IN THE CHANCERY COURT FOR THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY, PART III

LESLIE NEWMAN, Commissioner of the Tennessee Department of Commerce and Insurance,	)	
Petitioner,	)	
VS.	)	NF NO. 10-507-III
SMART DATA SOLUTIONS, LLC, a Tennessee limited liability company, AMERICAN TRADE ASSOCIATION, INC., an Indiana nonprofit corporation with its principal place of business in Tennessee, AMERICAN TRADE ASSOCIATION, LLC, an Arkansas limited liability company, SERVE AMERICA ASSURANCE, a corporation with an unknown location, BART S. POSEY, SR., ANGIE POSEY, OBED W. KIRKPATRICK, SR., LINDA KIRKPATRICK, RICHARD H. BACHMAN, KRISTY WRIGHT, WILLIAM M. WORTHY, II, and COLIN YOUELL,	)	
Respondents.	)	

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MEMORANDUM AND ORDER

This matter is before the Court pursuant to Tennessee Code Annotated section 56-9-306(2) to liquidate three businesses on the grounds that they are insolvent insurors. After conducting an evidentiary hearing on April 26, 2010, in which the State presented testimony from the Deputy Commissioner, an Examiner, and the Financial and Receivership

Director, the Court concludes that the businesses are insolvent and shall be liquidated. The findings of fact and conclusions of law on which the Court bases its decision are as follows.

Background

This lawsuit was filed by the Tennessee Commissioner of Commerce and Insurance (the "State") to liquidate three businesses, Smart Data Solutions, LLC ("SDS"); and American Trade Association, Inc., and American Trade Association, LLC ("ATA"); collectively referred to herein as the "Businesses." The State asserts liquidation is authorized on two statutory grounds: that the Businesses pose a significant hazard to the public and that the Businesses are insolvent (TENN. CODE ANN. § 56-9-306(2) and (3)). The Businesses' defense is that they are not insurors, as they have not entered into insurance contracts with any policyholders, and, therefore, that they do not come within the State's regulatory liquidation power applicable to insurance companies. The State's position is that the Businesses are subject to insurance regulation because in fact and in substance they transacted and engaged in insurance business in the State of Tennessee.

In an April 14, 2010 Memorandum and Order, incorporated herein by reference, the Court ruled in favor of the State, concluding as a matter of law that the conduct of the Businesses in facilitating nonexistent insurance coverage months after they knew the insurance did not exist constituted transacting insurance business in Tennessee and subjected the Businesses to regulation including liquidation by the State. Further, the Court concluded

that there were no genuine issues of material fact that the Businesses' hazardous condition referred to in section 56-9-306(3) had been demonstrated by the State to authorize their liquidation. That relief, however, was held in abeyance temporarily for the Court to conduct an evidentiary hearing on another statutory ground authorizing liquidation: insolvency.

At the April 26, 2010 insolvency hearing, the State presented three witnesses: Mr. Eggers, Special Deputy Commissioner; Mr. White, Examiner in Charge for the Department of Commerce and Insurance; and Mr. Jaquish, Financial Director and a Receivership Director with the Department. Counsel for the Businesses cross-examined the State's witnesses but presented no oral testimony relying, instead, upon previously submitted affidavits of the respondents.

Preliminary Rulings

As noted above, the statute in issue is Tennessee Code Annotated section 56-9-306(2) which authorizes liquidation of an insuror who is insolvent. Adopting and incorporating herein by reference the findings of fact and conclusions of law contained in the April 14, 2010 Memorandum and Order, including, but not limited to the Court's analysis that the Businesses have engaged in acts that constitute transacting insurance business in Tennessee thereby subjecting themselves to the insurance regulatory statutes including liquidation, the Court concludes that section 56-9-306(2) does apply to the Businesses. The Court also adopts and incorporates herein by reference its findings and conclusions of law, particularly

at pages 11-12 of the April 14, 2010 Memorandum and Order, that SDS and ATA were collaborators and commingled funds such that the accounts and action of SDS and ATA shall be considered together and in totality in analyzing the question of insolvency. Further, the Court concludes as a matter of law that "insolvency," as that term is used in the liquidation statue 56-9-306(2), is defined in Tennessee Code Annotated section 56-9-103(13)(B) as:

> (B) For any other insurer, that it is unable to pay its obligations when they are due, or when its admitted assets do not exceed its liabilities, plus the greater of:
>
> (i) Any capital and surplus required by law for its organization; or
>
> (ii) The total par or stated value of its authorized and issued capital stock;

Rulings from April 26 Hearing

Turning now to the proof provided by the State, the Court notes that tracking the definition provided in section 56-9-103(13)(B), the State's insolvency calculation began with comparing assets to liabilities. On liabilities, as of March 24, 2010, Special Deputy Commissioner Paul Eggers testified that reports run by the SDS staff from the computer system "Eldorado," used by SDS for processing health insurance claims, showed $1,621,482.00 in adjudicated claims liability. That liability has not been challenged or disputed by the Businesses, and, therefore, is found by the Court to constitute a liability of the Businesses. The next liability Mr. Eggers testified to was approximately $398,000.00 of

checks that had been issued by the Businesses but which did not clear the bank due to the seizure order freezing transactions. That "check run," as well, has not been disputed or challenged and is found by the Court to constitute a liability.

Mr. Eggers also testified to another 23,951 claims, consisting of 11,951 that had been scanned but not yet adjudicated and entered into Eldorado; and 24,000 claims located in various parts of the offices that were neither scanned nor entered. As to the 24,000, Mr. Eggers applied a 50% discount (12,000) to take into account duplicate filings of the same claim. He applied no duplication discount to the 11,951 scanned but not yet adjudicated claims. By adding the 11,951 claims to the 12,000 scanned but not entered claims, he came up with the 23,951. He then applied an average per claim liability of $220.13. He arrived at that amount by simply referring back to the information he had found in Eldorado on adjudicated claims. Mr. Eggers divided the value of adjudicated claims found in Eldorado by the number of adjudicated claims to arrive at an average per claim liability which, as stated, he found to be $220.13. Taking that average per claim liability and multiplying it by the 23,951 additional claims produced $5,272,348.00 of liabilities for unadjudicated claims.

The $5,272,348.00 was then added to the $398,00.00 check run and the $1,628,482.00 of unpaid adjudicated claims for a total claims liability of $6,895,830.00.

On the asset side, it is undisputed that the cash available to the Businesses is approximately $2.1 million.

When the latter cash assets are compared to the $6,895,830.00 in liabilities, there is a $4 million deficit. That deficit, the State asserts, under Tennessee Code Annotated section 56-9-103(13)(B), constitutes insolvency as "admitted assets do not exceed liabilities."

In the first instance, the Businesses challenge the State's calculations of $5,272,348.00 in unadjudicated claims liability as inflated in two ways. Based on the affidavit of Mr. Bachman, the vice president of ATA, the Businesses assert that a 50% discount rate for duplicates should also be applied to the 11,951 scanned but unadjudicated claims. A review of Mr. Eggers' testimony summarized above reveals that though he applied a 50% discount to the 24,000 claims he located in various parts of the offices that had neither been scanned nor entered, he did not apply a discount to the 11,951 claims that had been scanned but not yet adjudicated. Mr. Eggers agreed when he testified that he should have applied a discount for duplicates as to the 11,951 but that the discount, from his experience with the scanned but unadjudicated claims, was 6%, not 50%. He justified the lesser 6% discount with the explanation that in the process of scanning, duplicates would have been located and discarded. In contrast the 24,000 claims randomly located in the office had not been scanned and therefore not filtered for duplicates, justifying a higher 50% duplicate discount. The other way the Businesses challenge the State's calculation of unadjudicated claims liability is also based upon Mr. Bachman's experience in operating the Businesses. They assert that the $220.13 average per claim liability is not accurate and that average claim liability is more in the range of $75.00 per claim.

With respect to these disputes on the amount of unadjudicated claims liability, the Court concludes that the truth is somewhere in between. What the Court means by that is that Mr. Bachman's testimony must be credited to a certain extent because he has experience with the Businesses but must nevertheless be tempered because of his motivation to keep liabilities down. Mr. Eggers' testimony, although expert and credible, has to be tempered by the short amount of time he had to make his analysis and his lack of familiarity with the Businesses. The Court finds that a more accurate calculation of the liabilities is to split the difference between $75.00 per claim liability asserted by the Businesses and the $220.13 per claim liability asserted by the State to come up with a $150.00 per claim liability. The Court also applies a 20% discount to the 11,951 claims to take into account duplicates for a total 9,560. Using these figures, the Court sees that, nevertheless, the results are that there are more liabilities ($5,253,482) than assets ($2,100,000), and under section 56-9-103(13)(B) the Businesses are insolvent.

But even more telling is that if the $75.00 per claim liability asserted by the Businesses and a 50% discount of the 11,951 scanned but unadjudicated claims is applied, liabilities ($3,367,682) remain greater than assets ($2,100,000). There is, though, another aspect to the Businesses' insolvency calculation that puts them, they say, with assets exceeding liabilities.

The Businesses count as assets a $2 million claim they have against a Mr. Worthy to whom they paid that money to purchase insurance for the members, and a $600,000.00 claim

paid to Andone Insurance to purchase insurance for the members. A lawsuit was filed several months ago against Mr. Worthy; no lawsuit has been filed against Andone. These claims to recoup $2.6 million the Businesses paid to purchase insurance for their members should be counted, they say, as assets. If that were done it would bring the Businesses' balance sheet up to $4.7 million as compared to their calculation of $3,367,682 in liability. After carefully considering this argument, the Court dismisses it. The Court shall not include the $2.6 million of claims against third parties as assets under the section 56-9-103(13)(B) definition of insolvency.

The reason for the exclusion from assets of the $2.6 million claims against third parties is that the Court accredits the testimony of the State's witness, Mr. Jaquish, the Financial Director and a Receivership Director for the Department of Commerce and Insurance. He cited to the Court Tennessee Code Annotated section 56-1-405 which provides that only concrete, actual assets can be counted in tallying up the assets of an insuror for an insolvency determination: "The commissioner shall allow to the credit of an insurance company in the account of its financial condition only the assets that are or can be made available for the payment of losses in the state." The scope of assets stated in section 56-1-405 does not permit the Court to take into account the $2.6 million claims against third parties. Those claims are not presently available to pay losses. Without the credit of the $2.6 million in third party claims, the Businesses, even using their figures, are insolvent.

In addition to excluding the $2.6 million claim against third parties, there is one final aspect of insolvency for the Court to address. The foregoing analysis has tracked section 56-9-103(13)(B): a comparison of assets and liabilities. There is an additional subpart of that section. It is (i) which provides that "any capital and surplus required by law for its organizations" are to be taken into account. This reference in subpart (i) is to the $2 million in reserves the State of Tennessee requires insurors to maintain to conduct insurance business. Consistent with its previous rulings that the Businesses are *de facto* insurors in Tennessee and are subject to regulation by the State as insurors, this Court concludes that the requirement of subpart (i) applies. Accordingly, an additional $2 million in reserves is required in making the insolvency calculation which places the Businesses at an even greater deficit.

Based, then, upon all the foregoing findings and conclusions of law, the Court determines that for purposes of section 56-9-306(3) Smart Data Solutions, LLC; American Trade Association, Inc.; and American Trade LLC are insolvent.

It is therefore ORDERED that in conjunction with this Court's April 14, 2010 determination that the Businesses pose a significant hazard to the public, the Court grants the State's Petition for Liquidation based, as well, upon insolvency. It is further ORDERED that the State shall submit to the Court for entry an Order of Liquidation containing the terms proposed by the State at pages 43 through 49 of its March 23, 2010 Petition, including

therein a date asserted by the State as an appropriate Claims Deadline (*see* e.g. paragraph 22 p. 46 of March 23, 2010 Petition).

Motions to Dismiss

Also pending before the Court are the motions of the respondents, Bart Posey and Angie S. Posey, to dismiss as to them, individually, the Petition for Liquidation and Injunctive Relief. The Court had held these motions in abeyance until conclusion of the evidentiary hearing on insolvency.

In support of their motions, the Poseys argue, first, that the Commissioner's Petition is improperly verified. The Court dismisses the argument. Another argument the Poseys make in support of their motion to dismiss is that they are not persons and are not incorporated entities. As such, they contend they do not qualify as domestic insurors or alien insurors domiciled in Tennessee and, therefore, are not subject to liquidation. The Court dismisses this argument, as well, because, as explained below, injunctive not liquidation relief is sought as to the Poseys. Left is the Poseys' argument that they have not engaged in transacting insurance business in Tennessee because the Commissioner has not pled or proven the existence of any contract under which the Poseys are obligated to pay. Based on the same legal analysis contained in the April 14, 2010, Memorandum and Order, the Court concludes that proof of existence of a contract signed by the Poseys is not necessary. Instead, factual allegations of transacting insurance, such as promoting and paying claims on

nonexistent insurance business in Tennessee, could subject the Poseys to an injunction. As a matter of law, then, the State's Verified Petition states a viable legal theory against the Poseys, and on that basis the motion to dismiss is denied.

However, as to the State's factual allegations of the Poseys individually transacting insurance business, the Verified Petition does not contain sufficient detail as at the time the Petition was filed the State had not yet seized the Businesses.

In addition to the lack of factual detail, there is also lack of clarity in the Petition on the scope of the injunctive relief the State seeks. If the State seeks to preclude the Poseys from conducting any "future deceptive acts" and "unauthorized insurance business" in Tennessee, this relief, as it relates to the events and conduct stated in the lawsuit, is surplusage and unnecessary in light of the Court's determination to liquidate the Businesses. The Order of Liquidation the Court has instructed the State to prepare places the Commissioner in charge of the Businesses and closes the Businesses, thereby effectively enjoining the Poseys from transacting business in Tennessee through those entities. Additionally, paragraph 2 at page 43 of the Commissioner's proposed order of liquidation, contained in the Petition and which the Court has instructed the State to prepare and submit to the Court for entry, enables the Commissioner to take possession of accounts, assets, money and property of the Poseys which relate to, arise out of or are derived from the activities described in the Petition. As well, paragraphs 11, 12, 17 and 26 of the proposed order of liquidation at pages 45 through 48 of the Petition grants the Commissioner powers

that effectively enjoin the Poseys from engaging in any transactions or operations, whether they be unauthorized, insurance or deceptive, with respect to the Businesses in issue. Because the effect of the Order of Liquidation the Court shall enter prevents further operations of the Businesses, an injunction along those lines against the Poseys is unnecessary.

If, though, the relief the State seeks against the Poseys is broader in scope than the liquidation order that it has proposed, say, for example, an order enjoining the Poseys from operating businesses in Tennessee in the future, the Petition of the State, as it presently stands, does not contain sufficiently detailed factual allegations. Realizing that the State prepared the Petition before it had seized the respondents and that now the State has more information than it did when the case was filed, the Court ORDERS that should the State seek injunctive relief against the Poseys broader in scope than that afforded by the anticipated Order of Liquidation, the State has, until May 14, 2010, to amend its pleadings. Should the State so amend, thereafter the Poseys may reassert their motion to dismiss for Court consideration based upon the amended pleadings. In the event that the State does not amend its pleadings, no separate injunctive relief shall be issued against the Poseys; instead, for clarity, their actions shall be regulated and restricted by the terms contained in the Order of Liquidation to be entered by the Court.

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AT THE ABOVE ADDRESSES
DATE 4/28/10 CLERK _____