

STATE OF SOUTH CAROLINA
RICHLAND COUNTY

IN THE COURT OF COMMON PLEAS
FIFTH JUDICIAL CIRCUIT

Scott H. Richardson, as Director of the
South Carolina Department of Insurance,

vs.

Guardian Healthcare, Inc.,
Respondent.

**MEMORANDUM IN SUPPORT OF
AMENDED PLAN OF
REHABILITATION**

C.A. No. 2010-CP-40-7093

2010 OCT 28 PM 4:44
JEANETTE M. BOYD
CLERK OF COURT
RICHLAND COUNTY
FILED

In the Order commencing the instant rehabilitation proceedings, this Court appointed Petitioner, Scott H. Richardson, the Rehabilitator of Guardian Healthcare, Inc. in Rehabilitation (Guardian). As Rehabilitator, he has all powers and responsibilities set forth in S.C. Code Ann. § 38-27-330 (2002) of the South Carolina Code. Subsection (d) of that Code section provides:

(d) If the rehabilitator determines that reorganization, consolidation, conversion, reinsurance, merger, or other transformation of the insurer is appropriate, he shall prepare a plan to effect the changes. Upon application of the rehabilitator for approval of the plan, and after any notice and hearings the court may prescribe, the court may either approve or disapprove the proposed plan, or may modify it and approve it as modified. Any plan approved under this section must be, in the judgment of the court, fair and equitable to all parties concerned. If the plan is approved, the rehabilitator shall carry out the plan. In the case of a life insurer, the plan proposed may include the imposition of liens upon the policies of the company, if all rights of shareholders are first relinquished. A plan for a life insurer may also propose imposition of a moratorium upon loan and cash surrender rights under policies, for the period and to the extent necessary.

Pursuant to this statutory authority, the Rehabilitator has prepared an Amended Plan of Rehabilitation (Plan) which is attached as Exhibit A and incorporated by reference herein. The Rehabilitator believes that the Plan is fair, equitable, and in the best interests of the enrollees and creditors of Guardian.

I. FACTUAL BACKGROUND

A. Guardian's Business Operations

Guardian Healthcare, Inc. is a privately held South Carolina domestic insurer specializing in the marketing and sale of Medicare Advantage health insurance products. Its principal place of business is in Greenville, South Carolina. It is not authorized to transact the business of insurance in any other state.

Guardian is subject to the dual regulation of the state and federal government. The South Carolina Department of Insurance (Department) has regulatory jurisdiction over the Respondent pursuant to, *inter alia*, Chapters 3, 5, 9, 13 and 71 of Title 38 of the South Carolina Code of Laws 1976, as amended. The Department licenses the Respondent to act as an insurer in South Carolina and monitors its financial condition. The Respondent is also subject to the regulatory jurisdiction of the Center for Medicare and Medicaid Services (CMS). CMS approves the contracts for insurers, such as Respondent, that market Medicare Advantage programs. CMS approves the rates, product benefits, the provider network and provides all guidelines for the sale of the Medicare Advantage product.

Guardian's bank balances at September 30, 2010 were \$1,836,339 with estimated unpaid claims reported and unprocessed totaling \$9,758,643 (excluding incurred but not reported (IBNR)) and outstanding payables of \$86,407 thus a negative cash position of (\$7,835,897.) On a weekly basis, since early July 2010, unpaid claims have continued to be between \$9 million and \$11 million. Actuarial estimates for September 30, 2010 for incurred but not reported (IBNR)

claims are approximately \$27 million. Accordingly, Respondent had a negative surplus position at September 30, 2010 of more than (\$25,000,000).

Guardian is dependent on new monthly premium revenue to pay past incurred claims; however, that revenue flow ends with contract year ending December 31, 2010 with no more incoming revenue. Premium revenue coming in for the month of October is \$14,431,430. For November and December, approximately \$28,000,000 premium will materialize if the CMS contract remains in force, but likewise, claims unpaid will increase. Administrative expenses have been running approximately \$5 million per quarter. CMS denied Guardian's bid for a 2011 contract, citing solvency concerns. On or about August 31, 2010, CMS denied Respondent's appeal of the denial of its contract bid for 2011. The management of Guardian engaged in extensive efforts to sell stock and various discussions and negotiations were had with potential purchasers. The offer made by Sterling Life Insurance Company (Sterling), appears to be the only viable one. Other potential purchasers declined to make or did not follow through on offers after completing their due diligence review of the financial status of Guardian.

B. Order Appointing Rehabilitator of Guardian Healthcare, Inc.

On October 12, 2010, the Honorable Alison R. Lee placed Guardian in receivership and issued an order appointing Scott H. Richardson Rehabilitator and vesting title of Guardian's assets in the Rehabilitator; and directing the Rehabilitator to take possession of Guardian's books, records, and assets and to conduct as Rehabilitator the business of Guardian. The Rehabilitation Order also provided the Rehabilitator with certain powers and authorities as set forth in both the Order and Chapter 27 of Title 38 of the South Carolina Code. Guardian was placed into rehabilitation because it was financially impaired pursuant to S.C. Code Ann. § 38-9-

80 (2002) and deemed to be operating in a hazardous financial condition due to its negative surplus position. Guardian lacked sufficient paid-in capital and surplus to ensure enrollee safety.

C. Guardian's Assets and Liabilities

Guardian's liabilities were estimated as of October 14, 2010 to be in excess of \$20,000,000. Guardian's assets include its name, network, book of business, certain recoverables, South Carolina certificate of authority, office furniture and equipment and certain contracts.

D. Third Party Assumption

Based on Guardian's financial condition and the denial of its appeal by CMS, it was determined that Guardian's business operation was not sustainable. Guardian's Board of Directors has pursued the sale of the company over the past several months with little success. This transaction presents the best opportunity to realize value from the corporate shell and certificates of authority of Guardian. Sterling proposes to assume, as of the Assumption Effective Date as set forth in the Assumption Agreement attached as an exhibit to the Plan Guardian's Medicare Advantage book of business and certain related liabilities, in accordance with the terms of the Assumption Agreement.

E. Summary of Assumption

The Rehabilitator proposes that the corporate shell of Guardian, together with its name and certificates of authority to do business in South Carolina, be transferred to Sterling free and clear of any liabilities other than those liabilities expressly assumed in accordance with the assumption or novation agreements. Sterling is entering into the CMS Novation Agreement effective November 1, 2010. Sterling has also agreed to pay into the Respondent estate the sum of

\$4,000,000 for these assets. Sterling has also agreed to lease certain personal property belonging to Guardian. Sterling has also agreed to collect, for a fee of 5%, certain recoverables due to the Guardian estate.

F. Notice of this Application and Rehabilitation Plan

The Rehabilitator has provided written notice of this application, the Rehabilitation Plan and the agreements forming the Plan to Guardian's creditors, employees and all persons and entities known to the Rehabilitator to have a substantial unsatisfied claim that may be affected by the Order, the Plan and the Notice of Motion and Motion for Approval of the Preliminary Rehabilitation Plan and any Court orders pertaining thereto. Notice has been and is being provided by: 1) electronic mail and/or mailing it first class to the last known address of the person; 2) posting it in no less than five newspapers of general statewide circulation; and 3) placing it on the website of South Carolina Department of Insurance.

II. PLAN OF REHABILITATION

A. Overview of the Rehabilitation Plan

Copies of the Plan and the agreements comprising the Plan are attached. They will also be made available for review and downloading at: <http://doi.sc.gov/legal/pages/receivershipcompanies.aspx>. Anyone requiring a full and detailed understanding of the terms and provisions of the Plan should carefully read the documents and consult with attorneys, accountants, consultants and other professionals of their own choosing. The Rehabilitator and his representatives cannot provide advice, legal or otherwise, to policyholders, creditors or other interested persons concerning the Plan. The information set forth below is just a summary of the plan.

Under the Plan, as of November 1, 2010, Sterling will assume the CMS contracts previously issued to Guardian in accordance with the Assumption Agreement. Except as provided under the Assumption Agreement, all premium income, including capitation revenue from CMS, medical recoverables, reserves, etc., related to the Medicare Advantage plans and other will be transferred to Sterling. Assets not transferred to Sterling, including certain reinsurance recoverables as specified in the attached agreements, will remain a part of the receivership estate and will be marshaled and used for the purpose of satisfying claims liabilities for services rendered October 31, 2010 and prior. These claims will be administered in accordance with a court approved claims process. This Plan is subject to judicial approval.

B. Retention by Guardian Healthcare Inc. in Rehabilitation of Certain Guardian Assets and Liabilities

The Rehabilitator will retain after the closing certain assets of Guardian for the administration of the rehabilitation. Other than as set forth in the Assumption Agreement, Sterling will have no right or interest in the non-transferred assets. In addition, other than claims for services rendered after October 31, 2010, all other claims of any kind or nature against Guardian, except as set forth in the Assumption Agreement, will not be assumed by Sterling; and therefore, will remain with the rehabilitation estate of Guardian. The distribution of assets from the rehabilitation estate will be governed by the Plan.

C. Administration of Guardian's Retained Assets and Liabilities

The assets and liabilities not transferred to Sterling will be monetized by the Rehabilitator and subject to the claim priority and asset distribution procedures set forth under South Carolina law. Following the closing of this transaction with Sterling, it is likely that further orders of rehabilitation and/or liquidation may be requested for the Guardian estate, and a proof of claims process and claims bar date will be established in accordance with the Plan.

D. Employees of Guardian

Sterling has agreed to work with the Rehabilitator to identify any employees of Guardian whom Sterling wishes to hire. Although Sterling is not obligated to hire any employee of Guardian, the Rehabilitator is optimistic that Sterling may do so.

III. BENEFITS OF THE REHABILITATION PLAN

Upon approval of the Plan, the plans under the CMS Novation Agreement will be assumed by Sterling effective November 1, 2010, subject to the Assumption Agreement. As a result of this assumption, Sterling will be solely responsible to pay all claims for covered health care services rendered on or after November 1, 2010.

As a part of the closing of the transactions contemplated by the Plan, Sterling will pay as consideration to the Rehabilitator into the Guardian estate \$4,000,000. In exchange, the Rehabilitator will transfer assets to Sterling that include the Guardian Healthcare, Inc. name, its license to transact business in South Carolina and the Medicare Advantage book of business described above.

Assets not transferred by the Rehabilitator to Sterling shall remain with the Receivership estate of Guardian Healthcare (i.e., Guardian estate), subject to the Assumption Agreement, and all other existing assets will be liquidated and applied toward liabilities in accordance with South Carolina law.

The purpose behind this proposed Plan is to maximize the capital resources available to pay claims. There is no South Carolina guaranty fund protection for these types of claims. The Rehabilitator intends to marshal any retained assets and the \$4,000,000 consideration for the purpose of paying claims on services rendered on or before October 31, 2010. These claims will be administered in accordance with a court-approved plan. Following the closing of these

transactions, it is possible that further orders of rehabilitation or liquidation will be requested and a proof of claims process will be established in accordance with applicable South Carolina law. A general description of the proof of claims process is set forth in the attached Plan.

The primary benefits of the Plan are the following:

- a. Effective November 1, 2010, Medicare Advantage benefits due and payable under the plans for covered services rendered on or after that date will be paid by Sterling;
- b. The Plan allows for the continuation of Medicare Advantage benefits for enrollees with minimal disruption in benefits for the enrollees.
- c. The Guardian estate will receive a financial contribution that will enable it to pay some liabilities and claims of certain creditors. The Guardian estate would not have that ability without this contribution.

IV. RISKS OF THE REHABILITATION PLAN

The primary risks of the Rehabilitation Plan are the following:

- a. Sterling is an insurance company and there is a risk with any insurance operation. While there can be no absolute guarantee that a well-capitalized company assuming a book of business will never experience financial difficulty in the future, the Rehabilitator is confident that such risks have been properly considered and reasonably addressed.
- b. Due to the limited value of retained assets to pay liabilities and potential claims of Guardian's creditors, some creditors may not be paid, in whole or in part;
- c. Time is of the essence. This transaction must be approved by all necessary parties effective November 1, 2010 for it to be of any benefit to Sterling; and

- d. Litigation, objections, appeals and future economic conditions could affect the results of the Plan and impact the closing of this transaction.

V. RECOMMENDATION OF THE REHABILITATOR

The Rehabilitator recommends approval of the transactions and agreements set forth in the Plan because the transactions and agreements are fair, rational and in the best interests of Guardian enrollees, creditors and the public. The Rehabilitator's recommendation is based on the following:

1. Sterling Life Insurance Company is rated A- by A.M. Best Company. It will assume the CMS contracts as referenced above. Sterling will also collect for the Guardian estate, for a reasonable fee, certain recoverables owed to Guardian. Sterling is also willing to lease the premises and lease Guardian office furniture and equipment. Furniture will be leased to the Sterling until the furniture and other personal property can be sold by the Rehabilitator. Sterling's proposal is the only viable offer for this company. Without it, Guardian will be placed into liquidation immediately where there will be little, if any, funds available to pay claims. Sterling's offer increases the potential that Guardian's creditors may receive a pro rata portion of their claim. Without this offer, the \$4,000,000 consideration, it is unlikely that any of Guardian's creditor's claims could be paid.
2. By the assumption and transfer of the CMS contracts to Sterling, in accordance with the Assumption Agreement, there should be minimal, if any, disruption to Guardian enrollees. Sterling may continue to use the Guardian name through December 31, 2011. Accordingly, Guardian's enrollees are assured that they have coverage and benefits on a going forward basis on or after November 1 without having to re-enter the market and

obtain coverage through another Medicare Advantage contractor with CMS. Sterling will execute a novation agreement with CMS.

3. An immediate liquidation of Guardian is not a better alternative to the Plan because without the \$4,000,000, the anticipated lease payments, and certain recoverables (except capitation and medical), it is unlikely that the claims of any of Guardian's creditors would be paid. Further, liquidation of Guardian would result in a detrimental change in benefits for enrollees.

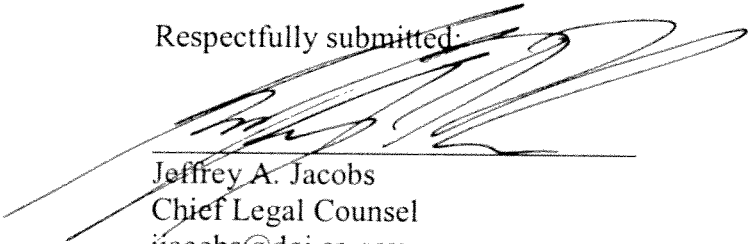
The Rehabilitator believes the Plan is fair, equitable and in the best interest of the creditors of Guardian. Through this transaction, there should be funds available to pay some creditor claims. In all likelihood, there would be little, if any, funds available to pay claims without this transaction. The overriding purpose of the Insurers' Rehabilitation and Liquidation Act, which, is to protect the interests of insureds, claimants, creditors and the public generally, is best met by the implementation of this Plan. *See* S.C. Code § 38-27-10 *et seq.* Under the Act, this Court serves in a supervisory capacity over the Rehabilitator, approving or disapproving the recommendations of the Rehabilitator. *See Ins. Comm. v. New South Life Ins. Co.*, 270 S.C. 612, 244 S.E.2d 289 (1978). When acting in such capacity, it is proper for the court to both (1) rely on the Rehabilitator's expertise as Director of Insurance for the State of South Carolina and (2) to evaluate the soundness of the Plan.

As set forth above, the Rehabilitator recommends this Plan with Sterling because the Plan and the agreements comprising the Rehabilitation Plan appear to be fair, rational, and in the best interest of Guardian's enrollees and creditors.

VI. CONCLUSION

For the reasons stated above, the Rehabilitator believes that an Order should be entered approving this Plan because it is fair, equitable, rational and in the best interests of Guardian's enrollees and creditors. The Petitioner respectfully requests that this Court issue an Order: (1) approving the Plan as proposed; (2) providing for a claims bar date; (3) authorizing the Rehabilitator to carry out the Plan in its entirety; (4) approving the transaction as being in the best interests of Guardian's claimants, creditors and the general public; (5) authorizing Rehabilitator to set up a claims fund, liquidating trust or other mechanism necessary to efficiently and effectively administer any claims that remain after the closing of the sale; and (6) approving the allocation of the contribution and other payments from Sterling be used by the Liquidation Trust for the administration of the estate and payment of claims.

Respectfully submitted:

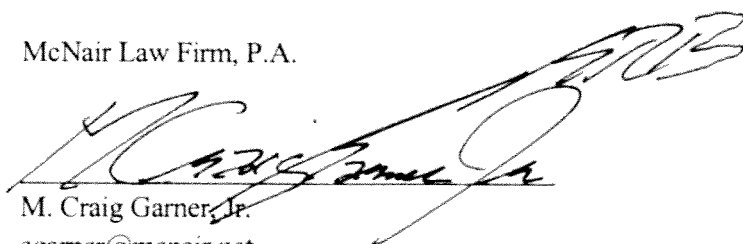


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A handwritten signature in black ink, appearing to read "M. Craig Garner, Jr.", is written over a horizontal line. The signature is stylized and extends to the right of the line.

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