ORIGINAL

In the
Supreme Court of Ohio

MARY JO HUDSON, Superintendent of Insurance, State of Ohio, acting in her capacity as Liquidator of The Oil & Gas Insurance Company, Plaintiff-Appellant, v. PETROSURANCE, INC., Defendant-Appellee.	: : : : : : : : : : : :	Case No. 2009-1816 On Appeal from the Franklin County Court of Appeals, Tenth Appellate District Court of Appeals Case No. 08AP-1030

REPLY BRIEF OF PLAINTIFF-APPELLANT,
MARY JO HUDSON, SUPERINTENDENT OF INSURANCE

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INTRODUCTION

Appellee Petrosurance, Inc. takes several stabs at proving that shareholders of a liquidated company should receive funds remaining after the company's various creditors have been paid the principal of, but not the interest accruing on, their claims. It examines a few select statutes in R.C. Chapter 3903 and, finding no explicit provision to govern this situation, declares that it must be allowed to take remaining funds over the timely filed creditors of the Oil and Gas Insurance Company ("Company"). It claims that, by accepting the principal of their debts, the creditors are foreclosed from later receiving interest on that principal. It argues that the liquidation of the Company was improper at the outset, and makes several other similar claims.

Petrosurance's arguments—all of which are meritless—subvert the principles underlying the debtor-creditor relationship and liquidation in general. If a solvent company fails to pay a debt to a creditor in a timely manner, it is responsible for both the principal and the interest accruing on that principal. The same rules apply to insolvent companies, though the fact of insolvency generally means that insufficient funds exist to pay these debts in full. Liquidation exists solely to gather funds to satisfy these debts as fully as possible under the circumstances, not to eliminate the traditional rules of debt repayment.

To be sure, equitable rules generally limit initial recovery to principal, but that is so that all creditors may have a chance to recover at least *something*. The situation is different when funds still remain after all creditors are paid in principal. In those circumstances, the usual equitable rules are satisfied because the creditors have at least partially recovered. But still they are entitled to interest, because it remains part of the existing debt that they are owed. Almost every jurisdiction to have considered the issue agrees that creditors are entitled to interest in these circumstances.

Shareholders, as the owners of and investors in the liquidated company, have rights to recovery as well, but those rights are only activated if their company can escape insolvency by repaying *all* of the debts it owes *in full*. Petrosurance's various arguments are thinly veiled attempts to leapfrog its rightful place in line and recover ahead of those entities that were injured by its failed enterprise. For these and other reasons, this Court should reverse the Tenth District's decision and permit the Superintendent to pay the Company's creditors and other debt-holders for the interest that accrued on their claims during liquidation.

ARGUMENT

A. R.C. Chapter 3903 protects the rights of creditors and other debt-holders to receive interest on their claims against a liquidated estate above the rights of the company's shareholders.

The parties agree on two principles that occupy much of Petrosurance's brief: that statutes can only be applied as written, and that Revised Code Chapter 3903 does not contain a provision that explicitly speaks to the payment of interest in liquidation. But those principles do not settle the question of whether interest must nonetheless be paid in these circumstances. When confronted with a discrete problem and no clear statutory direction to resolve it, the Court must look to the statute's more general terms to resolve the issue at hand. *Cheap Escape Co. v. Haddox, L.L.C.*, 120 Ohio St. 3d 493, 2008-Ohio-6323, ¶ 13. And when dealing with "a complex series of statutes," like those involved here, the appropriate step is to review the statutes in pari materia, reading those statutes together and "interpret[ing] them in a reasonable manner that 'give[s] proper force and effect to each and all of the statutes.'" *Id.* (quoting *State ex rel. Herman v. Klopfleisch* (1995), 72 Ohio St. 3d 581, 585).

In her merit brief, the Superintendent followed that process, walking through the entirety of R.C. Chapter 3903 and showing how its provisions work in concert to preserve the rights of all entities affected by an insurer's financial turmoil. Appellant Br. at 3–5; 10–12. She also discussed four key provisions regarding the precise issue in this case: (1) R.C. 3903.02(C) & (D), which proclaim that this chapter must be construed liberally so as to protect "the interests of insureds, claimants, creditors, and the public generally" and to limit the interference with the business of insurers; (2) R.C. 3903.42, which sets the priority of distribution of assets and requires every class of claims against a liquidated estate to be paid in "full or adequate funds" before the remainder can be paid to the company's shareholders; (3) R.C. 3903.18(B), which fixes the value of claims against the estate; and (4) R.C. 3903.02(D)(4), which provides for the "equitable apportionment of any unavoidable loss[es]."

These provisions work together to fix the value of claims so that the principal is distributed first, because in most cases there will not be sufficient funds to pay both the principal and interest of all creditor claims. Appellant Br. at 12. But these provisions also recognize that creditors are entitled to full repayment, and, if sufficient funds exist to pay accrued interest these creditors, they should be paid in full (or as fully as possible) before shareholders, as the terminal class of claimants, take anything. *Id.* This is a logical extension of the basic idea that insolvency proceedings exist to protect creditor rights to the fullest repayment possible under the circumstances, something this Court has repeatedly recognized. See *Covington v. Ohio Gen. Ins. Co.*, 99 Ohio St. 3d 117, 2003-Ohio-2720, ¶ 3; *Anderson v. Ohio Dep't of Ins.* (1991), 58 Ohio St. 3d 215, 219, overruled on other grounds, *Wallace v. Ohio Dep't of Commerce*, 96 Ohio St. 3d 266, 2002-Ohio-4210, syll. ¶ 1; *Cay Mach. Co. v. Firestone Tire & Rubber Co.* (1963), 175 Ohio St. 295, 299–300; *Rouse v. Merchants' Nat'l Bank* (1889), 46 Ohio St. 493, 502–03.

Though it often refers to R.C. 3903.42 (primarily to note the absence of an explicit interest provision), Petrosurance fails even to cite R.C. 3903.02 and R.C. 3903.18 in its brief, ignoring the overarching concern for creditor rights that drives liquidation. Instead, it plucks two tangential references to other Revised Code sections from the Superintendent's brief—R.C. 3903.21 (which sets forth the Superintendent's powers in liquidation) and R.C. 3903.43 (which gives the Superintendent the authority to compound, compromise, and negotiate claims)—and suggests that these provisions alone are insufficient to permit the payment of interest to creditors. Appellee Br. at 8–9, 11. But the Superintendent never suggested that those sections alone resolved the present issue, and Petrosurance's disregard of the full statutory context is not enough to change the clear implication of the above provisions—that, when sufficient funds exist to pay both the principal and interest accruing on a creditor's claim, both should be paid.

Although Petrosurance suggests that the Superintendent has concocted this process to deprive Petrosurance of its property, this charge is belied by the fact that the vast majority of other jurisdictions to have considered the issue have taken the Superintendent's approach. See Appellant Br. at 14–18. Petrosurance dismisses this broad consensus by noting that most of the courts followed this rule in the banking liquidation context "during a time when most banking statutes, including Ohio's, provided for the 'superadded liability' of shareholders." Appellee Br. at 14–15.

Petrosurance's observation is irrelevant. While many of the cases cited in the Superintendent's merit brief were from the banking liability context, their holdings were not premised on any unique facet of banking law; rather, the rule that accrued interest should be paid to creditors if funds from a liquidated estate prove sufficient to do so "is but a statement of the general rule applicable to the liquidation of all insolvents," and "is supported by a wealth of authority." *In re Liquidation of Badger State Bank* (S.D. 1944), 15 N.W. 2d 744, 748; see also W.E. Shipley, *Claim in Bankruptcy as Bearing Interest after Filing of Petition Where There Is a Surplus*, 27 A.L.R.2d 586 (2008) (tracing the same basic rule in the context of bankruptcy, and noting, at *2, that "it has generally been recognized that where the bankruptcy estate shows a general surplus, interest should be allowed . . . on creditors' claims which would be entitled to such interest if there had been no bankruptcy"). Indeed, the seminal United States Supreme Court case on point, *Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.* (1914), 233 U.S. 261, arose from a railway company's insolvency, and even there the Court spoke in broad, general terms about the rule's applicability to insolvent estates generally: "[A]s a general rule, after property of an insolvent is in *custodia legis* interest thereafter accruing is not allowed," but if "the estate prove[s] sufficient to discharge the claims in full, interest as well as principal should be paid." *Id.* at 266. There is simply no credence to the argument that this rule is limited to banking liquidation cases, and Petrosurance does not cite a single authority suggesting otherwise.

Beyond that failed parry, Petrosurance makes no attempt to deny this general rule; it simply claims that this Court should not follow it because, unlike the rule on interest in the banking liquidation context, see R.C. 1125.24(B)–(C), no specific provision on the payment of interest exists in the statutes—just the general provision in R.C. 3903.42 that creditors have a right to be repaid in "full or adequate funds" before the shareholders, as the terminal class, take anything. The fact that the General Assembly provided an explicit provision regarding the payment of interest elsewhere does not change the analysis. Petrosurance cannot rebut the cumulative effect of (1) a complex set of statutes bound together by the singular goal of protecting the rights of creditors and other debt-holders to obtain the fullest relief possible from an insolvent debtor and (2) a broad consensus that such provisions should be interpreted to provide for the payment of both principal and interest to these claimants (and ahead of shareholders) when sufficient funds exist to do so. Given this weight of authority, and because such funds exist here, interest should be paid to the Company's creditors and other debt-holders.

B. Petrosurance's remaining arguments against the payment of interest have been strongly rejected in the liquidation context.

Petrosurance makes a flurry of other arguments in an attempt to avoid this result, none of which are persuasive. First, it suggests that interest may not even be applicable here. It disclaims the longstanding rule that "interest follows principal," *Sogg v. Zurz*, 121 Ohio St. 3d 449, 2009-Ohio-1526, ¶ 7, claiming that that rule "applies only in the *absence of statute*" and noting that "[a] statute is present both in this case and in that case." Appellee Br. at 10–11 (emphasis original).

Petrosurance simply misreads this Court's decision in *Sogg*, which states that the general rule applies "'in the absence of a *specific* statute or stipulation to the contrary.'" *Sogg*, 121 Ohio St. 3d 449, 2009-Ohio-1526, at ¶ 7 (quoting *Eshelby v. Cincinnati Bd. of Edn.* (1902), 66 Ohio St. 71, 74) (emphasis added). In other words, interest follows principal unless a statute or other provision specifically says that it does not. Cf. *In re Liquidation of First-Central Trust Co.* (1945), 145 Ohio St. 498, syll. ¶¶ 1–2 (refusing to award interest to a bank's creditors when they explicitly agreed to accept non-interest-bearing instruments). Petrosurance points to no statute forbidding interest here, because none exists. Nor does Petrosurance identify some explicit stipulation among the creditors not to seek interest. Thus, interest may be paid on these claims, and, barring a specific provision setting out a unique rate for an individual creditor, it should be paid at the legal rate of interest. See R.C. 1343.03(A) (establishing the legal interest rate rule); *Mayer v. Medancic*, 124 Ohio St. 3d 101, 2009-Ohio-6190, ¶ 12.

Petrosurance also repeatedly claims that the Company's creditors and other debt-holders are not eligible for interest payments because, by accepting the principal of their debts, they have already received "full" payment of their debts. See Appellee Br. at 3, 5, 10, 11, 13. And it attempts to paint this process as a procedural trick designed to deprive it of its rights. "Now, because she has funds remaining, [the Superintendent] wants to treat Class 9 Claimants differently by suggesting that those funds are somehow 'surplus.' . . . The only difference between Class 5 creditors and the Class 9 shareholder is that the creditors have been paid and the shareholder has not." Appellee Br. at 19–20.

Nothing could be farther from the truth. Petrosurance simply fails to appreciate the equitable rules that drive the course of liquidation, and the fundamental differences between creditors and other debt-holders on the one hand and shareholders on the other. As noted above, the Superintendent is required to protect creditor rights through the "equitable apportionment of any unavoidable loss." R.C. 3903.02(D)(4). Because "assets are generally insufficient to pay debts in full" in liquidation, *Am. Iron & Steel Mfg. Co.*, 233 U.S. at 266, claimants against the liquidated estate are generally limited to the principal of their debts; in such circumstances, "a payment of interest to certain creditors will deny others the recovery of even the principal. He who seeks equity must do equity." *State Banking Comm'r v. Metro. Trust Co.* (Mich. 1940), 291 N.W. 228, 229; see *People ex rel. Barrett v. Farmers State Bank of Irvington* (Ill. 1938), 20 N.E. 2d 502, 504.

In view of these guiding equitable concerns, the proper procedure is (1) to pay each class of non-shareholder claimants (that is, the Company's creditors and other debt-holders) the principal of their debts first; (2) if funds remain after that, to pay interest to these claimants; and (3) if funds remain after that, to pay the remainder to the shareholders. Indeed, the various States that have codified interest payments all follow this procedure. See Appellant Br. at 16–17. And while waiver may apply to creditors of solvent companies in certain circumstances, it is inapplicable in the equity-driven liquidation process:

> The rule as to waiver of interest . . . does not apply in receiverships for the reason that during the administration nothing could have been accomplished by a formal demand

> for interest. Until the principal of all the claims are paid it can not be known whether the estate would have enough remaining assets to make payment upon the interest. Therefore there can be no waiver of the claim for interest. . . . "The general rule in this regard is that when the creditor *voluntarily* accepts the principal as such, he ought to be regarded as having waived the interest. In the insolvency cases there is no voluntary acceptance of principal because the creditor is precluded from rejecting the dividends and demanding payment of principal and interest in full."

Stein v. Delano (3d Cir. 1941), 121 F.2d 975, 979–80 (quoting Fred T. Hanson, *Effect of Insolvency Proceedings on Creditor's Right to Interest*, 32 Mich. L. Rev. 1069, 1085 (1934)) (emphasis original); see also *In re Liquidation of Badger State Bank*, 15 N.W. 2d at 746 (refusing to apply strict claim requirements to interest in these circumstances "[b]ecause the assertion of such a claim before it could be determined whether a surplus would eventuate would be pointless, and would not tend to further the legislative purpose").

Petrosurance claims that this process unfairly draws a line between it and the Company's creditors, noting that "it has been waiting for payment of its claim for 20 years—longer than any creditors had to wait." Appellee Br. at 18. But of course it has to wait longer than everyone else; as a shareholder, it sits in the final priority class in R.C. 3903.42 (Class 9) and is entitled to the Company's remaining assets only when all debts have been paid. And shareholders have this terminal priority because *they own the companies that owe the debts that exist in Classes 1–8.* As investors, shareholders take "a risk in the concerns of the company, not only as to dividends and a proportion of assets on the dissolution of the company, but as to the statutory liability for debts in case the corporation becomes insolvent." *Miller v. Ratterman* (1890), 47 Ohio St. 141, 154. The Superintendent is not trying to deprive Petrosurance of its property by making some improper payment to the Company's creditors; she is performing her statutory duty to ensure that all of the company's outstanding debts are paid first before she turns any remnants over to the owners of the company.

Finally, Petrosurance claims that it objected to liquidation at the outset (in 1990) and has continued to do so on the grounds that the Company had sufficient assets to pay all creditors at the time. See Appellee Br. at 2, 5. Though the Superintendent strongly maintains that liquidation was appropriate here, such post hoc quibbling over a decision made nearly twenty years ago sheds no light on the meaning of the statutes at hand.

But even if liquidation were inappropriately ordered here (and it was not), that fact would not provide a reason to reward shareholders by elevating their rights over those of their company's creditors. Indeed, the Third Circuit rejected a similar claim long ago: "If there is a surplus . . . it may be argued that the proceedings were wrongfully instituted and so the debtor should be excused from paying interest during the delay." *Stein*, 121 F.2d at 978–79. But, "[e]ven here a large majority of the creditors may have nothing to do with the commencement of the proceedings and the debtor may be at fault in conducting his business in such a way as to subject himself to reasonable suspicion of insolvency." *Id.* at 979. In other words, whatever disputes Petrosurance has with the Superintendent about the specific degree of the Company's financial turmoil when the liquidation began are irrelevant to the question of whether creditors should be fully compensated for their losses. Whether Petrosurance agrees with the decision or not, the liquidation has occurred, and the Company's creditors' claims must be properly honored under the guiding equitable rules of that process.

CONCLUSION

For the above reasons, this Court should reverse the decision below and remand this case to the trial court for further proceedings.

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Reply Brief of Plaintiff-Appellant Mary Jo Hudson, Superintendent of Insurance, was served by U.S. mail this 30th day of April, 2010, on the following counsel:

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