

THE DILEMMA OF INSURANCE RECEIVERS IN WINDING UP ESTATES WHERE FEDERAL GOVERNMENT CLAIMS IT IS NOT BARRED BY STATE RECEIVERSHIP LAWS

John J. Partridge, Esq.
(617) 342-7361

The purpose of this article is to examine the dilemma faced by insurance receivers in the First Circuit, as well as others similarly situated, in light of the discrepancy between federal and state law regarding filing deadlines for claims in insurance liquidation proceedings.

According to First Circuit precedent, the federal government is exempt from state law deadlines for filing claims in insurance liquidation proceedings.¹ This exemption creates uncertainty for state insurance receivers seeking to wind up estates as the receiver may be personally liable for any claims filed by the federal government once the estate is closed pursuant to the Federal Priority in Claims Act.² The Act accords a first priority to claims of the United States in insolvency cases not arising under Title 11 of the Federal Bankruptcy Code³. This has led to the dilemma faced by insurance receivers in the First Circuit as to how to terminate a receivership where the federal government claims it has an open-ended exemption from state deadlines for filing claims.

Federal v. State Law and Analysis:

As can be plainly seen, the Federal Priority in Claims Act gives first priority to the United States for its claims against an insolvent insurance company's estate.⁴ The United States Supreme Court held in *United States Department of Treasury v. Fabe* that the Federal Priority in Claims Act superceded a state statute governing priorities in an insurance company liquidation.⁵ In that case, the United States Supreme Court upheld the priority for policyholders and for administrative expenses, holding that these provisions fit within the interests protected by the McCarran-Ferguson Act, but declined to give priority to the claims of employees and general creditors holding that these claims did not fall within the regulation of the business of insurance.⁶ The Court found that a state statute establishing the priority of creditors' claims in a proceeding to liquidate an insolvent insurance company is not a law enacted for the purpose of regulating the business of insurance within the meaning of the McCarran-Ferguson Act, which provides that no Act of Congress, except one relating to the business of insurance, shall be construed to supercede a State law enacted for the purpose of regulating the business of insurance.⁷

The First Circuit, relying on the Supreme Court's decision in *Fabe*, extended the conclusion in *Garcia* in concluding that only those provisions in state liquidation statutes that regulate policyholders fall within the McCarran-Ferguson Act's definition of a law regulating the business of insurance, and that a state filing deadline related priority provision in insurance liquidation proceedings was preempted by the Federal Priority in Claims Act.⁸ The decision in *Garcia* provided the basis for its decision in *Ruthardt v. U.S.*⁹, wherein the First Circuit held that consistent with its decision in *Garcia*, state statutes of limitations for filing claims are not necessary for the protection of policyholders and thus are not safe from preemption under McCarran-Ferguson.¹⁰ It noted that "an early bar date for United States claims has only a limited effect on policyholders – who have priority anyway – and equally or primarily helps other general creditors."¹¹ Thus, the First Circuit held that *Garcia* correctly applied *Fabe*, but noted that despite the fact that it was bound by these holdings, it felt that open-ended exemptions are "terrible public policy."¹² The *Ruthardt* decision has fueled much controversy among insurance regulators and practitioners bound by First Circuit precedent.

This indefinite exemption from the filing deadline is of course subject to other federal statutes of limitations as noted by the First Circuit in *Ruthardt*.¹³ For example, 28 U.S.C. §2415 (2000) provides a general six-year statute of limitations for contract-based actions for money damages brought by the United States and 26 U.S.C. §6501 (2000) provides for a three-year statute of limitations on income taxes.¹⁴ Despite the foregoing statutes of limitations, however, insurance receivers may be hesitant to rely upon such statutes, especially if the receiver is unaware of any undiscovered and/or unasserted claims of the United States.¹⁵ Thus, the First Circuit advocated for a uniform limit.¹⁶

Based on the foregoing, and in light of the First Circuit’s call for a uniform limit on statutes of limitations for claims in insurance liquidation proceedings, we need to have a mechanism whereby a state insurance receiver is not forced to keep an estate open for fear of personal liability in the event a federal claim is brought once the estate is closed. Receivers are in dire need of a federal legislative solution, like the exemption afforded for ordinary bankruptcies in the Federal Priority in Claims Act. The United States Supreme Court recently denied certiorari in the *Ruthardt* case, thus a solution outside of the courts is needed.¹⁷

While only the First Circuit continues to be bound by its precedent, a solution for a state insurance receiver seeking to close an estate would be to enter into some sort of binding resolution with the federal government with respect to claims it may have against the estate in the future. This could be done via court order, but would consume time and money. Alternatively, the receiver and the federal government could also agree to limit the liability of the receiver to his/her professional rather than individual capacity. This, however, would necessitate having to have a fund available from which to pay claims of the United States should they arise in the future. Clearly, the most effective solution would come from Congress via an exemption similar to the one afforded in bankruptcies under the Federal Priority in Claims Act. Congress could decide to put a time limit on the period within which the United States must file its claims, perhaps give them a bit more than a year, but not forever, consistent with the suggestion by the First Circuit.¹⁸

The First Circuit succinctly stated the dilemma when it wrote that “giving the United States an open-ended exemption from deadlines is (in the liquidation context) simply terrible public policy and was almost certainly not the result of any considered judgment by Congress.”¹⁹ One must bear in mind that this dilemma is not limited to the First Circuit, since the issue has not been resolved in other jurisdictions. Clearly, we need to take heed of this problem and seek a legislative resolution from Congress to alleviate the uncertainty faced by receivers who fear personal liability for claims of the federal government when seeking to close an estate. Failure to resolve this issue will not only create chaos as many insurance receivers will likely refuse to close an estate for fear of personal liability, but will also be a nagging issue for those who do decide to close an estate.

* My associate, Christine E. Burke, provided additional editorial research for this article.

¹ See *Ruthardt v. U.S.*, 303 F.3d 375 (1st Cir. 2002).

² See 31 U.S.C. §3713.

³ See *id.*

⁴ See *id.*

⁵ See *United States Department of Treasury v. Fabe*, 508 U.S. 491, 113 S.Ct. 2202, 124 L.Ed.2d 449 (1993).

⁶ See *id.*

⁷ See *id.* at 493, quoting 15 U.S.C. §1012(b).

⁸ See *Garcia v. Island Program Designer, Inc.*, 4 F.3d 57 (1st Cir. 1993).

⁹ 303 F.3d 375 (1st Cir. 2002).

¹⁰ See *Ruthardt* at 384.

¹¹ *Id.* at 385

¹² *Id.*

¹³ See *id.*

¹⁴ See *id.*

¹⁵ See *id.*

¹⁶ See *id.*

¹⁷ See 123 S.Ct. 2072 (2003).

¹⁸ See *Ruthardt* at 385.

¹⁹ See *id.*