10-2(a); ALASKA STAT. § 21.33.037(d); ARIZ. REV. STAT. ANN. § 20-402(B); ARK. CODE ANN. § 23-65-101(f); COLO. REV. STAT. ANN. § 10-3-906(2); CONN. GEN. STAT. ANN. § 38a-275; FLA. STAT. ANN. § 626.901(2); GA. CODE ANN. § 33-23-41(a); HAW. REV. STAT. § 431:8-204; 215 ILL. COMP. STAT. ANN. 5/121-4; IND. CODE ANN. § 27-4-5-2(6)(c)(2); KAN. STAT. ANN. § 40-2702(7)(c)(2); KY. REV. STAT. ANN. § 304.11-030(3)(b); LA. REV. STAT. ANN. § 22:1148; ME. REV. STAT. ANN. Tit. 24-A § 2101; MASS. GEN. LAWS. ANN. ch. 175 § 171; MINN. STAT. ANN. § 60A.209(6); MISS. CODE ANN. § 83-17-3; MO. ANN. STAT. § 375.786(3)(2); NEB. REV. STAT. § 44-2002(3)(b); NEV. REV. STAT. § 685B.030(5); N.H. REV. STAT. ANN. § 406-B:8(I); N.C. GEN. STAT. ANN. § 58-33-95; N.D. CENT. CODE § 26.1-02-08; OKLA. STAT. ANN. tit. 36, § 1101(B); OR. REV. STAT. ANN. § 746.310(2); 40 PA. CONS. STAT. ANN. § 991.1603 (b); P.R. LAWS ANN. tit. 26, § 1001(2); R.I. GEN. LAWS § 27-16-1.2(8)(d); S.C. CODE ANN. § 38-25-360; TENN. CODE ANN. § 56-2-107; TEX. INS. CODE ANN. § 101.201(a); UTAH CODE ANN. § 31A-15-105(3); VA. CODE ANN. § 38.2-1802(B); W. VA. CODE ANN. § 33-44-4; WIS. STAT. ANN. § 618.39.

state statute by declaring bankruptcy and having the obligations clearly imposed by state law discharged. A debtor's personal liability for unpaid claims on insurance policies the debtor was not authorized to negotiate is determined by state legislatures. It is not for the federal bankruptcy courts to discharge this liability.

C. State Regulation of Insolvency Is Jeopardized by the Discharge of These Liabilities

The federal bankruptcy code holds that a person may not be a debtor under the code if such person is a domestic insurance company. *See* 11 U.S.C.A. § 109 (b)(2). The U.S. Court of Appeals for the Fourth Circuit cited a widely accepted reasoning for this provision:

> No reasons for making these exceptions were assigned by the committees of Congress, but they may be surmised to lie in the public or quasi public nature of the business, involving other interests than those of creditors, in the desirability of unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs. *See In re Supreme Lodge of the Masons*, 286 F. 180, 184 (D.C.Ga. 1923).

Subsequent analysis reveals other advantages to placing the liquidation of insurance companies squarely within the purview of the state insurance regulators; including judicial economy, ease of administration, and the states' interest in protecting the public. *See*

Sims v. Fidelity, 129 F. 2d 442, 448-9 (4th Cir. 1942). When the rights of policyholders are at stake, deference must be paid to the expertise of state insurance departments in liquidation proceedings and issues of insolvency.

State proceedings are ideal for insurer insolvency because they are fluid. Different situations call for different responses. A state court can order liquidation, rehabilitation, receivership, seizure, or combinations thereof. *See* National Association of Insurance Commissioners, Receivers Handbook for Insurance Company Insolvencies, 1-1 to 1-5 (2004). If a state court rules that liquidation is appropriate, the ensuing order will cancel the policies at hand, stay actions pending against the insolvent, and require that all creditors be provided with a proof of claim form. *See* Davis J. Howard, How to Fail at Liquidating an Insurance Company Without Really Trying; Appoint a Policyholders' Committee, 39 FED'N OF INS. & CORP. COUNS. Q. 31, 34 (1988). This process is entirely separate from bankruptcy, to the point where "the very concept of analogizing any type of insurance company delinquency proceeding to a bankruptcy proceeding is inappropriate". *Id.* at 56.

The exclusion of insurers from the Bankruptcy Code also

follows the mandate of the McCarran-Ferguson Act. *See* 15 U.S.C. §§ 1011-1015. Congress enacted the McCarran-Ferguson Act to communicate its intent that, in the absence of federal laws specifically applicable to the business of insurance, state laws take precedence. *See id.* The Bankruptcy Code does not specifically relate to the business of insurance, and therefore cannot supersede state law on insurer insolvency.

The U.S. Congress charged state insurance commissioners with a great responsibility in enacting the McCarran-Ferguson Act and excluding insurers from the Bankruptcy Code, and the NAIC has responded vigorously. Among the hundreds of model acts and regulations that the NAIC has promulgated, one of the first to be adopted focused on insolvency. The insolvency model act was developed following the Great Depression, when the need to deal more effectively with the emergencies related to the insolvency or receivership of insurers was recognized. A 1935 Report of the Special Committee on Interstate Liquidation and Reorganization resolved, in part:

> WHEREAS, Although the institution of insurance is rapidly approaching a state of stabilization and there is ample reason to believe that the period of extensive

> liquidation and rehabilitation has been passed, it is desirable to have available adequate machinery to meet the emergencies that may arise in the future;
>
> NOW, THEREFORE, BE IT RESOLVED, That the [NAIC] urges the enactment into law of the necessary statute or statutes whereby such unitary control of liquidations or rehabilitations may be effected by extending the authority and control of the appropriate Insurance Commissioner ... and the appropriate court.... 1935 NAIC Proceedings, p. 97.

In its several versions since 1936, the Insurer Receivership Model Act has served as a guide for state legislatures as they adopted statutory receiverships for insurers. *See* 3 NAIC *Model Laws, Regulations and Guidelines*, 555-1 to 555-98 (2005).

It has also been a guide to NAIC members in discharging their duties as rehabilitators and liquidators of insurers. Kentucky adopted the model in 1970 and has amended the act as recently as 2004 to reflect improvements NAIC has made to the model over time. *See* KY. REV. STAT. ANN. §§ 304.33-010 to 304.33-600.

The painstaking efforts NAIC members have taken to craft a system of insolvency and liquidation regulation, and regulation of unauthorized insurers, are effectively wasted if the federal bankruptcy courts do not take into consideration the end results of a state

proceeding. To discharge the Debtor's unauthorized bonus and loan payments and unpaid claims liability is to deny justice to policyholders with legitimate insurance claims. These claimants paid premiums on illusory coverage. The Kentucky Office of Insurance took the appropriate actions and obtained a suitable remedy for its residents from the Kentucky Court. The District Court's failure to acknowledge the primacy of a state court over insurer insolvency proceedings threatens the extensive system of state regulation of insolvency that NAIC members and state legislatures have striven mightily to establish and operate.

V. CONCLUSION

The NAIC joins the Kentucky Office of Insurance in asserting that neither the bonus and loan payments nor the unpaid claims liability should be dischargeable in bankruptcy. The Kentucky Court provided an appropriate remedy for statutory violations committed by the Debtor, and it issued a legal determination on the single entity status of NBAT. The District Court did not give due deference to the Kentucky Circuit Court in these matters. Furthermore, the NAIC's Nonadmitted Insurance Model Act and its ongoing efforts to

effectively regulate insurer insolvencies are undermined by the District Court's ruling as to debts dischargeable in bankruptcy.

For all the above reasons, the NAIC respectfully urges the Court to reverse the decision of the District Court.

Respectfully submitted,

Dated: February 1, 2008

BARGER & WOLEN LLP

By: Charles R. Cohen
CHARLES R. COHEN
Attorneys for National Association of Insurance Commissioners

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS

Case No. 07-16188

This *amicus curiae* brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 3,005 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using Word 2002 in Times New Roman 14 point font.

Executed this 1st day of February 2008 at Phoenix, Arizona.

BARGER & WOLEN LLP

By: Charles R. Cohen /MN
CHARLES R. COHEN
Attorneys for National Association of Insurance Commissioners

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: Barger & Wolen LLP, 633 West Fifth Street, 47th Floor, Los Angeles, California 90071-2043.

On **February 4, 2008** , I served the foregoing document(s) described as **BRIEF *AMICUS CURIAE* OF NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS IN SUPPORT OF APPELLANT** on the interested parties in this action by placing [ ] the original [ ] a true copy thereof enclosed in sealed envelope addressed as stated in the attached mailing list.

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(Name)

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SERVICE LIST

In re: Andrew D. Glowgower, Debtor
Janie A. Miller v. Andrew D. Glogower; Case No. 07-16188
United States Court of Appeals for the Ninth Circuit

Kathy M. Sandweiss
Roger L. Cohen
Jaburg & Wilk, P.C.
3200 North Central Street, Suite 2000
Phoenix, Arizona 85012
Counsel for Debtor

James P. Kneller
Law Offices of James P. Kneller, P.C.
7509 East First Street
Scottsdale, Arizona 85251
Counsel for Debtor

Greg E. Mitchell
Frost Brown Todd LLC
250 West Main Street
2700 Lexington Financial Center
Lexington, Kentucky 40507-1749
Counsel for Liquidator

John R. Tellier, #005959
Titus, Brueckner & Berry, P.C.
Scottsdale Centre, Suite B-252
7373 North Scottsdale Road
Scottsdale, Arizona 85253-3527
Counsel for Liquidator

BARGER & WOLEN LLP
633 W. FIFTH ST.
FORTY-SEVENTH FLOOR
LOS ANGELES, CA 90071
(213) 680-2800