

STATE OF VERMONT

SUPERIOR COURT
WASHINGTON UNIT

COMMISSIONER OF THE)
DEPARTMENT OF FINANCIAL)
REGULATION)
PLAINTIFF,)
v.)
EMERGENCY PHYSICIANS INSURANCE)
EXCHANGE RISK RETENTION GROUP)
RESPONDENT.)

CIVIL DIVISION
DOCKET NO. - - Wncv

**PETITION FOR ORDER OF REHABILITATION FOR EMERGENCY
PHYSICIANS INSURANCE EXCHANGE RISK RETENTION GROUP**

Now comes the State of Vermont Department of Financial Regulation (the “Department”), by its Commissioner Michael S. Pieciak (the “Commissioner”), pursuant to 8 V.S.A. § 7051, and petitions the Court for an Order of Rehabilitation for Emergency Physicians Insurance Exchange Risk Retention Group (“EPIX” or the “Company”). In support of this Petition, the Commissioner states as follows:

1. Jurisdiction and Authority. This Court has exclusive jurisdiction of this action pursuant to 8 V.S.A. § 7032(e).

2. Petitioner is the Commissioner of the Vermont Department of Financial Regulation, charged with, inter alia, enforcing the insurance laws of the State of Vermont. Pursuant to 8 V.S.A. § 7032(a), the Commissioner has the sole authority to commence a delinquency proceeding under Chapter 145 of the Vermont Statutes.

3. Background. Respondent EPIX was originally organized on July 21, 2003 as a Nevada-domiciled risk retention group to write medical malpractice insurance for emergency physician groups. Medical malpractice insurance was not then readily available at a reasonable price for emergency physician groups. The Company operated from a California location as Emergency Physicians Insurance Company Risk Retention Group. Over time, the market softened, and coverage became available from other carriers on competitive terms. Written premium declined and operations were accordingly reduced. During the first quarter of 2015, the Company's name was changed to Emergency Physicians Insurance Exchange Risk Retention Group and it re-domesticated to Vermont. The Company is therefore a "domestic insurer" within the meaning of 8 V.S.A. § 7051. See also 8 V.S.A. §§ 6018 and 7031(13)(H). Affidavit of J. David Leslie, filed herewith, ¶ 2 (hereinafter, "Leslie Aff., ¶ ___").

4. As of December 31, 2020, the Company was registered in 30 states but all its in-force business had been cancelled as of September 1, 2020. See Leslie Aff., ¶ 3.

5. The Commissioner has monitored the Company's financial condition since its re-domestication to Vermont. Written premium dropped throughout this period, the operations in California were downsized, and operations were ultimately transferred to Madison, Wisconsin, where they have been conducted by independent contractors. By late 2019, it became clear that EPIX was experiencing a surge in high severity claims which generated a consequent reduction in surplus. As of December 31, 2019, the Company recorded its liability for unpaid claims at the low end of the range provided by its consulting actuary. Following review of the Company's most recent financial statements, a recent report from its consulting actuary concerning unpaid claim liabilities as of December 31, 2020, discussions with management, and consideration of other materials the Commissioner concluded that EPIX was insolvent and that continued

transaction of business would be hazardous financially to policyholders, claimants, and the insurer's creditors. Leslie Aff., ¶ 4.

6. EPIX's Current Condition.

a. The Company's actuaries, The Actuarial Advantage ("TAA"), have completed an Actuarial Review of Loss and Loss Adjustment Expense Reserves as of December 31, 2020 (the "TAA Report") and discussed its findings and implications with the Department. The TAA Report presents a range of reasonable reserve estimates with a low (optimistic), high (conservative) and central (select) estimate. The select estimate is a point within the range of reasonable estimates that represents an expected value over the range of reasonably possible outcomes. Leslie Aff., ¶ 5.

b. EPIX reports \$10.7 million of cash and invested assets. If EPIX were to establish loss and defense and cost containment ("DCC") claim reserves consistent with TAA's select estimate (\$11.0 million), those reserves alone would exceed EPIX's assets (\$10.7 million) by \$0.3 million, and would be \$1.3 million less than the statutory minimum surplus of \$1.0 million. See, 8 V.S.A. §§ 6001(4) and 6004(a)(5). EPIX also has \$0.9 million of accrued expenses and the Department estimates (on a conservative basis) that the costs of running off EPIX's obligations would be \$1.9 million. Using TAA's select estimate for unpaid loss and DCC claim liabilities, adding accrued expenses and the Department's estimate of runoff expenses means that EPIX's surplus would be negative \$3.1 million. Using the high TAA reserve estimate, the Company's surplus would be negative \$5.3 million. If EPIX were to establish unpaid claim reserves at the most optimistic level estimated by TAA, its surplus would still be a negative \$1.7 million, which is \$2.7 million less than the statutory minimum. Leslie Aff., ¶ 6.

7. For the reasons described above, the Commissioner has concluded that EPIX is insolvent and that continuing operations on the current basis would be hazardous to the public, its policyholders, and its creditors. The Department advised the Company's board of directors of these conclusions and requested their consent to an order of rehabilitation. EPIX has consented to the entry of an order of rehabilitation pursuant to the Stipulation of Emergency Physicians Insurance Exchange Risk Retention Group to Entry of Order for Rehabilitation filed herewith. Grounds for an order authorizing the Commissioner to rehabilitate EPIX therefore exist. See 8 V.S.A. §§ 7051(1), (12), and (13); Leslie Aff., ¶ 7.

8. Proposed Plan of Rehabilitation. As a risk retention group, EPIX's policyholders and claimants are not eligible for guaranty fund protection. 15 U.S.C.A. § 3902(a)(2) (Risk retention groups are "exempt from any State law" that would "require or permit [them] to participate in any insurance insolvency guaranty association..."). This means that EPIX's assets are the sole source of recovery for the Company's creditors (including those with policy-related claims). The distribution percentage that can finally be paid to EPIX creditors is therefore the ratio of court-allowed claim amounts (based on the creditor priority levels established by law) to the assets available after deductions for administrative expenses. The principal variables that will impact the ultimate distribution percentage are therefore the allowed claim amounts and the expenses of administration. As Rehabilitator, the Commissioner will investigate whether it is possible to cede EPIX's insured obligations to another insurer at a lower cost than the estimates described above. He will also seek to reduce administrative expenses to the lowest level possible. It is possible that EPIX's ultimate claim obligations will prove to be less than TAA's low range estimate. For the foregoing reasons, since there is no guaranty fund protection, and since EPIX creditors would do no better from a financial perspective in a straight liquidation

proceeding, the Commissioner proposes the runoff rehabilitation receivership set forth below.

Leslie Aff., ¶ 8.

a. EPIX would continue to incur and pay all reasonable administrative expenses associated with its operation. Cf. 8 V.S.A. § 7081 (In liquidation, claims entitled to Class 1 priority include “[t]he costs and expenses of administration, during conservation, rehabilitation, and liquidation...”). Leslie Aff., ¶ 8.

b. The Company, pursuant to the Rehabilitator’s control, would continue to adjust policy-level claims and other policy-related obligations and make immediate reimbursement payments equivalent to 40% of such defense costs and indemnity values (the “Initial Distribution Rate”) while deferring payment of the remainder. Cf. 8 V.S.A. § 7081(3) (in liquidation, claims under policies are entitled to Class 3 priority).¹ Policyholders would assume the immediate responsibility for all defense costs and indemnity payments and EPIX would promptly reimburse such defense costs and indemnity payments at the Initial Distribution Rate. As policyholders see fit, EPIX claim staff would continue to be available (at EPIX’s expense) to coordinate the defense and adjustment of claims but policyholders would advance defense costs and indemnity amounts to be promptly reimbursed by EPIX at the Initial Distribution Rate. The Commissioner believes that such partial payments reasonably balance the risk of preferential transfers (payments to some policyholders that might need to be clawed-back in a liquidation proceeding if insufficient funds are available to pay other policyholders)

¹ The liquidation priority statute assigns the administrative expenses of guaranty associations to priority Class 2. See 8 V.S.A. § 7081(2). Because EPIX is a risk retention group and therefore prohibited by federal law from participating in guaranty associations, Class 2 would be empty in a liquidation. All assets available to the estate after payment of administrative expenses would therefore be dedicated to the payment of policy-related claims. See 8 V.S.A. § 7081(3).

against the desire to minimize disruption to policyholder-level claimants and overall estate liabilities (maintaining stability in claim defense and adjustment should reduce total defense and indemnity costs). See 8 V.S.A. § 7067 (regarding voidable preferences) and 7081 (regarding equality of treatment within priority classes). The Commissioner recommends that the Court adopt a 40% Initial Distribution Rate as reasonable and prudent in light of the fact that, using TAA's conservative reserve estimate, estate assets may be sufficient to permit a 66.6% distribution on policy-related claims.² It is appropriate to use this conservative figure for purposes of recommending an Initial Distribution Rate, and the Commissioner notes that, if EPIX's loss experience develops in conformity with the more favorable scenarios envisioned in TAA's central (\$11.0 million) or low (\$9.6 million) loss and DCC reserve estimates, an ultimate distribution of 80% or more could be possible on policy-related claims. Leslie Aff., ¶ 8.

c. The Company would defer payment of liabilities that would fall within priority classes 4 through 10 in liquidation. See 8 V.S.A. § 7081. It does not appear that EPIX assets would be sufficient to make any distribution to such creditors if the Company were placed in liquidation so deferral of payment during rehabilitation does not place such creditors in a worse position than they would face in liquidation.

Leslie Aff., ¶ 8.

d. When EPIX's claim obligations can be estimated with a high level of confidence, the Rehabilitator will propose to the Court an additional (final) distribution.

² Current liquid estate assets (cash & invested assets) total approximately \$10.7 million. After payment of administrative expenses (the equivalent of Class 1 claims in liquidation) conservatively estimated at \$1.9 million, this would leave \$8.8 million in assets available to pay policy-related claims (the equivalent of Class 3 claims in liquidation). The high (conservative) end of TAA's estimate of EPIX's policy-related exposures is \$13.2 million. Potential distribution can therefore be calculated as follows: \$8.8 million in assets available to pay policy-related claims / \$13.2 million in policy-related claims = 66.6%.

At that time, the Rehabilitator will most likely request that the Court convert this proceeding into a liquidation in order to fix EPIX's obligations and facilitate a final distribution. Leslie Aff., ¶ 9.

WHEREFORE, based on the grounds for rehabilitation set forth above and pursuant to 8 V.S.A. § 7051(1), the Commissioner requests that this Court issue a rehabilitation order:

- (a) Appointing the Commissioner and his successors in office the Rehabilitator of EPIX pursuant to 8 V.S.A. § 7052;
- (b) Directing the Rehabilitator to take immediate control and possession of the assets of EPIX;
- (c) Directing the Rehabilitator to administer the assets of EPIX under the general supervision of the Court;
- (d) Directing the Rehabilitator to implement the Plan of Rehabilitation including: paying all reasonable administrative expenses in full in the ordinary course of business; adjusting and determining policyholder-level claims and other policy-related obligations, and pay such defense and indemnity amounts at the Initial Distribution Rate and otherwise deferring claims below priority Class 3;
- (e) Directing the Rehabilitator to exercise all of his powers and duties under Chapter 145 of Title 8, Vermont Statutes Annotated, as he deems appropriate, including but not limited to:
 - (i) The authority to appoint one or more Special Deputy Rehabilitators, who shall have all the powers and authority of the Rehabilitator granted under Chapter 145 of Title 8, Vermont Statutes Annotated;
 - (ii) The authority to employ such counsel, clerks, assistants and other


- personnel as deemed necessary;
- (iii) The authority pursuant to 8 V.S.A. § 7053(b) to take such action as the Rehabilitator deems necessary or appropriate to reform and revitalize EPIX, including, for example: power to limit or to suspend the issuance of new or renewal policies or to issue or renew policies on terms he deems appropriate; power to pay or to defer payment of claims or other obligations as he deems appropriate; and, the power to enter into, extend, modify or cancel contracts or agreements;
 - (iv) All the powers of the directors, officers and managers, whose authority shall be suspended, except as they are re-delegated by the Rehabilitator;
 - (v) Full power to direct and manage, to hire and discharge employees, and to deal with the property and business of the insurer;
 - (vi) The authority to prepare a plan to reorganize, consolidate, convert, reinsure, merge or otherwise transform EPIX should the Rehabilitator determine it appropriate;
 - (vii) The authority to petition the Court for an order to terminate the Order of Rehabilitation under 8 V.S.A. § 7055;
 - (viii) The power to avoid fraudulent transfers as set forth in 8 V.S.A. §§ 7065 and 7066;
 - (ix) The power to initiate such legal or equitable action in the State of Vermont, in other states and in the federal courts as he deems appropriate to carry out his duties as Rehabilitator;
 - (x) The authority to pay the expenses of this proceeding, including but not

limited to the compensation of special deputies, counsel, clerks, assistants and other personnel and the expenses of taking possession of the insurer, as determined by the Rehabilitator out of the assets of EPIX.

- (f) Enjoining all persons from instituting any suit, action or other proceeding against EPIX, its directors, officers, employees or agents, or against the Rehabilitator, except before this Court or from executing or issuing or causing the execution or issuance of any writ, process, summons, attachment, subpoena, replevin, execution or other proceeding for the purpose of impounding or taking possession of or interfering with any property owned by or in the possession of EPIX, or owned by them and in the possession of any of its directors, officers, employees or agents, or owned by them and in the possession of the Rehabilitator;
- (g) Enjoining the termination of reinsurance agreements on the basis of the entry of the rehabilitation order;
- (h) Requiring accounting to the Court by the Rehabilitator pursuant to 8 V.S.A. § 7052(b) at least semiannually for so long as the rehabilitation order remains in effect;
- (i) Retaining this Court's jurisdiction for purposes of granting such other relief as may be necessary and equitable; and
- (j) Authorizing the Commissioner as Rehabilitator to make further application to this Court for such further relief as is deemed necessary.

Dated at Montpelier, Vermont, this 18th day of February, 2021.

MICHAEL S. PIECIAK, COMMISSIONER,
DEPARTMENT OF FINANCIAL REGULATION

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