COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
CASE NO. 2008-SC-000381-TG

GALLATIN HEALTHCARE, LLC, ET AL., *Appellants*

v.

SHARON CLARK, IN HER OFFICIAL CAPACITY AS COMMISSIONER FOR THE KENTUCKY DEPARTMENT OF INSURANCE AND REHABILITATOR OF AIK COMP, *Appellee*

On Appeal from the Franklin Circuit Court
Civil Action Nos. 04-CI-1067
Transferred from Court of Appeals No. 2008CA000945

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Officers and Trustees of AIK Comp, through counsel, are named signatories to this Appellees Brief because they fully support the Rehabilitator's statement of the issues before the Court and the position that the Franklin Circuit Court's Order of April 17, 2008 approving the Settlement Agreement should be affirmed. Joining in Appellees' Brief is not intended as a waiver of any matters resolved by the Settlement Agreement which are otherwise vigorously contested and undecided by the Franklin Circuit Court.

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of June, 2009, true and accurate copies of this Appellees Brief were served by U.S. Mail upon Sally Jump, Clerk, Franklin Circuit Court, Courthouse, 214 St. Clair Street, P.O. Box 678, Frankfort, Kentucky 40602; the Hon. Thomas D. Wingate, Franklin Circuit Court Judge, 214 St. Clair Street, Courthouse, P.O. Box 378, Frankfort, Kentucky 40602; Samuel Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; J. Guthrie True, 326 West Main Street, Frankfort, Kentucky 40601; Ron Parry, 411 Garrard Street, P.O. Box 2618, Covington, Kentucky 41012-2618; and, Robert W. Bishop, 6520 Glenridge Park, Suite 6, Louisville, Kentucky 40222. I hereby further certify that counsel for Appellees have not withdrawn the record on appeal.

Counsel for Appellee Sharon Clark, Rehabilitator of AIK Comp

STATEMENT CONCERNING ORAL ARGUMENT

Because of the unique nature of the litigation, Appellee believes that oral argument will assist the Court in deciding the issues presented.

COUNTERSTATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION

This case involves an appeal from an Order of the Franklin Circuit Court approving a Settlement Agreement between the Rehabilitator of AIK Comp, and the former officers and trustees of AIK Comp, and their liability insurance carrier, Philadelphia Insurance Company ("PIC"). AIK Comp is a group self insurance fund initially authorized to do business by 803 KAR 25:026. It was placed into rehabilitation on August 4, 2004 pursuant to Kentucky's Insurers Rehabilitation and Liquidation Law, KRS Chapter 304, Subtitle 33 (the "IRLL"). Over a period of twenty-five years AIK Comp had several thousand group members who pooled their liabilities together to insure their worker's compensation liabilities. Appellants are four such members.

At the hearing to approve the settlement, Appellants mounted only a superficial challenge, limited to one procedural and two substantive issues. Appellants' brief makes arguments never advanced to Judge Wingate as objections to the Settlement Agreement. Unsurprisingly, Appellants did not comply with CR 76.12(4)(c)(v), which requires "at the beginning of the argument a statement with reference to the record showing where the issue was properly preserved for review and, if so, in what manner."

Appellants camouflaged another new argument as "facts" at pages 5 through 9 of their brief relating to the validity of AIK Comp's by-laws and the authority of AIK Comp's trustees to act for group members. Appellants never advanced these facts as reasons to reject the Settlement Agreement. Moreover, they cite facts which were not findings by the lower court, nor was the lower court asked to find these as facts. Indeed, in 2005, Appellants unsuccessfully raised this argument regarding the efficacy of AIK Comp's bylaws as a defense to the Rehabilitator's right to assess them for the deficit which led to the Rehabilitation. They lost that issue and never appealed the Franklin

Circuit Court's final and appealable orders of December 8, 2005 and January 11, 2006. (R.A. Tabs 24 and 29).

Recognizing that the General Assembly vests only the Rehabilitator with responsibility to protect "the interests of insureds, creditors, and the public generally" KRS 304.33-010(4), the Franklin Circuit Court's approval of the settlement is in the mainstream of insurance regulatory jurisprudence on the power of an insurance receiver to compromise the claims and property rights of third parties. Judge Thomas Wingate's decision to approve the Settlement Agreement is in complete harmony with the *Kentucky Central Life* line of cases and with case law from other jurisdictions.

COUNTERSTATEMENT OF THE CASE

I. AIK COMP IN REHABILITATION.

A. Background.

Kentucky employers must maintain workers' compensation insurance for their employees KRS 342.340(1) either by insuring liability through an entity authorized to sell workers' compensation insurance in the Commonwealth, or it must furnish proof of its financial ability to insure itself to the Kentucky Department of Insurance. KRS 342.340(1). A third option allows Kentucky employers to pool their liabilities to qualify as a group self-insurer. *See* KRS 342.350(4).

AIK Comp has been a group self-insurer for workers' compensation liabilities for employers in the Commonwealth of Kentucky since 1979. (R.A. Tab 24 at S0000416.) Its group members jointly self-insure their workers' compensation liabilities through AIK Comp. Like all group self-insurers in the Commonwealth, AIK Comp was required to file, and did file, with the Office of Workers' Claims an executed copy of an indemnity agreement "by which group members jointly and severally bind themselves to pay their

workers' compensation liability..." 803 KAR 25:026 § 3; (R.A. Tab 24 at S0000423-425.)

AIK Comp learned of its perilous financial condition in the Summer of 2004. (R.A. Tab 2 at S000017.) It attempted a remediation with the Office of Workers' Claims and informed its members. Ultimately, the trustees of AIK Comp decided that they could not remediate and agreed to rehabilitation under the auspices of the Executive Director of the Office of Insurance pursuant to KRS 304.33, the statutory scheme which governs insolvent insurance companies in Kentucky. (R.A. Tab 4 at S000034-39.) Governor Fletcher transferred regulatory authority over workers' compensation self-insurers from the Office of Workers Claims to the Office of Insurance on August 4, 2004. (*See, e.g.*, R.A. Tab 4 at 36).[1] A Petition for Rehabilitation was filed on August 5, 2004 (the "Rehabilitation Petition"). On August 5, 2004, the Franklin Circuit Court entered an Order Directing the Rehabilitation of AIK Comp. (R.A. Tab 3.) Since being placed into rehabilitation AIK Comp continues to honor previously issued policies covering all workplace injuries and illnesses suffered by the employees of its several thousand group members, including the four Appellants.

Following a special financial examination, the Rehabilitator determined that AIK Comp's deficit as of December 31, 2003 was approximately $58,000,000. (R.A. Tab 4 at S000039.) Thus, in November 2004, the Rehabilitator issued assessments to

[1] The transfer was approved by the General Assembly at the next legislative session. *See* 2005 Ky.Acts ch. 7 (containing the enrolled text of Senate Bill 86 as amended by a Senate committee substitute). Such ratification is necessary for an executive order to survive a legislative session.

approximately 3,800 AIK Comp group members to fill the deficit.[2] The Rehabilitator had to act expeditiously to recover the funds to protect the injured workers dependent upon AIK Comp for workers' compensation. That assessment was met with a firestorm of protests from many of the 3,800 assessed group members. Approximately 400 – 500 members intervened in the rehabilitation action for the limited purpose of objecting to the assessment.

In the Spring of 2005, the Rehabilitator and most of the intervenors, including one of the current Appellants, Appalachian Regional Hospital Healthcare, Inc. ("ARH"), agreed that the Rehabilitator should propose a new assessment plan and a reorganization plan pursuant to KRS 304.33-160(5) to be considered by the Franklin Circuit Court at a hearing in the Fall of 2005. The parties conducted discovery for the October 11, 2005 hearing.

B. Summer of 2005 – A Flurry of Activity.

In addition to the discovery relating to the Rehabilitation, on May 12, 2005, pursuant to provisions of the IRLL, KRS 304.33-010, *et seq.*, the Rehabilitator, on behalf of AIK Comp, filed suit against Maurice Turner, Donald Vish, Dewey Minton, Cheryl Guidice, Kathy Baker, Bill Marzian, Richard Spears, Thomas Prow, George Sotsky, Ernie Stamper, Henry L. Stephens, Jr., and Roy Stevens ("Officers and Trustees"). That action is now styled *Sharon P. Clark, in her Capacity as Commissioner of the Kentucky Department of Insurance v. Turner, et al.*, Franklin Circuit Court, Civil Action No. 05-CI-658. With this action, the Rehabilitator sought to recover damages, on behalf of AIK

[2] The total number of employers who have been members of AIK Comp and whose workers compensation liabilities are still being met by AIK Comp is probably in the tens of thousands. Because the Rehabilitator determined that the deficit leading to AIK Comp's being placed into rehabilitation began in 1999, only those employers (a little over 3,800) who were members from that date forward were subject to the assessment.

Comp, against the Officers and Trustees for their alleged failures in the management of AIK Comp. The Rehabilitator has reached a settlement of these claims with the Officers and Trustees, a settlement which will greatly benefit the AIK Comp estate and the injured workers reliant on it.

The Officers and Trustees were also sued in three separate proceedings by the four Appellants and eight other group members ("Plaintiff group members") in the following actions: *Gallatin Health Care, Inc.,et al. v. Associated Industries of Kentucky, Inc., et al.*, Gallatin Circuit Court, Civil Action No. 04-CI-00184; *Modco Transport, et al v. Associated Industries of Kentucky, Inc., et al.*, Boone Circuit Court, Civil Action No. 04-CI-1833; and, *Appalachian Regional Healthcare, Inc., et al. v. Turner, et al.*, Franklin Circuit Court, Civil Action No. 05-CI-00344. Former Franklin Circuit Court Judge William Graham stayed the prosecution of those actions while he considered the Rehabilitator's assessment and reorganization plans. (R.A. Tab 14.) AIK Comp was not named as a party in any of those actions.

Prior to the hearing on the amended assessment and reorganization plans, the Rehabilitator moved for Partial Summary Judgment on the issue of the group members' joint and several liability to the Rehabilitator for the deficit. Rejecting allegations of material breach and fraudulent inducement, Judge Graham granted that motion and held *all* group members jointly and severally liable for the deficit based upon Kentucky insurance regulations, the AIK Comp indemnity agreement, and AIK Comp's bylaws, all of which were ultimately incorporated into Judge Graham's Findings of Fact and Conclusions of Law, a final and appealable order from which Appellants did not appeal. (R.A. Tabs 24 and 29.)

Immediately thereafter the Rehabilitator and most of the intervening group members, including Appellant ARH, consented to modified assessment and reorganization plans. The Rehabilitator, under the Franklin Circuit Court's supervision, published notice in various newspapers throughout the Commonwealth and on AIK Comp's website of a hearing set for October 11, 2005 on those modified plans. Appellants were given notice of the hearing. ARH even appeared at the hearing in support of the modified plans.

Judge Graham approved the modified Assessment and Reorganization Plans by his December 8, 2005 Findings of Fact and Conclusions of Law (as amended on January 11, 2006). (R.A. Tabs 24 and 25.) The modified assessment plan obligates the group members to fill the deficit of $90,775,000, as of February 28, 2005, by partial payments plus execution of promissory notes for any remaining balance. Group members remain liable for more funding, if necessary. The court-approved Reorganization Plan explicitly directs the Rehabilitator to "seek cost effective recoveries from any third parties responsible for the financial circumstances which have developed." (R.A. Tab 18 at S0000252.) Any recovery by the Rehabilitator will reduce the deficit of the group members, including the four Appellants. Appellants never appealed from the Findings of Fact and Conclusions of Law approving the Reorganization Plan, even though they were *final and appealable*. (R.A. Tabs 18, 24 and 29.)

C. The Consolidated Action.

On May 25, 2006, Judge Graham lifted his stay of the prosecution of the Plaintiff group members' claims against the Officers and Trustees to enable those group members to file a Consolidated Amended Compliant to replace their separately filed individual complaints. (R.A. Tab 38.) In June 2006, the Plaintiff group members' actions were

consolidated in the Franklin Circuit Court under Civil Action 05-CI-00344 (the "Consolidated Action"). In this Consolidated Action, the group member plaintiffs state the right to maintain their action as a class action under CR 23. Plaintiff group members' claims against the Officers and Trustees in the Consolidated Action are virtually identical to the Rehabilitator's claims against the Officers and Trustees. Moreover, Appellants have never moved the Franklin Circuit Court to certify a class or to name them as class representatives, nor have any of the other Plaintiff group members, despite the fact that more than three years have passed.

D. The Rehabilitator's Settlement Agreement With The Officers And Trustees And PIC.

AIK Comp's former Officers and Trustees maintained Directors & Officers insurance coverage through PIC. (R.A. Rehabilitator Ex. 16.) This policy coverage limit is $5,000,000. *Id.* There is no other insurance coverage available to the Officers and Trustees.

In the Summer of 2007, following lengthy negotiations, the Rehabilitator, the Officers and Trustees, and PIC agreed to the Settlement Agreement ultimately approved by the Franklin Circuit Court (and which is the subject of this appeal). The settlement eliminated the arduous and potentially risky task of proving officer and trustee legal malfeasance which the Officers and Trustees strongly denied. The Settlement Agreement also eliminates a real hazard that the proceeds of the PIC insurance policy would be lost to a policy defense predicated on the "insured vs. insured" exclusion, leaving the Rehabilitator in the unenviable position of trying to obtain similar or greater proceeds from uninsured officers and trustees. (R.A. Rehabilitator Ex. 14.) Eliminating these costs and risks made the settlement advantageous and remunerative for all involved.

The Settlement Agreement requires PIC to pay $5,000,000 (policy limits) to the estate of AIK Comp, plus any interest accrued while those funds are held in escrow pending this Court's approval. (R.A. Rehabilitator Ex. 15.) In return, the Rehabilitator agreed to (1) release all claims it has against the officers and trustees, (2) seek a bar order (akin to those routinely entered in insolvency proceedings) from the Franklin Circuit Court preventing other claims from being asserted against the Officers and Trustees arising out of their duties as such on behalf of AIK Comp, and (3) indemnify the Officers and Trustees from any damage claims, including legal fees, associated with any future claims filed against them for actions related to AIK Comp. *Id.*

The proceeds of the settlement will reduce the deficit of AIK Comp as required by the Reorganization and Assessment Plans approved by the Franklin Circuit Court and in accordance with the IRLL. The Rehabilitator determined that the Settlement Agreement is fair, reasonable and in the best interests of AIK Comp, its members, injured workers, claimants, creditors and the Commonwealth of Kentucky. The Franklin Circuit Court agreed. (R.A. Tab 100 at 0002286.)

The Settlement Agreement, however, is operative only if the claims against the Officers and Trustees in the Consolidated Action are dismissed with prejudice. (Rehabilitator Ex. 15.) This condition is necessary because the Officers and Trustees and PIC refuse to settle if they must continue to defend the Consolidated Action. If the claims are not dismissed, with prejudice, the Settlement Agreement becomes null and void. *Id.* Should that happen, the AIK Comp estate will lose the $5,000,000, and the Rehabilitator will be forced to call promissory notes signed by certain AIK Comp group

members much sooner than should be necessary. Both the Rehabilitator and the Franklin Circuit Court want to avoid calling the promissory notes if at all possible.

II. THE FEBRUARY 27, 2008 HEARING ON THE REHABILITATOR'S MOTION TO APPROVE THE SETTLEMENT AGREEMENT.

On November 6, 2007 the Rehabilitator moved the Franklin Circuit Court to approve the Settlement Agreement as in the best interest of AIK Comp, its members, injured workers and the public. (R.A. Tab 54.) So that all interested parties could be heard, the Circuit Court established a hearing date of February 27, 2008 and issued a Procedural Order governing notice, the filing of objections or supporting statements, and describing how parties could protect their rights at the hearing. (R.A. Tab 62 and R.A. Tab 63 at S0001604-08.) The Procedural Order required the Rehabilitator to give notice of the Settlement Agreement and the February 27 hearing to all assessed AIK Comp group members, to all parties who entered an appearance in the Rehabilitation Action, and to the third-party auditors and professionals who are also parties to litigation with the Rehabilitator; to post notice on AIK Comp's website; and, to publish multiple notices of the hearing via all major newspapers in the Commonwealth. *Id.* All parties who may have been affected by the Settlement Agreement were notified and afforded the opportunity to be heard on February 27, 2008. No party appealed from this Procedural Order.

Of AIK Comp's approximately 3,800 assessed group members, 112 noted an objection to the Settlement Agreement, including the four Appellants. Appellants filed a brief before the hearing, raising three objections to the Settlement Agreement: Appellants urged a limitation on the Rehabilitator's indemnification liability; Appellants sought the elimination of a perceived "gag order"; and, the four Appellants wanted a class to be

certified. (R.A. Tab 89 at S0002107-09.) Appellants, however, never moved for class certification. Remarkably, Appellants made no effort at the hearing to show that the elements justifying class certification had been met. Though arguing that approval of the Settlement Agreement without certifying a class was error, Appellants did not, and have not, identified whether the purported class should have been certified under CR 23.02 (a), (b), or (c).

At the February 27, 2008 hearing Appellants' counsel, Ron Parry, made it clear in his opening statement that there were no substantial objections to the settlement. Parry urged Judge Wingate to approve the Settlement Agreement with "insubstantial" modifications. (R.A., Feb. 27, 2008 tape at 10:39:38-43.) Two minutes later, Parry repeated that Appellants' objections were minor. *Id.* at 10:41:50. Parry emphasized just a few seconds later that the Settlement Agreement was a good settlement. *Id.* at 10:42. To make sure that he did not miss the point, Parry reiterated that Judge Wingate should approve the settlement with only minor modifications. *Id.* at 10:44:05. Concluding his presentation, Appellants' counsel reminded the Court that very little separated the Rehabilitator and the group members - two minor substantive issues and one procedural one for the Court to address prior to approving the Settlement Agreement. *Id.* at 10:48:20- 10:49:15.[3]

At the hearing, Joseph Pope, Special Deputy Rehabilitator of AIK Comp, testified at length regarding the reasonableness of the Settlement Agreement. (R.A., Feb. 27,

[3] Following the hearing, Appellants did object to the bar order (R.A. Tab 95 at S0002218), but on appeal they take no exception to the bar order, failing to identify it as an issue in either their Notice of Appeal or their brief to this Court. Therefore, the bar order is not an issue before this Court.

2008 tape at 1:18:20 – 3:12:40.) Pope explained that the Settlement Agreement relieved the Officers and Trustees and, accordingly, the AIK Comp estate, from the serious risk that PIC may not be liable for any judgment rendered against the Officers and Trustees, leaving the possibility of a judgment upon which the Rehabilitator could never collect. *Id.* at 1:18:20 – 1:19:30. Pope explained that the $5,000,000 proceeds of the settlement would be placed in an escrow account once the Settlement Agreement was approved by the Circuit Court, where it would earn interest until the Effective Date. *Id.* at 1:22:50 – 1:23:18; 2:08:14 – 46; 2:09:13 – 25; 2:12:48 – 2:13:30. Pope testified that at the Effective Date, appeals from the order approving the Settlement Agreement will have been exhausted, thereby making the order approving the Settlement Agreement final and not appealable. Until then, PIC must continue to provide a defense to the officers and the trustees against any claims that may be asserted against them arising out of their duties for AIK Comp.[4] (Rehabilitator Ex. 15.) Pope explained that the risk to the estate from the duty to indemnify Officers and Trustees is quite low, and that it will virtually evaporate with the bar order which, upon the Effective Date, will fully and finally bar any and all claims that could be made against the officers and the trustees by any of the group members or anyone else who has knowledge of the bar order. Pope further testified that the Settlement Agreement eliminates claims that have been made against the

[4] At this point, the only claims asserted against the Officers and Trustees are those of the Rehabilitator, claims hopefully extinguished with the Settlement Agreement, and the claims in the Consolidated Action. No other claims have been asserted against any of the Officers and Trustees though it has now been more than five years since the failed remediation with the Department of Workers Claims disclosed the financial peril of AIK Comp. Accordingly, the applicable statute of limitations for any claims against the Officers and Trustees has most likely run. *See* KRS 413.120 (7) and (12).

Rehabilitator by the former President of AIK Comp, Maurice Turner (R.A. Feb. 27, 2008 tape at 1:23:50 – 1:24:30) and by Dewey Minton. *Id.* at 1:27:15 – 45.

Finally, Pope testified that if the Franklin Circuit Court were to disapprove the Settlement Agreement, or if this Court were to find that the Circuit Court abused its discretion in approving the Settlement Agreement, the money will return to PIC. *Id.* at 2:12:48 – 2:13:30.

As to the issues actually raised by Appellants before the trial court – a cap on indemnity, limitations on the so-called gag order, and class action – Pope testified that none were necessary. After many months of negotiations with PIC, Pope testified that the indemnification was "a deal breaker" and without it there would be no settlement at all. *Id.* at 2:16:05 – 13. As to the so-called "gag order," it is no such thing; rather, the cooperation clause of the Settlement Agreement requires that the Officers and Trustees simply cooperate with the Rehabilitator, and nobody else without the approval of the Rehabilitator or the Court.[5] In any event, that provision is not effective until the Effective Date when all the claims against the Officers and Trustees have been extinguished. *Id.* at 2:21:15. According to Pope, if anyone wishes to speak with the officers or the trustees, they may do so with the Rehabilitator's permission. *Id.* at 2:21:48. Of course, the Franklin Circuit Court retains the power to order an informal discussion, and certainly any officer or trustee could be subpoenaed. *Id.* at 2:21:50 – 2:22:15.

[5] Judge Wingate, in his order approving the Settlement Agreement, found there to be no such "gag order" as alleged by Appellants to the lower court. (R.A. Tab 100 at S0002285.)

According to Pope, a class action would not improve the settlement and would not maximize money into the estate. Allowing a class action would also have an adverse effect upon the administration of rehabilitation estates. Pope is concerned that a class would claim the same powers expressly provided to the Rehabilitator. Pope said that he has no authority to agree to a settlement class, or to delegate or share power with a settlement class because the General Assembly never authorized such actions in the IRLL. Pope also noted that substantial differences among group members make it impossible to certify a class. *Id.* at 1:45:15. Of course, Appellants produced no evidence at the February 27, 2008 hearing to establish the elements of CR 23.

ARGUMENT

I. BOTH THE REHABILITATOR'S AND THE CIRCUIT COURT'S DECISIONS TO APPROVE THE SETTLEMENT AGREEMENT ARE TO BE REVIEWED FOR AN ABUSE OF DISCRETION.

Appellants argue that the Franklin Circuit Court's approval of the Settlement Agreement must be reviewed under a "fair and reasonable" standard. The Settlement Agreement is fair and reasonable, and Appellants do not strongly, if at all, argue otherwise.[6] Appellants, however, have inaccurately framed the standard of review applicable to both the Rehabilitator's and the Franklin Circuit Court's respective decisions to approve the Settlement Agreement.

In *Minor v. Stephens*, 898 S.W.2d 71 (Ky. 1995), Kentucky Central Life Insurance Co.'s ("KCL") non-voting shareholders, sought an order that the Franklin Circuit Court erred by denying their motions to appoint an official committee and to

[6] On this point, the Court should immediately ask itself just what it is Appellants seek from this appeal. They do not object to the amount of the settlement; they agree that it is a good settlement; and, they allege no wrongdoings on the part of the Rehabilitator. Should four group members and their lawyers be allowed to destroy this Settlement Agreement when it is not even clear what they want?

intervene. Some of the shareholders specifically argued on appeal that "they were not informed of the progress of the case or given an opportunity to participate" and that "the trial court erred by failing to determine that the Commissioner neglected a statutory duty to rehabilitate KCL." *Id.* at 75-77.

This Court rejected the shareholders' arguments, holding that the "rehabilitation and liquidation of an insolvent insurance company is a special statutory proceeding," and that application of special statutory rules are to be "left largely to the supervision of trial judge, in the exercise of sound judicial discretion." *Id.* at 75; *see also* KRS 304.33-010, *et seq*. This Court explained that "[t]he [Insurance] Commissioner is best qualified to perform the rehabilitation/liquidation process as he has no special interest in the outcome except to administer the matter for the maximum benefit of all interested parties." *Id.* "Statutorily, the [Insurance] Commissioner is the appointed person in exclusive control over the proceedings, with guidance and approval provided by the court." *Id.*

In *Minor*, as here, the KCL shareholders argued that the standard of review for the Commissioner's actions in deciding to liquidate KCL was not "abuse of discretion," but whether "his actions were fair and reasonable." *Id.* at 77. This Court disagreed:

> With the judgment of the Commissioner of Insurance being that liquidation was subsequently desirable and necessary, we determine that only a strong showing to the contrary would have justified the trial court's refusal to follow the recommendations of the administrative officers to whom the supervision of the insurance company was entrusted by the legislature. *Id.* at 81.
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> ...
>
> Proof, as in this case, may take on several forms and the Commissioner, in his role as rehabilitator/liquidator, is granted authority to take such action or make such judgment as he believes to be in the public interest. ***The trial court's primary role is a supervisory one and the***

> ***standard of the court's review of the Commissioner's actions is one of abuse of discretion***. Under the special statutory proceedings, the Commissioner is granted administrative discretion in the contest of the insolvency proceeding and the burden of proof is upon those contesting the Commissioner's actions. *Id.* at 83. (All emphasis added.)

Thus, the standard of review for the Rehabilitator's decision to settle with the Officers and Trustees is abuse of discretion.[7] Accordingly, those contesting the Rehabilitator's actions must establish that the Rehabilitator abused its discretion in negotiating the settlement, and that the Franklin Circuit Court abused its broad discretion in approving the Settlement Agreement. *See also Kentucky Central Life Ins. Co. v. Stephens*, 897 S.W.2d 583, 587-88 (Ky. 1995) ("application and utilization of [the IRLL's] special statutory procedures ... may be left largely to the supervision of the trial judge in the exercise of sound judicial discretion.").

Courts across the country agree with *Minor's* holding that the standard of review applicable to a statutory rehabilitator's actions is abuse of discretion. *See, e.g., Ario v. Fidelity Mut. Life Ins. Co.*, 935 A.2d 55 (Pa. 2007) ("[T]his Court and the Insurance Commissioner 'are obligated to interact in order to supervise, implement and regulate equitably the process engaged to rehabilitate an ... insurer.' Thus, we are to review Insurance Department actions integral to implementation of a rehabilitation plan for *potential abuses of discretion.*"); *Mills v. Florida Asset Financing Corp.*, 818 N.Y.S.2d 333, 334 (N.Y.A.D. 3 Dept. 2006) ("The courts will ...disapprove the rehabilitator's

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[7] Kentucky favors the settlement of litigation. *M.N. Barry Co. v. Gray*, 434 S.W.2d 43 (1968). "The courts have long looked with favor upon settlements which put an end to extended litigation." *Childs v. Hamilton*, 214 S.W.2d 106, 108 (Ky. 1948). "[T]he settlement of cases serves the dual and valuable purposes of reducing the strain on scarce judicial resources and preventing the parties from incurring significant litigation costs." *LaFleur v. Shoney's, Inc.*, 83 S.W.3d 474, 478 (Ky. 2002).

actions only when they are shown to be arbitrary, capricious or an *abuse of discretion.*"); *Garamendi v. Golden Eagle Ins. Co.*, 27 Cal.Rptr.3d 239, 249 (Cal. App. 1 Dist. 2005) ("It has consistently been held that the trial court ... must affirm the actions of the commissioner as conservator unless they constitute an *abuse of discretion.*"); *State ex rel. Pope v. Xantus Healthplan of Tennessee, Inc.*, 2000 WL 630858 (Tenn. Ct. App. 2000) ("[T]he Commissioner being required to follow the statutory mandates and to use reasonable discretion in the rehabilitation of a seized company, with *abuses of discretion* to be checked by the judiciary."); *Ratchford v. Proprietors' Ins. Co.*, 546 N.E.2d 1299 (Ohio 1989) (Court is authorized to withhold approval of sale, by statutory liquidator, of real property of company only where there is finding of fraud or *abuse of discretion* on part of liquidator.); *In re American Investors Assur. Co.*, 521 P.2d 560 (Utah 1974) ("trial court in its supervisory ...role may not substitute its judgment for that of the Commissioner, but may ... intervene or restrain when it is made to appear that the Commissioner is manifestly abusing the authority and discretion vested in him and/or is embarking upon a capricious, untenable or unlawful course.") (All emphasis added.)

Therefore, as this Court previously found in *Minor*, the Court is to review the decision to approve the Settlement Agreement for an abuse of discretion, and "[t]he test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair, or unsupported by sound legal principles." *Goodyear Tire & Rubber Co. v. Thompson*, 11 S.W.3d 575, 581 (Ky. 2000). Under this highly deferential standard, the Circuit Court's decision to approve the Settlement Agreement must be affirmed.

II. THE REHABILITATOR, NOT CLASSES OF AIK COMP GROUP MEMBERS, EXCLUSIVELY CONTROLS AND MAY PURSUE ALL CLAIMS OF AIK COMP AND COMMON CLAIMS OF THE GROUP MEMBERS.

A. Kentucky's IRLL Places Exclusive Control Over Claims Against Tortfeasors with the Rehabilitator.

Appellants argue that "the trial court erred in permitting the Rehabilitator to settle and compromise claims which [s]he does not own." Appellants never objected to the Settlement Agreement on these grounds, though they did raise this argument in 2006 on a different issue. Appellants' counsel simply asked the Circuit Court at the hearing to approve the Settlement Agreement, making "insubstantial" modifications. As this Court well knows, an appellate court "is without authority to review issues not raised in or decided by the trial court." *Regional Jail Authority v. Tackett*, 770 S.W.2d 225, 228 (Ky. 1989); *Matthews v. Ward*, 350 S.W.2d 500 (Ky. 1961).

In any event, Kentucky's IRLL empowers only the Rehabilitator with the authority to assert claims that could otherwise be asserted by the insurer. Kentucky's IRLL provides a comprehensive and mandatory scheme for the rehabilitation of delinquent insurers for "*the protection of the interests of insureds, creditors, and the public generally....*" KRS 304.33-010(3)-(4). The key component of this scheme being that the Commonwealth's police power gives the Rehabilitator the exclusive right to bring actions on behalf of the insurer and all insureds, with the goal of bringing the maximum possible amount into the rehabilitation estate and to put the insurer back on the track to financial solidity and stability, an outcome that is beneficial to all policyholders, group members, creditors, injured workers and to the general public.

Allowing various group members to pursue actions serves to undermine the comprehensive scheme and stated purpose of Kentucky's IRLL. Additionally, this Court

has previously and explicitly recognized that the "Commissioner [of the Office of Insurance] is best qualified to perform the rehabilitation/liquidation process as he has no special interest in the outcome except to administer the matter for the maximum benefit of all interested parties." *Minor*, 898 S.W.2d. at 76. In this case, the Rehabilitator's bringing actions against third parties on behalf of AIK Comp is most certainly a performance within the "rehabilitation/liquidation process."

Kentucky's IRLL empowers the Rehabilitator, and not classes of insureds (Appellants), to sue those who have wronged the insurer. The IRLL requires the Rehabilitator to take possession of the assets of the insurer and administer them under the orders of the court. KRS 304.33-150(1). Here, the Court ordered the Rehabilitator "to immediately take possession and control of all the assets, property, books, accounts, documents, and other records of AIK Comp, wherever located and regardless of whose custody or control they may be found...." (R.A. Tab 3 at S000032.) KRS 304.33-030(11) defines "general assets" to include personal property, and in Kentucky "personal property" includes choses in action. *Button v. Duke*, 195 S.W.2d 66, 69 (Ky. 1946). The causes of action pursued by the Rehabilitator are, therefore, personal property over which the Court ordered the Rehabilitator to take possession "immediately" and "regardless of [in] whose custody or control ... [the property] may be found." (R.A. Tab 3 at S000032.) The Franklin Circuit Court's order to take control of all personal property, including choses in action, was firmly based on Kentucky law.

The IRLL further provides that the Rehabilitator has the explicit statutory right to pursue "all appropriate legal remedies on behalf of the insurer" against the insurer's insiders "[i]f the rehabilitator finds that there has been criminal or tortious conduct or

breach of any contractual or fiduciary obligation detrimental to the insurer by any officer, manager, agent, employee, or other person." KRS 304.33-160(4). This statute reads:

> If the rehabilitator finds that there has been criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer by any officer, manager, agent, employee, or other person, he may pursue all appropriate legal remedies on behalf of the insurer.

KRS 304.33-150(1) and KRS 304.33-160(4) must be read in conjunction with one another. KRS 304.33-150(1) requires the Rehabilitator is to take possession of AIK Comp's assets. The IRLL does not allow for shared possession of assets, such as a cause of action that belongs to the rehabilitation estate. KRS 304.33-150(1) is clear on its face. KRS 304.33-160(4) then allows the Rehabilitator, in her discretion, to pursue all appropriate legal remedies on behalf of AIK Comp if she finds evidence of criminal or tortious conduct. The word "may" in KRS 304.33-160(4) does not mean that the Rehabilitator's control is non-exclusive; rather, it leaves the business judgment to prosecute claims in the Rehabilitator's discretion. Obviously, the word "shall" would make little sense in KRS 304.33-160(4), as it would require the Rehabilitator, or any rehabilitator, to pursue all possible legal actions on behalf of an insurer, even if the costly pursuit of those actions would be a burden to the insurer's estate. KRS 304.33-150(1) removes all doubt as to who controls those claims against third-party tortfeasors. KRS 304.33-160(4) simply vests with the Rehabilitator the discretion as to if, when and how to pursue any legal action against those who caused harm to the estate.

Appellants rely on the word "may" in KRS 304.33-160(4) to argue that the Rehabilitator's power to pursue claims against insiders is "permissive" and "not mandatory," thereby leading to the "conclusion" that the Rehabilitator does not possess the "sole authority" to pursue such claims. (Appellants' Br. at 12.) Appellant's reliance

upon the word "may" is inapt. This conclusion is controlled by *Smith v. Wilson*, 269 S.W.2d 255 (1954), a case in which presumptive adoptive parents sought to terminate the parental rights of the natural mother. The statute said, "[p]roceedings under this section *may* be instituted upon petition by the department, any probation officer, any state or local law enforcement officer, any county or commonwealth's attorney or any natural parent." The Court rejected the petition, stating:

> The mother's challenge of the right of the plaintiffs to maintain the action was overruled. This was doubtless based upon the conclusion that the phrase '*may* be instituted' by the public officials is *permissive* but not *exclusive*. Ordinarily, '*may*' is a word conferring permission or discretion to act. But the word is frequently construed to be the equivalent of 'shall' or 'must' by the consideration of the general provisions and scope of the statute in which it is used. It is especially so where the *act authorized to be done concerns the public interest or the performance or non-performance of a duty of a public officer which affects the rights of others.* ...
>
> ...
>
> [W]e think that in providing that the action 'may be instituted' *the legislative intent was to vest exclusive discretionary power ion the designated public officers. This is a matter of public and not private concern.* (Some emphasis added; some in original)

269 S.W. 2d at 256-7. It is presumed that when the legislature enacted KRS 304.33-160(4) it knew and was familiar with canons of construction utilized by the judiciary to interpret comparable language used in other police power statutes. *Popplewell's Alligator Dock # 1, Inc. v. Revenue Cabinet*, 133 S.W. 3d 456, 465 (Ky. 2004).

The General Assembly's grant of discretion to the Rehabilitator vests control over the claims against the Officers and Trustees exclusively with the Rehabilitator. *See also Commonwealth ex. rel. Fox v. Swing*, 186 A.2d 24, 25 (Pa. 1962) (Supreme Court of

Pennsylvania holding that the use of the word "may" in legislation granting police power connoted a grant of *exclusive discretion*, not a sharing of police power with a private entity as urged here by Appellants).

Therefore, not only does Kentucky law enable the Rehabilitator to initiate and prosecute any and all actions on behalf of a delinquent insurer like AIK Comp and those actions common to all insureds or, in this case, group members, it makes the Rehabilitator the sole and exclusive party who may do so. The General Assembly does not vest police powers with a state official (like the Rehabilitator) with the intent that those powers are in any way to be shared with private parties.

B. The Great Weight Of Authority From Foreign Jurisdictions With Statutes Similar To Kentucky's IRLL Supports The Rehabilitator's Exclusive Control.

Kentucky's IRLL makes the Rehabilitator's ownership over claims against the Officers and Trustees clear. While this is an issue of first impression in Kentucky, case law from other jurisdictions supports the Rehabilitator. Because Kentucky's IRLL is based on a model code, there are numerous other jurisdictions with strikingly similar insurance rehabilitation and liquidation laws, making their case law particularly persuasive in construing Kentucky's IRLL. That case law uniformly lends credence to the above interpretation of the IRLL.

1. *Insurance Commissioner of Michigan v. Arcilio*

In *Insurance Commissioner of Michigan v. Arcilio*, 561 N.W.2d 412, 420-21 (Mich. App. 1997), the Michigan Court of Appeals construed the Michigan IRLA (Insurance Rehabilitation and Liquidation Act), which is nearly identical in all relevant respects to the IRLL, to give the rehabilitator the power to seek, and the trial court the power to grant, orders preventing class actions from proceeding in three foreign courts

against the insurer's directors, officers, outside auditors and private insurance rating agencies for damages for common law fraud and negligent misrepresentation.

In *Arcilio*, the Michigan commissioner of insurance became the rehabilitator of Confederation Life Insurance Company (CLIC), the American branch of a Canadian company whose state of entry was Michigan. *Id.* at 414-15. Three different, non-Michigan citizens filed class actions, two in state courts and one in federal court, seeking damages from CLIC's directors, officers, outside auditors and private insurance rating agencies for common law fraud, negligent misrepresentation and federal securities violations. *Id.* at 415. In all three cases, the plaintiffs claimed to represent the class of policyholders who purchased or renewed policies or annuities from CLIC or its subsidiary during a certain timeframe. All plaintiffs conceded that their goal was to reach the proceeds of the directors' and officers' liability policies ("D & O policies"). *Id.* at 416. Those claims and arguments are virtually identical to what Appellants have presented in this case.

The rehabilitator in *Arcilio* sought an injunction against the three class actions because (1) the cause of action against the directors and officers was an asset of the rehabilitation estate, (2) the D & O policies were a potential source of funding for all policyholders, and (3) the suits disrupted the administration of the estate. *Id.* The trial court granted the injunction, "enjoining 'all persons or entities' from commencing or continuing 'any claims or actions' against CLIC's former or present directors and officers, its independent auditor," or a related bank, "'for actions arising out of business or transactions with' CLIC, and enjoining any attempt to represent CLIC 'policyholders or creditors in any class actions or in any other lawsuit in any forum." *Id.* The trial court

explicitly exempted from the injunction actions personal to persons or entities, which the rehabilitator could not pursue, as well as federal securities claims that persons or entities brought in their personal capacities. *Id.*

The Michigan Court of Appeals affirmed injunction in all respects, holding that Michigan's IRLA, like Kentucky's IRLL, provides that the rehabilitator must take possession of the insurer's assets, which include personal property. *Id.* at 417. Both Michigan and Kentucky courts have defined "personal property" to include choses in action, which include tort claims such as those the class action plaintiffs brought for fraud and negligent misrepresentation in *Arcilio*. *See id.* To bolster its point, the Michigan Court of Appeals quoted a provision of the IRLA that is nearly identical to the corresponding section of Kentucky's IRLL (KRS 304.33-160(4)), which reads:

> If the rehabilitator finds that there has been criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer by any officer, manager, agent, employee, or other person, he may pursue all appropriate legal remedies on behalf of the insurer.

The Michigan Court of Appeals further rejected the class action plaintiffs' contention that the rehabilitator was limited to pursuing actions on behalf of the insurer, not the insureds, by noting that the IRLA (like Kentucky's IRLL) must be construed liberally "to include the authority to pursue causes of action on behalf of all policyholders." *Id.* at 418. *Arcilio* firmly supports the Franklin Circuit Court's decision to approve the Settlement Agreement and to prevent the prosecution of Appellants' claims against the Officers and Trustees.

Here, Appellants have no personal claims that differ from those asserted by the Rehabilitator. Indeed, Appellants' brief is completely void of any reference to their own direct, personal claims. Their consolidated amended complaint contains none.

Finally, the court in *Arcilio* relied upon *Donovan v. City of Dallas*, 377 U.S. 408 (1964), to support its authority to enjoin the class actions in the foreign courts. *Arcilio*, 561 N.W.2d at 417. *Donovan* holds that "where a court has custody of property, that is, proceedings in rem or quasi in rem," that court has exclusive jurisdiction to proceed. *Id.* quoting *Donovan*, 377 U.S. at 412. Because the classes' claims were property vested in the rehabilitator, the court reasoned, when the rehabilitator brought its action to enjoin the class actions, the Michigan trial court obtained *exclusive* jurisdiction over the claims and could lawfully issue its injunction.

2. *Corcoran v. Frank B. Hall & Co., Inc.*

Corcoran v. Frank B. Hall & Co., Inc., 149 A.D.2d 165, 170-71 (N.Y. App. 1989) upheld the liquidator's *exclusive* right to assert claims on behalf of the insurer and its policyholders and creditors, staying two other state court actions. The policyholders and creditors argued in *Corcoran* that New York statutes only provided the liquidator "the title to all property, contracts and rights of action of such insurer as of the date of the entry of the order so directing ... to liquidate." *Id.* at 170. Rejecting that argument, the Court stated that "the paramount purpose of [New York liquidation and rehabilitation law] 'is the preservation and enhancement of [the estate's] assets to the end that the interests of all its creditors, policyholders, stockholders and the public will be served.'" *Id.* at 171. The court further observed that the structure of New York's insurance laws had been held to vest "the Supreme Court with the agency of the superintendent [receiver] ... exclusive jurisdiction of claims both for and against an insurance company," and that the insurance laws had been interpreted uniformly "to confer

expansive jurisdiction upon the Superintendent in liquidation and rehabilitation proceedings." *Id.* at 171-72.

Because Kentucky's IRLL has the same purposes and structure as New York's insurance laws, *Corcoran* supports for affirming the Franklin Circuit Court's approval of the Settlement Agreement.

3. *Foster v. Peat Marwick Main & Co.*

In *Foster v. Peat Marwick Main & Co.*, 587 A.2d 382 (Pa. 1991), the rehabilitator sued the insurer's independent auditor for negligence, malpractice, and breach of contract. *Id.* at 384. Peat Marwick moved to dismiss the rehabilitator's claims contending that the relevant statute, which provides that the rehabilitator "may pursue all appropriate legal remedies on behalf of the insurer,"[8] did not authorize the rehabilitator to pursue actions on behalf of policyholders, creditors or regulatory authorities. *Id.* Denying the motion, the court held that it was statutorily required to construe liberally the policy section of Pennsylvania's IRLL-equivalent,[9] which stated that its purpose was to "[protect] the interests of insureds, creditors and the public generally,"[10] meaning that "[t]he Rehabilitator is thereby authorized to take action -- including legal action -- to insure [sic] the protection of policyholders, among others." *Id.* at 385. The court further noted that "[t]he weight of authority in other jurisdictions militates toward an understanding that the Rehabilitator has such standing." *Id.* at 386.

The reasoning of the *Foster* court, which construed Pennsylvania statutes nearly identical to corresponding provisions of Kentucky's IRLL, strongly supports the

[8] This Pennsylvania statutory provision is nearly identical to KRS 304.33-160(4).

[9] KRS 304.33-010(3) identically requires liberal construction of the IRLL's purpose.

[10] This language is identical to KRS 304.33-010(4).

proposition that AIK Comp's Rehabilitator has the same exclusive power to bring actions on behalf of the AIK Comp group members.

4. *In re Integrity Ins. Co.*

In re Integrity Ins. Co., 573 A.2d 928, 939 (N.J. 1990) was relied upon by Appellant ARH below (in response to issues separate and apart from the Settlement Agreement) even though it did not involve a dispute between a statutory receiver in rehabilitation and policyholders. We address this case, however, only because Appellant ARH misinterpreted *Integrity* as holding that a rehabilitator faces an inherent conflict of interest and, because of that conflict, the group members should be allowed to proceed with certain claims against those liable to the insurer in receivership.

First, the Appellants do not claim that a conflict of interest exists here. The court in *Integrity* was concerned that the rehabilitator there might settle the case for less than he should and might be burdened by defenses to which the policyholders would not. *Id.* at 938. There is no danger of that here especially since the Appellants agree that the Rehabilitator should accept $5,000,000 in settlement.

Second, the court in *Integrity* construed an aspect of New Jersey law which differs from Kentucky's in an important respect. The New Jersey "statute vests the Commissioner, as Liquidator, with title to the rights of action belonging to Integrity, but concededly does not specifically bestow him with the rights to prosecute claims on behalf of, or belonging exclusively to creditors, policyholders, and the like." *Id.* at 933. This statute is quite unlike Kentucky's IRLL which specifically authorizes this action. KRS 304.33-060. Moreover, the Michigan statute, which is identical to Kentucky's on this

issue, was construed to empower a rehabilitator to bring actions on behalf of policyholders, creditors and insureds. *Arcilio*, 561 N.W.2d 412, 418.

Third, the court in *Integrity* dealt with a contention by defendants sued by a rehabilitator that there might be some individual claims of policyholders that the rehabilitator could not bring and those non-resident plaintiffs would not be bound for lack of notice. The court there expressed concern that only through a class action could non-resident plaintiffs be protected. 573 A.2d at 939. Here, all of the group members, by definition, are residents of Kentucky. Moreover, Appellants did not appeal from or take exception to the Procedural Order which set forth the notice procedures leading up to the hearing on the Settlement Agreement.

The Court in *Integrity* only observed that there might be personal claims, distinct from claims asserted by the rehabilitator which belong to the rehabilitation estate, and allowed policyholders to bring personal claims, not those which the receiver could bring in a representative capacity. Appellants' claims in the Consolidated Action are anything but personal. Appellants have not alleged any injury separate and distinct from that suffered by AIK Comp. Nor on appeal have the Appellants argued that they have asserted any unique personal claims. Because Appellants are insureds their rights are co-extensive with the Rehabilitator's, and are accordingly fully protected by the Rehabilitator. *See* KRS 304.33-010(4).

Appellants have failed to present any case law or statutory authority to support the position that they, and not the Rehabilitator, control the claims against those who wronged AIK Comp. Appellants rely almost exclusively on a tortured examination of the word "may" to make their argument. The great weight of authority, along with the actual

wording and intent of the IRLL, supports construing the Kentucky IRLL to make the Rehabilitator the sole party that may bring and maintain actions on behalf of AIK Comp.

Indeed, it is a rather bizarre notion that the police power granted the Rehabilitator by the General Assembly to bring actions against AIK Comp's tortfeasors is a shared power. *See State of California v. Altus Finance, S.A.*, 116 P.3d 1175 (Cal. 2005) (the use of the word may in a statute authorizing the insurance commissioner as conservator to sue the insurer's tortfeasors precluded both the State Attorney General and policyholders from bringing suit).

C. Appellants' Reference To "Prior Regulatory Issues" Camouflages The Fact That Appellants Have Waived That Issue.

On appeal, Appellants, *for the first time*, question the authority of the Rehabilitator because of AIK Comp's "prior regulatory issues." (Appellants' Br. 6 – 8.) Appellants curiously camouflaged this new-found argument in the "fact" section of their brief where they argue that the Rehabilitator's authority is somehow lacking because of AIK Comp's prior regulatory issues and an amended method by which AIK Comp amended its by-laws. Once again, as Appellants' brief differs so fundamentally from what they argued to the Franklin Circuit Court, it must be noted that this Court "is without authority to review issues not raised in or decided by the trial court." *Regional Jail Authority*, 770 S.W.2d at 228; *Matthews*, 350 S.W.2d 500. Moreover, the "facts" that they cite are not facts which are a part of the record on appeal. Finally, and even more amazing, Appellants waived this argument long before the Settlement Agreement was even negotiated.

Throughout this section of their brief Appellants refer to the 1997 remediation order of the Department of Workers Claims ordering AIK Comp to change its trustees

and adopt more prudent business practices to manage its affairs. (R.A. Tab 34 at S0000742). At the bottom of Page 7 of the brief Appellants assert, with no record citation, that "[t]his administrative regulation was not followed by AIK Comp to select its trustees." (Appellants' Br. 7.) Appellants then decry the process for selecting trustees and adopting by-laws. Appellants fail to explain, however, why they joined or remained members of AIK Comp after 1997 in light of these "objections."

Appellants' efforts to mislead do not end there. Contrary to Appellants' unfounded assertions, it is clear that AIK Comp did in fact replace the old trustees and the new trustees took prompt action to comply with the 1997 order. (R.A. Tab 76 at S0001919-22). Appellants again decry the trustee selection process and, creating a straw man, fulminate "[t]hese same trustees, who were not selected by the group members, played a direct role in placing AIK Comp into rehabilitation. R.A. Tab 24 at S433." Their cite is to the aforementioned final and appealable Findings of Fact and Conclusions of Law which concluded that two-thirds of the trustees voted to place AIK Comp into rehabilitation. Judge Graham, however, found no fault by the trustees. At any rate, what is amazing in light of Appellants' new-found objections is that they, though bound by the final and appealable order of Judge Graham, did not appeal, even though it held them to be bound by the actions of the trustees acting on their behalf. (R.A. Tab 24 at S0000435-438; Tab 17 at S0000217).

Examining the December 8, 2005 Findings of Fact and Conclusions of Law (as amended and made final and appealable on January 11, 2006) approving the modified Reorganization and Assessment Plans further illustrates this issue. In that order, the Circuit Court found that all AIK Comp group members "agreed to be bound by the

bylaws of AIK Comp [citation omitted] [and] the indemnity agreement filed by AIK Comp with the then Kentucky Department of Workers' Claims." (R.A. Tab 24 at S0000415.) The Circuit Court also concluded that "all AIK Comp group members ... received adequate notice ... of the hearing ... commencing on October 11, 2005, and were awarded a full, fair and complete opportunity to be heard at the hearing with respect to the [Rehabilitator's] plans." (R.A. Tab 24 at S0000434.) The Circuit Court further concluded that "no AIK Comp group member can rescind [its] contract [with AIK Comp] because none have made any effort to place AIK Comp back into the status quo existing prior to the time when the member in fact joined." (R.A. Tab 24 at S0000435; citing *Ruffner v. Ridgely*, 81 Ky. 165, 1883 WL 7819 (Ky. App. 1883); *In re Sallee*, 286 F.3d 878, 889-90 (6th Cir. 2002); Samuel Williston, 12 *Williston on Contracts*, Section 1460 (3d ed. 1970)).

Appellants appealed neither the Franklin Circuit Court's December 8, 2005 order nor its January 11, 2006 order. Indeed, Appellant ARH specifically appeared through counsel at the October 11, 2005 hearing to support the Rehabilitator's modified plans and fully participated in the process. For these reasons, Appellants' attempt to introduce a new argument on appeal is of both no consequence and, to the extent it is even an argument, Appellants waived it long ago.

D. The Effect Of The Findings Of Fact And Conclusions Of Law Is To Make Final That The Rehabilitator Has Authority To Bind The Group Members.

As stated, in his Findings of Fact and Conclusions of Law from which Appellants did not appeal, Judge Graham concluded that all group members were bound by the by-laws and indemnity agreements that they executed. In that order Judge Graham relied, in

part, upon *Scott v. Lloyds America of San Antonio*, 11 F.Supp. 787, 790 (W.D. Tex. 1935):

> [M]embers of an unincorporated association licensed under state law is [sic] subject to the control of insurance authorities. The association's attorney was designated by law to accept service of process and could bind association members in issuance of insurance contracts. The association was therefore suable in its collective name and members were bound to the judgment rendered against them in that name. Kentucky law is consistent with that principle. *Jim Host & Associates, Inc. v. Sharp*, 639 S.W. 2d 784, 785 (Ky. App. 1982).

Tab 24 at S0000437-38.

That decision was correct and binds the Appellants here. Bylaws, rules, and regulations of voluntary associations are valid and binding upon members consenting thereto so long as they are not immoral, unreasonable, contrary to public policy, or in contravention of the law of the land. *Kentucky High School Athletic Assoc. v. Hopkins County Board of Education*, 552 S.W.2d 685, 687 (Ky. App. 1977) (holding that voluntary associations may adopt reasonable bylaws and rules which will be deemed valid and binding upon members unless violating some law or public policy); *see also Medical Soc. of Mobile County v. Walker*, 245 Ala. 135, 16 So.2d 321 (1944); *Mitty v. Oliveira*, 111 Cal.App.2d 452, 244 P.2d 921 (1952); *Sult v. Gilbert*, 148 Fla. 31, 3 So.2d 729 (1941); *Hebert v. Ventetuolo*, 480 A.2d 403, 407 (R.I. 1984) (When the rules and by-laws of a voluntary association are reasonable, they become binding upon the association members.).

Members may adopt and enforce any just, fair, and reasonable rules and regulations to promote harmony among themselves and advance the best interests of the association, although the effect may be to limit the freedom of action that they would

enjoy if they were not connected with the association. *Cox v. Government Employees Ins. Co.*, 126 F.2d 254 (6th Cir. 1942) (applying Kentucky law); *Booker & Kinnaird v. Louisville Bd. of Fire Underwriters*, 188 Ky. 771, 224 S.W. 451 (1920). It is also a rule of general application that one who has become a member of an incorporated association will be deemed to have known and assented to the provisions of its charter and bylaws, which it was authorized to make, and cannot object to the enforcement thereof on the ground that he or she is deprived of any legal or constitutional right. *See Lake of the Forest Club v. Buttles*, 142 Kan. 538, 51 P.2d 18 (1935); *Colonial Country Club v. Richmond*, 19 La.App. 272, 140 So. 86 (1932); *Schroeder v. Meridian Imp. Club*, 36 Wash. 2d 925, 221 P.2d 544 (1950); *see also National Collegiate Athletic Assoc. v. Lasege*, 53 S.W.3d 77, 87 (Ky. 2001) (by becoming a member of a voluntary athletic association, university agreed to abide by association's rules and regulations).

Courts recognize an association's right to adopt, administer and interpret its own rules without judicial intervention. *See, e.g., Kentucky High School Athletic Assoc.*, 552 S.W.2d at 687 (holding that courts do not have the responsibility to inquire into expediency, practiciability, or wisdom of an unincorporated association's bylaws and regulations). The rules and by-laws of a voluntary association should not be subject to judicial interference unless enforcement would be arbitrary, capricious or constitute an abuse of discretion; where such rules are reasonable and in keeping with public policy, there will be no judicial interference. *Kentucky High School Athletic Assoc.*, 552 S.W.2d at 687; *Hebert*, 480 A.2d 403; *Butler v. USA Volleyball*, 673 N.E.2d 1063 (Ill. 1996).

Here, all of the assessed group members, including Appellants, either acquired or renewed membership after 1997 when AIK Comp was first ordered into remediation, and

when its first Board of Trustees was ordered to be replaced. The Franklin Circuit Court long ago rejected member claims that they were not bound by the by-laws and indemnity agreements that they executed. If Appellants did not want to be bound by that final and appealable decision or those decisions naturally flowing from it, they should have appealed; Appellants filed no such appeal.

IV. THE FRANKLIN CIRCUIT COURT'S MAY 25, 2006 ORDER IS NOT THE LAW OF THE CASE AND DOES NOT NOW BAR DISMISSAL OF APPELLANTS' CLAIMS AGAINST THE OFFICERS AND TRUSTEES.

Beginning in December 2004, the Rehabilitator successfully sought orders staying the prosecution of certain group members' claims against the Officers and Trustees. Certain group members, including Appellants, persuaded then Franklin Circuit Court Judge Graham to lift the stay to enable them to file a Consolidated Amended Complaint. Appellants now argue that the Circuit Court's May 25, 2006 order lifting the stay is the "law of the case," limits the Rehabilitator's exclusive authority to maintain and prosecute actions against the Officers and Trustees, and cannot be disturbed.

Judge Graham entered this order following arguments over whether the Court should lift a stay to enable the Appellants to file a consolidated amended complaint. Judge Graham entered this order having never seen the Consolidated Action, the purported class action complaint, filed by Appellants. Appellants now try to argue that the May 25, 2006 order is "the law of the case." It is not.

In *Inman v. Inman*, 648 S.W.2d 847, 849 (Ky. 1982), this Court explained the "law of the case" doctrine:

> The law-of-the-case doctrine is a rule under which an appellate court, on a subsequent appeal, is bound by a prior decision *on a former appeal* in the same court and applies to the determination of questions of law and not questions of fact. "As the term 'law of the case' is most commonly

> used, and as used in the present discussion unless otherwise indicated, it designates the principle that if an *appellate court* has passed on a legal question and remanded the cause to the court below for further proceedings, the legal questions thus determined by the *appellate court* will not be differently determined on a subsequent appeal in the same case. Thus, if, on a retrial after remand, there was no change in the issues or evidence, on a new appeal the questions are limited to whether the trial court properly construed and applied the mandate. The term 'law of the case' is also sometimes used more broadly to indicate the principle that a decision of the appellate court, unless properly set aside, is controlling at all subsequent stages of the litigation, which includes the rule that on remand the trial court must strictly follow the mandate of the appellate court.

The Franklin Circuit Court's May 25, 2006 order is not the "law of the case," and Appellants' reference to that doctrine is flat wrong. No appellate court has ruled upon the *merits* of that order. *See, e.g., Dickerson v. Commonwealth*, 174 S.W.3d 451 (Ky. 2005) (law of the case doctrine applies only to former rulings by an appellate court).

Furthermore, Appellants have previously argued that the Franklin Circuit Court's May 25, 2006 order was not final and appealable. The Rehabilitator, following the Court's entry of the May 25, 2006 order, moved for relief with the Kentucky Court of Appeals. Appellants moved to dismiss the Rehabilitator's motion, successfully arguing to the Court of Appeals that the May 25, 2006 order "did not terminate the litigation on the merits" and that the order is "plainly interlocutory" and "not appealable." Even more striking, Appellants stated:

> Indeed, the order does not even finally adjudicate all of the rights of the Class Action Plaintiffs or the Rehabilitator with respect to prosecution of the third party claims. There has been no final adjudication of the merits of the Class Action claims, much less a final adjudication of the respective rights of all parties to the Rehabilitation action with respect to any future recovery that might be had in the Class Actions.

As stated by Appellants themselves, the May 25, 2006 order was not final; it did not adjudicate all of Appellants' rights or all of the Rehabilitator's rights regarding the prosecution of claims against the Officers and Trustees. Significantly, it did not adjudicate the rights of the Rehabilitator or of the Appellants with respect to "any future recovery" from actions filed against the Officers and Trustees.

Appellants and the Kentucky Court of Appeals agree that the May 25, 2006 order is an interlocutory order. (Kentucky Court of Appeals, Case No. 2006 CA 86.) Kentucky law is crystal clear:

> An interim or interlocutory order is by its nature subject to further review in the court where the case is still pending, either at the request of a party or *sua sponte*, until a final, appealable decision has been entered, whether by judgment, order or opinion.

Knott v. Crown Colony Farm, Inc., 865 S.W.2d 326, 329 (Ky. 1993).[11]

The Franklin Circuit Court had plenary power to evaluate the Settlement Agreement and reconsider the May 25, 2006 interlocutory order. While we all respect Judge Graham, we are confident that he would acknowledge that his retirement did not convert his interlocutory rulings into inerrant biblical texts. When Judge Graham entered that order, over three years ago, he did not have the issues now presented to the Court. Judge Graham never saw the claims actually set forth in the Consolidated Action; he did not know that Appellants would have no direct, personal claims against the Officers and

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[11] In fact, Appellants should be judicially estopped from arguing that the May 25, 2006 order is anything other than an interlocutory order subject to further consideration. The judicial estoppel doctrine protect the integrity of the judicial process by preventing a party from taking a position inconsistent with one it successfully asserted in a prior phase of the same matter. *See, e.g., G.D. Deal Holdings, Inc. v. Baker Energy, Inc.*, 501 F.Supp.2d 914, 920 (W.D. Ky. 2007); *Colston Inv. Co. v. Home Supply Co.*, 74 S.W.3d 759, 763 (Ky. App. 2001).

Trustees; he did not know that all mediation attempts with the group members would prove unsuccessful; he did not realize the financial need for the settlement proceeds; and, he did not have before him a settlement that places 100% of the Officers and Trustees' insurance policy (plus interest) into the AIK Comp estate.[12] Moreover, Judge Graham's reliance on Appellants' "may/shall" argument, to the extent there was any, was misplaced. *Smith v. Wilson*, 269 S.W. 2d 255 (1954). Put simply, the issues before the Franklin Circuit Court in February 2008 are far removed from those before the Court on May 25, 2006. Furthermore, and as already stated, the notion that the Rehabilitator's police power is to be shared makes no sense. *See, e.g., State of* California, 116 P.3d 1175.

Therefore, the Circuit Court's May 25, 2006 order is no reason to disturb the Franklin Circuit Court's approval of the Settlement Agreement.

V. APPELLANTS' ATTEMPT TO CREATE SUBSTANTIVE RIGHTS OUT OF CR 23 IS WITHOUT MERIT.

Appellants argue that the trial court erred in approving the Settlement Agreement and terminating their claims "without following the procedure specified in Civil Rule 23" even though the Appellants never filed a motion to certify a class action. (Appellants' Br. 13.) The lower court approved a Settlement Agreement which calls for the dismissal of Appellants' claims against the Officers and Trustees because, absent that provision, there would be no settlement, and the AIK Comp estate would not receive $5,000,000, plus interest, all for the benefit of injured workers in the Commonwealth and the group members dependent upon AIK Comp. Losing the proceeds gained from the Settlement

[12] If the Rehabilitator's Agreement with the Officers and Trustees is ultimately approved on appeal, without the need for additional litigation, none of the settlement proceeds from the Rehabilitator's settlement with the Officers and Trustees will go to Rehabilitator's counsel.

Agreement because of procedural objections based on CR 23 would place the AIK Comp estate in great peril. Such a loss would cause undue risk that injured workers dependent upon AIK Comp may not receive coverage to which they are entitled, and would most likely cause the Rehabilitator not only to call the promissory notes signed by the group members, but also issue new assessments against the group members.

As set forth below, however, CR 23 presents no reason for this Court to disturb the Circuit Court's approval of the Settlement Agreement and dismissal of Appellants' claims against the Officers and Trustees.

A. The Rehabilitation Of AIK Comp Is A Special Statutory Proceeding.

The rehabilitation of AIK Comp is a "special statutory proceeding." *See Minor*, 898 S.W.2d at 75 ("rehabilitation and liquidation of an insolvent insurance company is a special statutory proceeding"). Appellants expressly admit in their brief that "the provisions of KRS 304 create a special statutory proceeding." (Appellants' Br. 9.)

Generally, in special statutory proceedings, statutory provisions control over conflicting civil rules/common law.[13] In *Kentucky Central Life v. Stephens,* 897 S.W.2d 583, 588 (Ky. 1995), this Court reiterated that tenet as it applies to the civil rules:

> Rule 1(2) of the Rules of Civil Procedure provides: 'These Rules govern procedure and practice in all actions of a civil nature in the Court of Justice except for *special statutory proceedings, in which the procedural requirements of the statute shall prevail over any inconsistent procedures set forth in the Rules.*' (Emphasis added.)

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[13] In *Wilson v. Dean*, 197 S.W. 547, 550 (Ky. 1917), the Court noted that tenet as it applies to the common law, commenting that special statutory proceedings are just that, statutory, and not in accord with or not according to the course of the common law. *See also Shackleford v. Ford*, 290 S.W. 43, 44 (Ark. 1927) (". . . the proceedings . . . under the above statutes are not in the nature of a common-law action or an ordinary civil suit under our Code of Procedure, but are special statutory proceedings, and must be specifically followed.")

Accordingly, the procedural requirements of the IRLL, not the procedural requirements of CR 23, apply to the Franklin Circuit Court's approval of the Settlement Agreement and to the Circuit Court's related and necessary decision to dismiss, or permanently enjoin, Appellants' claims against the Officers and Trustees.

B. The Circuit Court's Dismissal Of Appellants' Claims And Entry Of A Bar Order Is Akin To A Permanent Injunction, And The Proper Procedural Mechanisms For Such Actions Are Found In The IRLL, Not CR 23 Or Anywhere Else In Kentucky's Rules Of Civil Procedure.

With the approval of the Settlement Agreement, dismissal of Appellants' claims against the Officers and Trustees, and entry of the bar order,[14] the Circuit Court essentially permanently enjoined Appellants' claims. In special statutory proceedings, like the Rehabilitation of AIK Comp, the statutory injunction standard controls over any conflicting common law standards. The precedent for applying statutory injunction standards over common law or civil rules injunction standards is plentiful.

In *State, by and through Heltzel v. O.K. Transfer Company*, 330 P.2d 510 (Or. 1958), a case unrelated to insurance rehabilitations but instructive because of the Court's exhaustive listing of cases in which courts have upheld statutory injunctions entered without proof of the usual common law/civil rules elements for injunction and/or dismissal, the Court stated:

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[14] Appellants have taken no exception to the Circuit Court's entry of the bar order, an order barring any future claims against the settling officers and trustees relating to their management and/or oversight of AIK Comp. Any appeal of the bar order would have proven unsuccessful because courts from across the country have approved the bar order mechanism in the context of bankruptcy or insolvency proceedings similar to this one. *See, e.g, U.S. Oil & Gas v. Wolfson*, 967 F.2d 489, 493 (11th Cir. 1993); *In re Munford, Inc. (Shearson Lehman Bros., Inc. v. Munford, Inc., et al.)*, 97 F.3d 449 (11th Cir. 1996); *Kovacs v. Ernst & Young (In re Jiffy Lube Sec. Litig.)*, 927 F.2d 155 (4th Cir. 1991); *TBG Inc. v. Bendis*, 811 F.Supp. 596 (D. Kan. 1992); MANUAL FOR COMPLEX LITIGATION, FOURTH SEC. 13.13.

> [S]tatutory injunctions can issue without the showing traditionally required in equity courts. This is especially true where a government agency is authorized to seek the injunction in protection of the public interest.
>
> The same distinction is observed in [citations omitted], where the court says: 'The right of the United States or any agency thereof to obtain an injunction provided for by statute stands upon a different footing than a private party's right thereto, *the distinction being that instead of a procedural mechanism for the protection of private rights, the statutory injunction is for the purpose of effectuating Congressional policy and vindicating public rights*. Hence, the traditional equity concepts for the issuance of injunctions do not apply. The conditions upon which statutory injunctions shall issue are solely those provided by the statute in question . . .'

Id. at 513-14. [15]

Courts throughout the country have analyzed the statutory injunction standards in rehabilitation and liquidation laws based (like Kentucky's IRLL) on the Uniform Insurers Liquidation Act and held such statutory injunction standards to control a rehabilitator's motion for such relief, *not* common law injunction standards.

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[15] *See American Fruit Growers, Inc., v. United States*, 105 F.2d 722 (9th Cir. 1939); *Henderson v. Burd*, 133 F.2d 515 (2d Cir. 1943); *Securities and Exchange Commission v. Torr*, 15 F.Supp. 315 (D.C.N.Y. 1936); *Securities and Exchange Commission v. Jones*, D.C. N.Y.1936, 15 F.Supp. 321 (D.C. N.Y. 1936); *Fleming v. Salem Box Co.*, 38 F.Supp. 997 (D.C.Or. 1940); *Walling v. Builders' Veneer & Woodwork Co.*, 45 F.Supp. 808 (D.C. Wis. 1942); *United States v. Beatty*, 88 F.Supp. 646 (S.D. Iowa 1950); *Hammerberg v. Leinert*, 132 Conn. 599, 46 A.2d 420 (1946); 43 C.J.S. INJUNCTIONS § 23, p. 446; 28 AM.JUR. 243 (App. 80), INJUNCTIONS § 47. *See also Kautz v. Sheridan*, 118 Me. 28, 105 A. 401 (1919) (proof of actual harm and lack of adequate remedy is irrelevant and unnecessary notwithstanding the customary determination of these cases upon equitable principles); 42 AM.JUR.2d INJUNCTIONS §23, providing pointed insights into "injunctions specifically authorized by statute": A statutory request for injunctive relief is governed by the requirements of the statute, and express statutory language supersedes common law requirements . . . The issuance of an injunction authorized by statue is required if the prerequisites for the remedy have been demonstrated and if an injunction would fulfill the legislative purposes behind the statute's enactment.

For example, in *Fewell v. Pickens*, 39 S.W.3d 447 (Ark. 2001), an insurance rehabilitation action under Arkansas' version of the Uniform Insurers Liquidation Act, the Arkansas Supreme Court upheld the circuit court's issuance of a permanent injunction (prohibiting the insurer's parent corporation and its one other shareholder from transacting business with the insurer), despite the parent's and shareholder's objections that there had been no showing of irreparable harm or likelihood of success on the merits (as required under Arkansas common law and Ark. R. Civ. P. 65):

> Fewell [the shareholder] and Holdingsco [the parent] urge that the injunction was invalid because there was no showing of irreparable harm and no showing of the likelihood of success on the merits as required under our common law and Ark.R.Civ.P. 65. *The short answer to this point, as already stated in this opinion, is that the Uniform Act is a special statutory proceeding and applies rather than the Rules of Civil Procedure. See* Ark. R. Civ. P. 81(a). Hence, §23-68-105(1) applies and controls the grounds for issuing an injunction in delinquency proceedings.

Id. at 456.

In *Koken v. Fidelity Mutual Life Insurance Company*, 803 A.2d 807 (Pa. Cmwlth. 2002), after reviewing a plan of rehabilitation for a life insurer, and after quoting Pennsylvania's version of the Uniform Insurer's Liquidation Act's Injunction Statute,[16] almost identical to Kentucky's IRLL, the Court said it that in rehabilitation proceedings it

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[16] *Id.* at 817 (quoting "Section 505(a) provides: (a) Any receiver appointed in a proceeding under this article may at any time apply for and the Commonwealth Court may grant, such restraining orders, preliminary and permanent injunctions, and other orders as may be *necessary and proper* to prevent: (i) the transaction of further business; ... (iii) interference with the receiver or with the proceedings; ... (iv) waste of the insurer's assts; ... (vi) the institution or further prosecution of any actions or proceedings; ... (xi) any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of the proceeding. 40 P.S. §221.5(a) (emphasis added).") *CF* KRS §304.33-050 and its virtually identical language.

may issue injunction if they are "necessary and proper" and if they prohibit any of the of things listed in Pennsylvania's (*and Kentucky's*) Injunction Statute:

> Thus, it is clear that *we may enter injunctive orders in rehabilitation proceedings if they are "necessary and proper," and if they prohibit, inter alia, actions that would interfere with the company's rehabilitation*, waste its assets, lessen the company's value or cause prejudice to policyholders and creditors rights.

Id. at 817.

The Rehabilitator's proof more than meets Kentucky's IRLL controlling statutory injunction standard, and permanent injunctive relief (dismissing and permanently barring Appellants' claims) is therefore necessary and proper.

The IRLL provided the Franklin Circuit Court the power to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this subtitle." KRS 304.33-040(3)(c). The IRLL further provides that the Rehabilitator "may at any time apply for and any court of general jurisdiction may grant such restraining orders, temporary and permanent injunctions, *and other orders as are deemed necessary and proper to prevent*:

> (b) The transfer of property against which the receiver has a claim;
>
> (c) Interference with the receiver or the proceedings;
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> (d) Waste of the insurer's assets; . . .
>
> (f) The institution or further prosecution of any actions or proceedings by or on behalf of the insurer;
>
> (g) The institution or further prosecution of any action against the receiver or the insurer including, but not limited to, interpleader or other actions involving assets against which the receiver has a claim; . . .

> (l) Any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of the proceeding; ....

KRS 304.33-050.

Therefore, insofar as another party seeks to prosecute actions that truly are the insurer's actions or actions common to all policyholders or group members, and not individual actions, like the Consolidated Action, the Rehabilitator has the statutory right under the law to block such actions.

KRS 304.33-050 expressly provides the statutory injunction standard that controls a motion for injunctive relief *or other relief* (such as the dismissal of Appellants' claims) pursuant thereto. That standard provides that a Court may grant such injunctive relief and *other orders* "as are deemed necessary and proper to prevent" any one of the matters listed above in KRS 304.33-050.

Accordingly, the Rehabilitator presented sufficient proof to the Circuit Court showing that the dismissal of the Consolidated Action (and approval of the Settlement Agreement) will prevent any one of the harms set forth in KRS 304.33-050.

First, the Rehabilitator has met her statutory burden of proving that preventing the prosecution of the Consolidated Action is necessary and proper to prevent "the transfer of property against which the receiver has a claim"[17] because, among other reasons, any cause of action that may be brought by and/or on behalf of AIK Comp and/or that are common to the AIK Comp group members are property against which Rehabilitator has a claim. Furthermore, the proceeds, if any, of said causes of action are property against

[17] KRS 304.33-050(1)(b).

which Rehabilitator has a claim. Just as important, all 3,800 group members benefit by the $5,000,000 reduction in the deficit which they are legally obliged to pay.

Second, the Rehabilitator has met her statutory burden of proving that enjoining the prosecution of the Consolidate Action is necessary and proper to prevent "interference with the receiver or with the proceedings"[18] because, among other reasons, contemporaneously investigating and litigating claims and issues identical and/or similar enough to those investigated and litigated by the Rehabilitator could set up possible claim and/or issue preclusion defenses against the Rehabilitator and the AIK Comp rehabilitation estate.

Third, the Rehabilitator has met her statutory burden of proving that dismissing the Consolidated Action is necessary and proper to prevent "waste of the insurer's assets." [19] Allowing Appellants or any group members contemporaneously to seek funds that the Rehabilitator is seeking or may seek (or, in this case, actually obtained via the Settlement Agreement) on behalf of the AIK Comp rehabilitation estate and AIK Comp's policyholders will likely deplete those funds such that said funds may not exist or may be substantially diminished. Such an outcome would certainly waste AIK Comp's assets.

Fourth, the Rehabilitator has met her statutory burden of proving that dismissing and barring the prosecution of the Consolidated Action is necessary and proper to prevent "the institution or further prosecution of any actions or proceedings by or on behalf of the insurer."[20] For example, the Consolidated Action is expressly, on its face, an action

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[18] KRS 304.33-050(1)(c).

[19] KRS 304.33-050(1)(d).

[20] KRS 304.33-050(1)(f).

brought by particular group members "on their own behalf and for all persons similarly situated, and on the behalf of AIK Comp itself through a class of [] all group members of the unincorporated association of AIK Comp." Additionally, and as previously argued herein, Appellants are simply maintaining the same claims for themselves that the Rehabilitator by statute is granted authority to bring on behalf of the AIK Comp estate.

Fifth, the Rehabilitator has also met her statutory burden of proving that enjoining the prosecution of the Consolidated Action is necessary and proper to prevent "the obtaining of preferences, judgments, attachments, garnishments or liens against the insurer or its agents."[21] By seeking judgments for AIK Comp against tortfeasors or others who have caused recoverable damages which not all group members have a similar or equal interest in, Appellants will certainly create preferences if they obtain individually a greater or lesser judgment than group members who rely on the rehabilitator. Neither the Circuit Court nor this Court should allow that to happen.

Finally, the Rehabilitator has met her statutory burden of proving that enjoining the prosecution of the Consolidated Action through dismissal and the entry of the bar order is necessary and proper to prevent "any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of the proceedings" [22] To the extent that Appellants seek class action status, they prejudice the power and right of the rehabilitator to represent fairly the group members of AIK Comp.[23]

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[21] KRS 304.33-050(1)(h).

[22] KRS 304.33-050(1)(l).

[23] In sum, the successful rehabilitation of AIK Comp depends on the $5,000,000 settlement proceeds. The receipt of those proceeds in turn requires approval of the

Courts throughout the country that interpret the Uniform Insurers Liquidation Act (upon which Kentucky's IRLL is based) have granted the relief sought by the Rehabilitator and have barred intervening group members from pursuing claims that are and should be *exclusive* to the Rehabilitator, including claims on behalf of the insurer and claims common to and on behalf of the group members.[24] Those courts did not, and this Court should not, use CR 23, or any other civil rule of procedure inapplicable to special statutory proceedings, to require the Rehabilitator to present any greater showing than that expressly required by the IRLL to enjoin and/or dismiss damaging, parallel prosecutions like the Consolidated Action.

C. A Class Action Proceeding Is A Procedural Device Which Confers No Substantive Rights To Appellants Or To Any Putative Class.

CR 23 does not apply to the Rehabilitation of AIK Comp, and Appellants' citations to and reliance upon CR 23 are misleading. Appellants frame the issues in their brief relating to the notice given to putative class members of the dismissal of their "class action" complaint in a manner which implies that the notice provisions of CR 23 provides a substantive right which the lower court ignored. That, however, is not the case.

Settlement Agreement, and dismissal of Appellants' claims against the Officers and Trustees. Appellants' claims against the Officers and Trustees are thus interfering with the rehabilitation of AIK Comp. KRS 304.33-050(c) expressly allows the Franklin Circuit Court to enter an order dismissing Appellants' claims in this action to prevent such interference, and to do so without resort to CR 23. CR 1 makes it explicitly clear that CR 23 does not apply to or govern special statutory proceedings like the rehabilitation of AIK Comp.

[24] *See, e.g., Arcilio*, 561 N.W.2d 412 (enjoining three foreign class actions, brought on behalf of the class of policyholders, against insurer's directors, officers, outside auditors and private insurance rating agencies); *Corcoran*, 149 A.2d 165 (upholding the liquidator's exclusive right to assert claims on behalf of the insurer and its policyholders and creditors, staying two other state court actions that policyholders and creditors had initiated).

The United States Supreme Court has held that Rule 23's requirements must be interpreted consistent with Article III constraints, and with the Rules Enabling Act [28 U.S.C. § 2072(b)], which instructs that the rules of procedure 'shall not abridge, enlarge or modify any substantive right." *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 613 (1997); *see also Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999) ("[N]o reading of the Rule [23] can ignore the [Rules Enabling] Act's mandate that 'rules of procedures shall not abridge, enlarge, or modify any substantive right.").

State courts which have had addressed their own class action procedures have agreed with that reasoning. The Texas Supreme Court has rightly noted that

> [t]he class action is a procedural device intended to advance judicial economy by trying claims together that lend themselves to collective treatment. It is not meant to alter the parties' burdens of proof, right to a jury trial, or the substantive prerequisites to recovery under a given tort.

Southwestern Refining Co., Inc. v. Bernal, 22 S.W.3d 425, 437 (Tex. 2000).

The Louisiana Court of Appeals recently noted that

> a class action is nothing more than a procedural device; it confers no substantive rights. The purpose of a class action is to permit the institution and management of litigation involving a right of common character vested in a sufficient number of parties as to render their joinder impracticable in an ordinary proceeding.

Marshall ex rel. minor children v. Air Liquide – Big Three, Inc., 2 So.3d 541 (La. App. 2008). *See also Andry v. Murphy Oil, U.S.A., Inc.*, 710 So.2d 1126, 1129 (La. App. 1998) ("A class action is no more than a procedural device; it confers no substantive rights."); *Lilian v. Commonwealth*, 354 A.2d 250 (Pa. 1976) (finding that a class action is a procedural device and not a substantive right); *BT Securities Corp. v. W. R. Huff Asset*

Management Co., LLC, 891 So.2d 310 (Ala. 2004) ("[W]e conclude that [the plaintiff's] ability to bring a covered class action is a matter of procedure, not a substantive right.").

Thus, a substantial part of this appeal challenges procedural aspects of the lower court's decision – not its substance. Regardless, Appellants failed to offer any evidence supporting their position that a class should be certified with them as representatives.

D. The Rehabilitator Provided The Best Notice Practicable Under The Circumstances.

CR 23 does not control the issues before the Court, and does not mandate a particular form of notice. To the extent that Appellants contest the adequacy of the notice, it must be recalled that the Rehabilitator, under the Franklin Circuit Court's direct supervision, ensured that all interested parties had sufficient notice of the Settlement Agreement, of the terms and conditions of the Settlement Agreement, and of the date and time of the hearing at which the Franklin Circuit Court would consider and hear objections to the Settlement Agreement.

The Rehabilitator, pursuant to the Circuit Court's orders, noticed all assessed AIK Comp group members of the Settlement Agreement and of the February 27, 2008 hearing; posted notice of the hearing and of the Settlement Agreement on AIK Comp's website; noticed all parties who entered an appearance in the Rehabilitation action; ensured that the third-party auditors and professionals who are also parties to litigation with the Rehabilitator had notice of the hearing; and, provided multiple notices in all major newspapers in the Commonwealth. (R.A. Tab 100 at S0002278.) Hence, all parties conceivably affected by the Settlement Agreement were notified and afforded the opportunity to be heard on February 27, 2008.

Appellants, having never moved the Circuit Court to certify a class, cannot now complain in good faith that the Circuit Court erred by not adhering to "the protections afforded by the class action procedure." (Appellants' Br. 14.) Appellants not only failed to move for class certification, Appellants never argued to the lower court that a class action, or class action type "procedures," would be "superior to other available methods for the fair and efficient adjudication of the controversy," a finding necessary under CR 23.02(c). Appellants presented no evidence at the hearing that a class action would be superior to the mechanisms approved by the General Assembly in the IRLL or to the notice and procedural mechanisms approved and supervised by the Franklin Circuit Court. Moreover, Appellants fail to offer such proof in their brief to this Court.

Additionally, Appellants filed no appeal and have taken no exception to the lower court's December 3, 2007 Procedural Order which explicitly states:

> [T]he notice requirements ... of this Order constitute fair, adequate and proper notice, including any notice that may be required by the Kentucky Rules of Civil Procedure, to all current and former Group Members of AIK Comp.... (R.A. Tab 62 at S0001548-49.)

Appellants have failed to identify any due process problems whatsoever with the notice procedures established by the Franklin Circuit Court prior to its approval of the Settlement Agreement.[25]

Appellants tread carefully on this issue because, as is evident from their brief, there is no authority finding that members of a self-insurance fund, or policyholders of a

[25] Kentucky courts apply a test found in *Matthews v. Eldridge*, 424 U.S. 319, 333-35 (1976) to evaluate due process concerns raised by official state actions. *See, e.g., Div. of Driver Licensing v. Bergman*, 740 S.W.2d 948 (Ky. 1987). Although Appellants' brief is completely void of any reference to any alleged due process violations, thus making the issue irrelevant, an examination of the law on this issue strongly supports the Franklin Circuit Court's actions.

traditional commercial insurance policy, are better equipped or have a special right to bring a class action proceeding on behalf of a financially troubled insurer in receivership.

Appellants' reliance on *Wiley v. Adkins*, 48 S.W.3d 20 (Ky. 2001) is misplaced. First, *Wiley* does not involve a special statutory proceeding. Second, in *Wiley*, this Court reviewed a CR 23 class certification only because the trial court actually certified the plaintiffs as a class. Here, Appellants have never even moved for class certification.[26]

The Rehabilitation of AIK Comp is a special statutory proceeding and a matter of great public importance. It is not a mechanism by which a very limited number of group members (4 of approximately 3,800) and their lawyers can seek to profit in a class action proceeding. All parties affected by the Settlement Agreement received the best notice practicable under the circumstances, and Appellants have offered no reason to disturb the approval of the Settlement Agreement on notice or fairness grounds.

CONCLUSION

Disturbing the lower court's approval of this settlement will seriously injure the rehabilitation of AIK Comp. The Rehabilitator has negotiated a favorable settlement with the former Officers and Trustees and their insurer of $5,000,000, plus all interest being earned while in escrow. The only impediment to control of these funds is this appeal. KRS 304.33-050(b) expressly allowed the Rehabilitator to move for an order dismissing Appellants' claims against the Officers and Trustees to prevent any transfer or

[26] Appellants rely completely on case law which is inapposite to the issues before the Court. In each case cited by Appellants, a key issue was whether notice was appropriate or adequate. Here, Appellants have not made notice an issue, only the mechanism by which the Court supervised it – IRLL v. CR 23. Appellants did not even appeal from the Procedural Order which governs notice. Moreover, as already shown, the Franklin Circuit Court has at all times in this action, a special statutory proceeding, followed the IRLL.

loss of the assets from the Settlement Agreement. The order approving the Settlement Agreement and dismissing Appellants' claims was not an abuse of discretion.

Rejecting the Settlement Agreement now would cause irreparable harm to the rehabilitation estate, the group members and injured workers who depend on a successful rehabilitation and to the public who invariably will be saddled with the cost of supporting the injured workers if the rehabilitation fails. That balancing of interests can only be done by the Rehabilitator. KRS 304.33-010 (4) ("[t]he purpose of this subtitle is the protection of the interests of insureds, creditors, and the public generally..."). To ensure that all interested parties' rights are protected, that the comprehensive scheme set forth in the IRLL is followed, and that the Franklin Circuit Court can rely upon the General Assembly's clear mandates, the orders of the Franklin Circuit Court should be affirmed.

Respectfully submitted,

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