Health Care Committee

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Bankruptcy Court Recognizes the Doctrine of Reverse Preemption

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In *In re Medical Care Management Co.*, 361 B.R. 863 (Bankr. M.D. Tenn. 2003) ("*Medical*"), the United States Bankruptcy Court for the Middle District of Tennessee (the "Bankruptcy Court") recognized and applied the seldom-invoked doctrine of reverse preemption.[1] In *Medical*, the Bankruptcy Court interpreted that doctrine, in concert with the McCarran-Ferguson Act, 15 U.S.C. §1012(b) ("§ 1012(b)") to mean that, notwithstanding Congress' enactment of the Bankruptcy Code and the concomitant bestowal of jurisdiction over the subject of bankruptcy on the federal courts, bankruptcy courts are to defer the exercise of jurisdiction to state courts in matters requiring the interpretation and application of state laws concerning the business of insurance.

In the broadest sense, under the doctrine of reverse preemption, even where Congress bestows exclusive federal jurisdiction over a certain subject (such as bankruptcy), federal courts must yield their jurisdiction over that subject where: (i) state law expressly and comprehensively regulates the subject and (ii) a federal statute provides that the federal jurisdiction is to yield to the state jurisdiction and statutory scheme.[2]

I. Facts in *Medical*

In *Medical*, Tennessee Consolidated Network ("TCCN"), which was operated by two affiliates, Medical Care Management Company and Access Health Systems, Inc. (collectively, the "Affiliates"), was a nonprofit Tennessee corporation and a holder of a certificate of authority from the Tennessee Department of Commerce and Insurance (the "Department") to operate as a domestic health-maintenance organization ("HMO"). Under Tennessee law, the Department regulates insurance providers, including HMO's, operating in Tennessee. 361 B.R. at 866.

Due to concerns over the financial viability of TCCN and the Affiliates, the Department placed TCCN under administrative supervision. While under such supervision, without prior written authorization from the Department, TCCN could not make any disbursements, withdrawal any of its bank accounts or transfer any of its property or assets. *Id.* at 867. Nevertheless, without obtaining the necessary Department approval, TCCN attempted to make a material monetary withdrawal from one of its bank accounts and to transfer the proceeds to one of the Affiliates. In

response, the Department instituted judicial proceedings in the Tennessee state court with jurisdiction over insurance companies to seize TCCN. The disputed funds ("Disputed Funds") remained in TCCN's bank account and were not transferred to the Affiliate. While the state court proceeding was pending, the Affiliates filed chapter 11 petitions. To permit the state court proceedings to continue (including proceedings to set aside any preferentail transfers by TCCN to the Affiliates), the Department, invoking the doctrine of reverse preemption and §1012(b), filed a motion with the Bankruptcy Court seeking, among other relief, to lift the automatic stay. The Affiliates and the Affiliates' unsecured creditors' committees ("Committees") opposed same.

II. Analysis

1. Abstention

The Department also requested that Bankruptcy Court abstain. The court rejected that request as premature, because there was, at that time, no pending litigation before the Bankruptcy Court from which it could abstain. *Id.* at 869.

2. Stay Relief

In considering the Department's request for stay relief, the Bankruptcy Court initially focused upon whether the Disputed Funds were property of either of the Affiliates' bankruptcy estates. The Affiliates and the Committee argued that, under a broad definition of property of the estate, the court was not permitted by 28 U.S.C. §1334(e)(1)[3] to delegate to a state court jurisdiction over a debtor's property.

Relying on *In re Noletto*, 244 B.R. 845 (Bankr. S.D. Ala. 2000), which was followed by the Sixth Circuit[4] in *Blachy v. Butcher*, 221 F. 3d 896 (6th Cir. 2000), however, the Bankruptcy Court held that because 28 U.S.C. §§1334(c) and 1334(d) permit a bankruptcy court or district court to abstain from adjudicating a matter altogether in deference to state law considerations, the way to balance the various provisions of §1334 is to recognize that jurisdiction over the determination of whether an asset constitutes property of a bankruptcy estate can be shared between a state court and either a bankruptcy or district court. *Id*, at 869-70. However, the distribution of estate property falls solely within the jurisdiction of the bankruptcy or district court. *Id.* at 869.

The nub of the stay motion was whether cause existed under 11 U.S.C. §362(d)(1) to lift the stay to allow the pending Tennesee state court to determine the ownership of the Disputed Funds in the pending state proceeding. The Bankruptcy Court found guidance on that issue in *In re White*, 851 B.R. 170 (6th Cir. 1988), a divorce proceeding. There, the Sixth Circuit recognized the keen interest of states in domestic relations matters, "much like their interest in the regulation of insurance companies." *Medical*, 361 B.R. at 869. *White* held that a bankruptcy court could suspend jurisdiction over a case in deference to pending state proceedings to determine the debtor's interest in a marital estate. *Medical, id.* at 870, *citing White*, 851 F.2d at 173-74. As the Bankruptcy Code does not define a debtor's interest in property, that must be decided by reference to state law. *Medical, id.* Also, *White* rejected that debtor's argument that a bankruptcy court may never give up its jurisdiction for any reason, even for a limited purpose. *Id*. at 870.

Relying on *White*, the Bankruptcy Court reasoned that one cause for lifting the stay is to allow a state court to adjudicate property rights under state laws. *Id.* The focus for the Bankruptcy Court, therefore, became whether the need to determine property rights in the Disputed Funds under Tennessee insurance law provided a cause for the relief from the automatic stay similar to the cause found by the Sixth Circuit in White, where the Sixth Circuit was faced with a need to determine rights to marital assets under applicable state law. *Id*. In answering that question, the Bankruptcy Court next looked to the McCarren-Ferguson Act, particularly to § 1012(b).

3. The McCarran-Ferguson Act

A. Overview

In pertinent part, §1012(b) provides: "No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance … unless such Act specifically relates to the business of insurance."

According to the Department, the comprehensive regulatory scheme created under the Tennessee insurance laws for the regulation of domestic insurance companies and their rehabilitation and insolvency in particular provided cause to lift the stay – especially since the Bankruptcy Code does not purport to regulate insurance companies. *Id.* at 871. Indeed, the Bankruptcy Court note that 11 U.S.C. §109(b)(2) expressly prohibits a domestic insurance company from filing for chapter 7: "[a] person may be a debtor under Chapter 7 … only if such person is not … a domestic insurance company." *Id*. at 871, n. 3.

Next, the court recognized the long-standing federal deference to the state regulation of domestic insurance companies that began long before the 1945 enactment of the McCarren-Ferguson Act. *See* the Supreme Court's 1868 opinion *Paul v. Virginia*, 75 U.S. 168 (1868) (regulation of domestic insurance companies, especially administrative proceedings involving insolvent ones, is left to state laws). In *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), the Supreme Court overruled *Paul v. Virginia,* concluding that the policy enunciated therein constituted an unconstitutional violation of Congress' power to regulate interstate commerce. Congress swiftly reacted to *South-Eastern Underwriters* in 1945 by enacting the McCarren-Ferguson Act, thereby granting states the exclusive jurisdiction to regulate domestic insurance companies. *See* 15 U.S.C. §1012(a) ("the business of insurance … shall be subject to the laws of the several states"). Thus "[the McCarren-Ferguson Act represents a strong federal policy of deference to the states in matters relating to insurance." *Id.* at 871 (citations omitted).

In *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993), the Supreme Court revisited the application of reverse preemption in a case involving the McCarren-Ferguson Act. Because the Bankruptcy Code does not specifically relate to the business of insurance, under *Fabe*, there are two questions must be answered in the affirmative as a condition to the application of the doctrine of reverse preemption: (i) whether the state insurance statutes regulate the business of insurance and (ii) would application of the Bankruptcy Code invalidate, impair or supercede such state laws. *Id.* at 871-72.

B. The Tennessee Laws Regulated the Insurance of Business

The key to *Fabe* was that if the state law protects or regulates either directly or indirectly the relationship between an insurance provider and its policyholders, including but not limited to, by providing a priority scheme for the liquidation of an insurance company, then the state law regulates the business of insurance under §1012(b). *Id.* at 872–73. The Ohio statutes involved in *Fabe*, including those providing for the liquidation of insurance companies, were found to "regulate the business of insurance." *Id.* at 872.

By way of contrast, in *Int'l Ins. Co. v. Duryee*, 96 F. 3d 837 (6th Cir. 1996), the Sixth Circuit held that the statute at issue (aimed solely to establish a convenient forum) was not part of a comprehensive statutory scheme aimed at the monitoring, finances, rehabilitation and orderly liquidation of insurance companies. *Id*. at 873-74. The statute analyzed in *Duryee* starkly contrasted with the Tennessee statutes scrutinized by the Court in *Medical*. *Id.* at 873.

After analyzing *Fabe* and *Duryee*, the Bankruptcy Court reviewed the state insurance statutes involved in numerous §1012(b) cases that held that the doctrine of reverse preemption was applicable. The major factor in those cases was the existence of a comprehensive statutory scheme for an orderly liquidation of an insurer's assets in a single state court – with the goals of maximizing returns for policy holders, equal treatment for claimants and/or minimizing costs to the insolvent insurance companies. *Id.* at 873-74. In these cases, "state jurisdictional statutes were deemed to regulate the business of insurance and were found to reverse-preempt nonbankruptcy federal jurisdictional statutes." *Id.* at 874.

The Bankruptcy Court then analyzed cases in which bankruptcy courts held that federal bankruptcy jurisdiction under 28 U.S.C. §1334(e) must yield to state court adjudications under §1012(b) where there were comprehensive state statutory schemes enacted to regulate the business of domestic insurance companies in their states: *In re Amwest Ins. Group Inc.*, 285 B.R. 447 (Bankr. C.D. Cal. 2002); and *In re Advanced Cellular Sys.*, 235 B.R. 713 (Bankr. D. P.R. 1999).[5] *Amwest* involved a dispute between a debtor insurance company and a state-appointed insurance liquidator over a tax refund. There the court reviewed the state insurance laws and concluded that they regulated the registration and appraisal of tax allocation agreements and therefore protected policy holders. Consequently, §1012(b) preempted the court from determining ownership of the tax refund. *Id.* at 874-75. In *Advanced*, the court reviewed the state insurance laws, found them to be comprehensive, and gave the "state liquidator jurisdiction over everything related to the insolvent insurance company." *id.* at 874. For that reason, the court declined to decide whether the debtor insurer had property rights in a certificate of deposit. *Id*.

Turning to the Tennessee insurance laws governing HMO's, the Bankruptcy Court concluded that they too, under standards set forth in *Fabe*, constituted a comprehensive statutory scheme for the regulation of the business of insurance. *Id*. at 875. The plain language of these Tennessee laws stated that their purpose was to protect the interests of insureds, claimants, creditors and the public. *Id.* This purpose was accomplished through a comprehensive scheme for the rehabilitation and liquidation of insurance companies as part of the regulation of the business of insurance. *Id*. These policies were of vital public interest and concern. *Id*. at 875, n. 7. Further, these statutes provided that a "failing or insolvent insurer's assets can be marshaled, supervised and protected from wasteful litigation in many forums through an orderly and uniform liquidation process." *Id*. at 875. In sum, these statutes were aimed to protect the relationship between policyholders and insurers, and to provide for litigation in one forum – namely, the state court – in an orderly liquidation process. In short, Tennessee had enacted precisely the type of state statutory framework constituting regulating the business of insurance for purposes of §1012(b). *Id.* at 875.

C. Proceeding before the Bankruptcy Court Would Impair the State Statutory Scheme

In the face of the comprehensive Tennessee statutory scheme regulating insolvent HMO's, the Bankruptcy Court readily conceded that any exercise of its jurisdiction would seriously "invalidate, impair or supercede" the grant of exclusive jurisdiction in the HMO statutes to the Tennessee state court. *Id*. at 876. Such would be the result whether the Bankruptcy Court merely continued the automatic stay of §362 in the Affiliates' bankruptcy case or adjudicated the propriety of the "transfer"--and, therefore, the ownership-- of the Disputed Funds. *Id*. Any ruling by the court on the issue of the disputed funds would impinge upon and negate the obvious intent of the Tennessee legislature to consolidate all liquidation proceedings in one special Tennessee court. *Id.* at 876.

D. Cause Existed to Lift Stay Independent of §1012(b)

The Bankruptcy Court found additional cause--independent of § 1012(b)--to lift the automatic stay. The Bankruptcy Court concluded that concerns underlying the doctrine of comity, which were similar to those warranting abstention (not present here as there was no pending matter before the court) were present. *Id*. at 877. On the issue of comity, the court noted the Fourth Circuit in *In re Robbins*, 964 F. 2d 342 (4th Cir. 1992), which approved the deferral of a divorce dispute between spouses over the distribution of marital property to a state domestic relations court. *Robbins* court found that the subject of domestic relations matters, and particularly the ownership of marital property, belongs to "the laws of the States, and not of the laws of the United States". *Id.* at 877.

The Bankruptcy Court also noted how judicial economy would be promoted if it did not adjudicate the Disputed Funds. *Id*. at 878. Through the pending state law proceeding, Tennessee state court had already become familiar with the tortured history of the dispute between the Department and TCCN and its Affiliates over the supervision and liquidation of TCCN. By contrast, to adjudicate the dispute, the Bankruptcy Court would have to familiarize itself with the facts and to interpret and apply the state insurance statutes – tasks already begun by the Tennessee court. *Id.* at 878.

Finally, litigation before the Tennessee state court would not harm the estates or creditors of the Affiliates because ownership of the disputed funds and whether their transfer was valid had to be adjudicated pursuant to the Tennessee insurance statutes. *Id*. Bankruptcy trustees appointed for the Affiliates were entitled to appear before the Tennessee state court. If it were decided that the disputed funds properly belong to the debtor, then they could be distributed pursuant to the priority scheme provided under the Bankruptcy Code. Collection of damages awarded to the department by the Tennessee state court would have to be brought before the court via the claims process. For those reasons, the court concluded that it could find no harm to the estate by granting stay relief for the pending litigation to proceed before the Tennessee state court. *Id.* at 878-79.

III. CONCLUSION

Medical is an important decision for both the bankruptcy and insurance bars, especially those members of those bars that handle healthcare issues, addressing the seldom-invoked doctrine of reverse preemption.

FOOTNOTES

1. Other bankruptcy courts have recognized and applied the doctrine of reverse preemption. *See In re PRS Ins. Group Inc.*, 294 B.R. 609 (Bankr. D. Del. 2003) (bankruptcy court lacked jurisdiction to adjudicate preference and fraudulent conveyance claims involving debtor insurance company); *In re Amwest Ins. Group Inc.*, 285 B.R. 447 (Bankr. C.D. Cal. 2002) (discussed in text, above); and *In re Advanced Cellular Sys.*, 235 B.R. 713 (Bankr. D. P.R. 1999) (discussed in text, above). *Medical* cited *Amwest* and *Advanced* as authorities. *PRS* was published after *Medical* was decided.

2. Outside the context of domestic insurance companies, there are other examples of the application of the doctrine of reverse preemption, for example, in the context of public utilities. In that regard, the Federal Communications Commission (FCC) regulates *inter*state telephone service. *See* 47 U.S.C. §152(a) ("this chapter shall apply to all interstate … communications … which originates and/or is received within the United States"). "[C]harges, classifications, practices, services, facilities, or regulation for in connection with intrastate communication services by wire or radio of any carrier;" 47 U.S.C. §152(b)(1); *e.g.*, billing and termination practices. These matters are not within the jurisdiction of the FCC, rather, they belong within the jurisdiction of state utility commissions. *Texas Office of Pub. Util. v. FCC*, 183 F. 3d 393, 421-25 (5th Cir. 1999).

Reverse preemption also applies to electric and natural gas utilities. For example, Congress created the predecessor to the Federal Energy Regulatory Commission ("FERC") to regulate the interstate transmission of electricity and natural gas, but reserved the regulation of intrastate electricity and natural gas to state utility commissions. *See* 16 U.S.C. §§812, 813, and 824; and 15 U.S.C. §§717(b) and 717(c). In that regard, 16 U.S.C. §812 (electricity) provides, in pertinent part: "the jurisdiction of . . . . [FERC over the interstate transmission of electricity] shall cease and determine as to each specific matter of regulation and control prescribed in this section as soon as the State shall have provided a commission or other authority for the regulation and control of that specific matter." Similarly, 15 U.S.C. §717(c) (natural gas) provides, in pertinent part: "[t]he provisions of this chapter shall not apply to [a] person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State."

3. 28 U.S.C. §1334(e)(1) provides, in pertinent part that, "[t]he district court … shall have exclusive jurisdiction of all of the property … of the debtor … and of property of the estate."

4. Tennessee is within the Sixth Circuit Court of Appeals.

5. *See also PRS*, 294 B.R. 609, cited above in Note 1.