

May 13, 2011

Rhode Island Court Approves, For the First Time, a Solvent Insurer's Commutation Plan

Under the laws of the UK and Bermuda, solvent insurance companies that had ceased to write new policies have long been able to implement an expeditious run-off of their businesses through court approved schemes of arrangement. Schemes of arrangement are similar to Chapter 11 reorganization plans under the United States Bankruptcy Code. However, given that insurance companies are ineligible to seek relief under Chapter 11, nothing analogous to schemes of arrangement was available for them in the United States. That changed in 2002, when Rhode Island enacted its Voluntary Restructuring of Solvent Insurers Act (the "Restructuring Act"). The Restructuring Act, which became effective in 2004, permits a solvent commercial insurance or reinsurance company in run-off to propose a plan where it fixes, pays and extinguishes all of its liabilities for past and future claims and then terminates its business.

Even though the legislation is almost a decade old, it was only recently that the first commutation plan was approved by a Rhode Island court. The commutation plan (the "Commutation Plan") was proposed by GTE Reinsurance Company Ltd ("GTE RE"), a company that has been in run-off and has not written any new policies since 1990. The Commutation Plan sought to estimate unliquidated claims, primarily arising from property and casualty reinsurance, and to pay those claims. The Commutation Plan was challenged in court by several related creditors of GTE RE ("Objecting Creditors"), who argued that the Restructuring Act violated the United States and Rhode Island Constitutions. In a 44-page decision, the Honorable Michael A. Silverstein of the Rhode Island Superior Court, rejected the challenge and ruled that the Commutation Plan could become effective. [In Re GTE RE](#), C.A. No. PB 10-3777 (R.I. Super. Ct. Apr. 25, 2011). On April 27, 2011, Judge Silverstein entered an Implementation Order for the Commutation Plan. On May 2, 2011, the Objecting Creditors filed a notice of appeal from the Implementation Order.

FACTS

GTE RE originally was a Bermuda reinsurer and a wholly owned subsidiary of GTE Corporation. GTE RE reinsured third party property and casualty risks, but in 1990, it ceased writing new business and went into run-off. GTE RE redomesticated to Vermont in 1994 and to Rhode Island on June 24, 2010.

On June 28, 2010, GTE RE filed a petition for implementation of the Commutation Plan under the Restructuring Act and its implementing regulation, Rhode Island Insurance Regulation 68. Under the Commutation Plan, GTE RE would make lump sum payments to reinsureds based upon actuarially determined values. GTE RE will not have any remaining obligations to its cedent creditors after completion of the Commutation Plan. Andrew Rothseid, Principal, RunOff Re.Solve LLC, acted as the Commutation Plan Advisor.

On July 21, 2010, the Rhode Island Court granted GTE RE's motion to convene a meeting of creditors. At the meeting of creditors, the requisite majorities of creditors approved the Commutation Plan. On December 2, 2010, GTE RE filed its motion for an order confirming the vote of creditors and implementing the Commutation Plan. In response, the Objecting Creditors that voted against the Commutation Plan filed objections with the Rhode Island Court.

THE COURT DECISION

The Objecting Creditors challenged the constitutionality of the Commutation Plan and the Restructuring Act. In particular, they argued that both violate the Contract and Due Process Clauses of the United States and Rhode Island Constitutions. In general, the Contract Clause limits a State's ability to impair contractual obligations and the Due Process Clause prohibits a State from "retroactively and unreasonably" impairing substantive rights.

The Objecting Creditors principally argued that the Commutation Plan substantially impaired their contract rights by abrogating GTE RE's obligation to indemnify them for the actual value of all their present and future claims under their reinsurance contracts with GTE RE. In rejecting this challenge, the Rhode Island Court noted that insurance is a contract for the right to receive payment when a claim arises. Under the Commutation Plan, the Objecting Creditors would still receive payment of their claims under the contracts. "Put simply, the [Objecting Creditors] contracted for the payment of money, and under the Commutation Plan, that is exactly the benefit they will receive." According to the Rhode Island Court, an actuarial-based estimated payout of claims did not, as argued by the Objecting Creditors, substantially impair their contractual rights or expectations. Indeed, the Rhode Island Court held that the evidence did not establish that the Objecting Creditors would receive less than the total payments they would receive if GTE RE had continued its run-off. Therefore, the Rhode Island Court concluded that the Commutation Plan did not substantially impair the Objecting Creditors' contractual rights.

The Objecting Creditors further argued that the Restructuring Act and the Commutation Plan impaired their contractual rights by abrogating the arbitration and choice of law provisions in the contracts. The Rhode Island Court disagreed. In particular, the Rhode Island Court found that these provisions were not a "central undertaking" or "substantial inducement" and therefore any alteration thereof would not rise to the level of substantial impairment. The Rhode Island Court also found that (i) the Commutation Plan's dispute resolution mechanism protected the Objecting Creditors' rights and (ii) the Commutation Plan's choice of law provision was limited to disputes arising under the Commutation Plan and choice of law provisions contained in the contracts themselves were preserved.

The Rhode Island Court concluded that any impairment of the contracts was foreseeable given that the insurance industry in the United States is highly regulated and, therefore, state regulation of contract rights is foreseeable. Moreover, when GTE RE entered into the contracts with the Objecting Creditors in the 1980s, it was a Bermuda company. According to the Rhode Island Court, a Bermuda solvent insurer could have implemented a scheme of arrangement under the Bermuda Companies Act in effect in the 1980s. Therefore, a Bermuda solvent scheme of arrangement was reasonably foreseeable by GTE RE's reinsureds.

The Rhode Island Court upheld the constitutionality of the Commutation Plan and the Restructuring Act for two additional reasons. First, the Restructuring Act served the legitimate public purposes of promoting Rhode Island's economy by attracting segments of the insurance industry to Rhode Island. Second, the Restructuring Act is a reasonable and necessary means to address the run-off of solvent insurers, which is "a legitimate public purpose."

In addition, the Rhode Island Court rejected the Objecting Creditors' due process clause challenges noting that the Restructuring Act provides insureds with adequate notice and sufficient safeguards to protect their property.

CONCLUSION

Rhode Island is the only State that allows a solvent run-off commercial insurer or reinsurer to implement a commutation plan strikingly similar to a solvent scheme of arrangement under English and Bermuda law. A commutation plan may be proposed only by a Rhode Island domiciled commercial run-off insurer or reinsurer writing property and casualty lines of business (workers compensation, life and personal lines are ineligible for application of the Restructuring Act).

DISCLAIMER

Chadbourne & Parke LLP acted as a legal advisor to GTE RE regarding the Commutation Plan but did not represent GTE RE in connection with the Objecting Creditors.

For Additional Information

Our client alerts are for general informational purposes and should not be regarded as legal advice or expressing any view of any of Chadbourne & Parke's clients. If you would like additional information or have questions, please contact:

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