

BY WILLIAM P. SCHMITZ, JR.

# Recovering for Your P.I. Client Despite Insurance Company Insolvency

The company insuring the defendant in your client's lawsuit has filed for bankruptcy – now what do you do? This article describes important steps you need to take to assure that your client gets the highest possible recovery.



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**IN ILLINOIS' MANDATORY INSURANCE SYSTEM, A PLETHORA OF COMPANIES** are capitalizing on demand for reliable insurance coverage. Most companies are reputable and operate in good faith to meet the needs of policyholders and other claimants.

During the past few decades, however, Illinois consumers, tort victims, creditors, and attorneys have faced recurring difficulties with some insurance companies. This article surveys the increase in insurance company insolvencies in recent years and provides guidance for attorneys on how to proceed after receiving a notice of liquidation.

### Insurance company insolvency in Illinois

Although occasional insolvencies are inevitable in a volatile free market, insurance company financial meltdowns in Illinois have become all too common over the past 20 years.<sup>1</sup> From 1987 to 1997, not a single major insurance company declared bankruptcy in Illinois.<sup>2</sup> Since that time, more than 40 insurance companies have been declared insolvent, including the likes of Gallant, Legion, PHICO, Reliance, and Valor.<sup>3</sup>

At first glance, this might seem to be the result of unfortunate events or harsh economic times. Yet the underlying story is less about external circumstances and more about industry practices. Time and time again, certain insurance companies have formed, targeted especially risky consumers, collected payments from policyholders, and then filed for liquidation when faced with a sizeable claim.

In other words, segments of the insurance industry continue to profit while policyholders, claimants, creditors, and their respective attorneys are left grasping at straws. Repeatedly, it is the same song, different verse.<sup>4</sup>

**The rise and fall of affirmative insurance.** A fresh example of this scenario is the rise and fall of Affirmative Insurance Holdings, Inc. (“Affirmative”). According to the company’s website, Affirmative was “a group of insurance companies and underwriting agencies that provide[d] personal automobile insurance policies through a network of independent agents in multiple states.”<sup>5</sup> More specifically, Affirmative provided nonstandard automobile insurance policies in targeted geographic markets, including in Illinois, California, and Texas.<sup>6</sup>

Affirmative started doing business in 1998, selling nonstandard auto insurance through its website and call center. Affirmative then experienced a period of expansion from 2001 to 2003 by focusing on underwriting and retail agency operations and working closely with its largest stockholder, Vesta Insurance Group.

In 2007, Affirmative then acquired the US-Agencies Insurance companies. As of September 2015, Affirmative was licensed in 13 states and continued to offer only one insurance product: nonstandard auto insurance.<sup>7</sup>

**Nonstandard insurance.** As background for those unfamiliar with the distinction between standard and nonstandard insurance, it is largely tied to the level of risk associated with a given policy holder. Standard insurance is what most individuals carry and is available to the majority of consumers, whom insurance companies consider to have manageable levels of risk.

1. See Illinois Insurance Guaranty Fund, *Insolvencies*, <http://igf.ncigf.org/insolvencies> (last visited Mar. 21, 2018).

2. See *id.*

3. *Id.*

4. See *id.*

5. Affirmative, <https://www.affirmative.com/> (last visited Mar. 21, 2018).

6. *Affirmative Insurance Holdings Inc.*, Bloomberg Law, [https://www.bloomberglaw.com/company/ticker/AFFMQ\\_US\\_Equity](https://www.bloomberglaw.com/company/ticker/AFFMQ_US_Equity) (last visited Aug. 6, 2017).

7. *Affirmative Insurance Holdings to Acquire USAgencies*, Insurance Journal (Oct. 18, 2006), <http://www.insurancejournal.com/news/southcentral/2006/10/18/73386.htm>.

### TAKEAWAYS >>

- Nonstandard insurance products are typically only for consumers who fall outside the “low risk” category. Those resorting to non-standard insurance often have a history of poor credit, multiple traffic violations, numerous accidents, DUI convictions, or other blemishes on their record disqualifying them from obtaining standard insurance.

- If you encounter an insurance company insolvency during litigation, it is imperative that you ensure clients are given the best chance of being compensated for their claims. It is important to follow bankruptcy rules, file a motion to lift the automatic stay, and file a proof of claim.

- After pursuing a claim in bankruptcy court, you should file a claim with the Illinois Insurance Guarantee Fund, remaining cognizant of the responsibility to first pursue alternative means of recovery.

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Because nonstandard insurance policyholders are inherently riskier to insure, the terms of their policies are often far less favorable than those of standard insurance policies. Likewise, their premiums are often far greater.

By offering only nonstandard insurance, Affirmative and similar companies in effect target consumers with few other options and capitalize on their vulnerability. Furthermore, they do business with the very same consumers statistically most likely to cause accidents, increasing the frequency of insurance claims. It is all but inevitable that companies offering nonstandard

insurance will face claims for substantial sums. When it came time for Affirmative to pay out, it proceeded as many of its predecessors have — it filed for bankruptcy.

**Insolvency declared.** On September 16, 2015, an agreed order of rehabilitation was entered against Affirmative.<sup>8</sup> On October 14, 2015, Affirmative and seven affiliates filed for relief under Chapter 11 of the Bankruptcy Code.<sup>9</sup> On March 1, 2016, Affirmative’s court appointed rehabilitator reported an insolvency in excess of \$30 million.

Soon after, a complaint for liquidation with a finding of insolvency was filed with the Illinois Supervising Court. A moratorium was then placed on any further claim payments, including the return of unearned premiums. Ultimately, Affirmative was put into liquidation by order of the Circuit Court of Cook County on March 24, 2016.

### What to do after receiving a notice of liquidation

An insurance company filing for liquidation during the course of litigation is an increasingly prevalent issue facing Illinois trial lawyers. When confronted with such an obstacle, some attorneys might be unsure what to do next. This section surveys some of the options and outlines how to proceed in the face of an insurance company insolvency.

**Step 1: Follow basic procedures in bankruptcy.** First, proceed under bankruptcy rules and attempt to collect from the bankruptcy estate or lift the automatic stay.

**Automatic stay.** Automatic stay is a

bankruptcy protection offered to the debtor against creditors and pending lawsuits. The effect of the automatic stay is threefold.

First, the moment a debtor files a bankruptcy petition, their creditors are forbidden from taking steps to collect debts. Second, the automatic stay suspends pending lawsuits against the debtor. Third, it forbids new lawsuits from being filed against the debtor.

Thus, when Affirmative filed for bankruptcy, the automatic stay went into effect. At the time of filing, all lawsuits against Affirmative were suspended and Affirmative’s creditors were forbidden from attempting to collect whatever Affirmative owed.

**Motion to lift the automatic stay.** When an insurance company files for liquidation during the course of litigation and the automatic stay goes into effect, an attorney whose client has a pending claim against the insurance company should file a motion to lift it. Bankruptcy courts might lift the automatic stay if an attorney can prove a company filed for bankruptcy in bad faith.

For example, the bankruptcy court might lift the automatic stay if it can be shown the insurance company only filed for bankruptcy to avoid going to trial in a specific suit where the claimant would likely be awarded a large sum. Once the stay is lifted, the claimant would be free to litigate or collect on the insurance company’s debts without violation of the bankruptcy rules or fear of a countersuit.

**Proof of claim.** Aside from filing a motion to lift the automatic stay, always be sure to file a timely proof of claim with the bankruptcy court. Doing so will protect your clients’ chances, however slim, of receiving money from the bankruptcy

### ISBA RESOURCES >>

- Christopher B. Lega, *Protecting Settling Plaintiffs When a Defendant Goes Bankrupt*, 101 Ill. B.J. 200 (Apr. 2013), <https://www.isba.org/ibj/2013/04/protectingsettlingplaintiffswheneade>.
- Marlene A. Kurilla & Melissa A. King, *Insuring Against Insolvent Insurers: The Illinois Insurance Guaranty Fund*, 91 Ill. B.J. 560 (Nov. 2003), <https://www.isba.org/ibj/2003/11/insuringagainstinolventinsurersthe>.

8. Office of the Special Deputy Receiver, *Affirmative Insurance Company* (“Affirmative”), <http://www.osdchi.com/open/affirmative.htm> (last visited Mar. 21, 2018).

9. L. John Bird, *Affirmative Insurance Holdings, Inc. Files for Bankruptcy – 341 and Formation Meetings Scheduled*, Fox Rothschild, <https://delawarebankruptcy.foxrothschild.com/2015/10/articles/bankruptcy-case-summary/affirmative-insurance-holdings-inc-files-for-bankruptcy-341-and-formation-meetings-scheduled/>.

estate. Any party that has an existing claim against an insurer at the time they received a notice of liquidation can protect their interests by filing a proof of claim by the claims filing deadline.

**Non-dischargeable debts.** Lastly, attorneys should keep an eye out for non-dischargeable debts after liquidation is complete. When a defendant's bankruptcy case has concluded, most debts and liabilities owed by the company are wiped clean through a bankruptcy discharge. If a lawsuit is discharged through bankruptcy, aggrieved parties may not continue the suit and no debts may be collected.

There is an exception, however, if a lawsuit alleges the company caused you willful and malicious injury or committed fraud. In that case, the debt is non-dischargeable, and the claim may survive the bankruptcy.

**Step 2: Illinois Insurance Guaranty Fund.** The biggest problem with seeking recourse in bankruptcy is that there are typically insufficient assets to meet all claims. Consequently, even an attorney who successfully files a proof of claim in bankruptcy may recover little if any of the value of that claim. There is, thankfully, further recourse.

After pursuing a claim in bankruptcy court, attorneys should file a claim with the Illinois Insurance Guaranty Fund ("the IIGF"). The IIGF is a nonprofit association that was created to limit losses arising out of insurer insolvencies.<sup>10</sup>

Any insurance company authorized to transact business in Illinois must be a member the IIGF and make contributions.<sup>11</sup> The IIGF protects covered claims of policyholders and claimants under casualty and property insurance policies issued by member companies.<sup>12</sup> Other than claims for unearned premiums, a covered claim is a "claim which appears on the books and records of the insolvent company as of the date of the Order of Liquidation."<sup>13</sup>

A claim must be filed prior to 18 months after the order of liquidation or before the date set in the liquidation proceedings, whichever is earlier.<sup>14</sup> For example, claims that were on Affirmative's books as of March 24, 2016 were eligible to be filed with the IIGF and had a claims filing deadline of August 27, 2017.<sup>15</sup>

**File a claim.** The IIGF does not require claims be filed in any specific manner,

10. See *Pierre v. Davis*, 165 Ill. App. 3d 759, 760 (1st Dist. 1987).

AN ATTORNEY WHO HOPES TO TAP THE ILLINOIS INSURANCE GUARANTY FUND MUST FIRST EXHAUST ALL OTHER POSSIBLE MEANS OF RECOVERY.

11. *Hasemann v. White*, 177 Ill. 2d 414, 417 (1997).

12. See 215 ILCS 5/534.3.

13. *Id.* at § 5/540.5.

14. *Id.*; see also Illinois Insurance Guarantee Fund, <http://iigf.ncigf.org/insolvencies>.

15. Office of the Special Deputy Receiver, *Affirmative Insurance Company ("Affirmative")*, <http://www.osdchi.com/open/affirmative.htm> (last visited Mar. 21, 2018).

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instead deferring to processes delineated by liquidators.<sup>16</sup> Claimants must fully comply with any procedures established by liquidators for reporting new claims or preserving claims of entitlement in liquidation proceedings. These procedures may include filing a proof of claim using a form specified by the liquidator.

**Limits on recovery from the IIGF**

Although the IIGF can be an effective security blanket, there are limits to full recovery. For an order of liquidation on or after January 1, 2011, there is a \$500,000 limit for most covered claims. For claims to refund unearned premiums, there is a limit of \$10,000, subject to a \$100 deductible. Note, however, there is no limit for worker's compensation claims.

**Alternative source rule.** The IIGF is not an independent source of recovery, it is merely a substitution when expected coverage ceases to exist due to insurer insolvency.<sup>17</sup> Consequently, if a claimant

has an alternative means of recovery, including an uninsured motorist policy, the claimant must first exhaust their rights under that policy before being entitled to any payments from the IIGF.<sup>18</sup> Furthermore, both the IIGF and the insured under an insolvent company's policy are entitled to have their obligations to a claimant reduced by the amount recovered or recoverable, whichever is greater, under the other insurance policy.


For example, an attorney with a claim resulting from an insolvency who plans to file with the IIGF must first exhaust all other possible means of recovery. This would include a duty to seek recovery under a client's uninsured motorist policy.

If an attorney fails to pursue an uninsured motorist claim in a timely manner, or settles an uninsured motorist claim for less than the limits of coverage, the IIGF and the insurance company would be entitled to deduct the full

amount of the uninsured motorist limits from any obligations otherwise owed to the attorney's client.

**Conclusion**

Insurance company insolvency can stymie claimants' efforts to get the money to which they are entitled. If you face insolvency during your lawsuit, it is imperative that you take the right steps to ensure the fullest possible recovery.

First, you must follow bankruptcy rules, file a motion to lift the automatic stay, and file a proof of claim. Second, you should file a claim with the Illinois Insurance Guarantee Fund, being aware of your responsibility to pursue alternative means of recovery first. 

16. See Illinois Insurance Guarantee Fund, <http://iigf.ncigf.org/insolvencies>.

17. See *Gines v. Ivy*, 358 Ill. App. 3d 607, 609 (5th Dist. 2005).

18. 215 ILCS 5/546(a).

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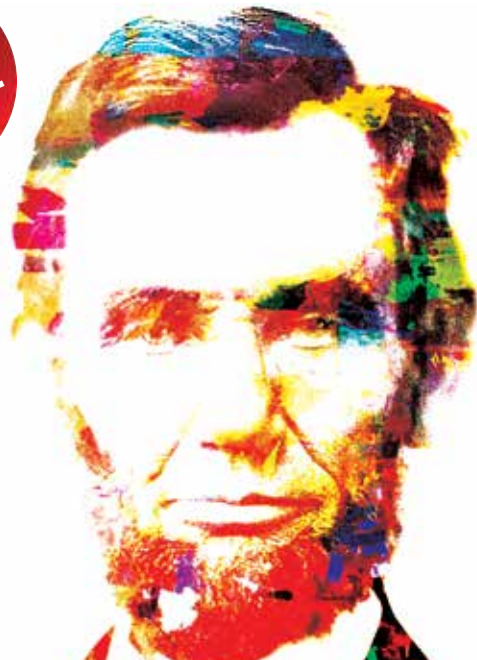
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