Nos. 13-CV-348 & 13-CV-358

District of Columbia
Court of Appeals

D.C. Healthcare Systems, Inc.,
Party in Interest and Appellant,

vs.

District of Columbia,
Department of Insurance, Securities and Banking,
Petitioner and Appellee,

D.C. Chartered Health Plan, Inc.,
Respondent and Appellee.

On Appeal from the Superior Court Civil Division
Civil Action No. 2012 CA2 8227
The Honorable Melvin R. Wright

D.C. HEALTHCARE SYSTEMS, INC.'S APPELLANT'S OPENING BRIEF

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Appellant's Corporate Disclosure Statement

Appellant D.C. Healthcare Systems, Inc. is a private corporation that has no parent corporation; no publicly-held corporation holds any of its stock; and its only subsidiary is Appellee D.C. Chartered Health Plan, Inc.

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I. STATEMENT OF ISSUES

1. Did the trial court deny appellant D.C. Healthcare Systems, Inc. (DCHSI) procedural due process by, without notice, converting a status conference concerning scheduling into a merits hearing and approving a reorganization plan and asset purchase agreement proposed by the Rehabilitator of DCHSI's subsidiary D.C. Chartered Health Plan, Inc. (Chartered) without affording DCHSI the opportunity to engage in discovery or file a brief in opposition, and without requiring or permitting testimony or other evidence despite material factual disputes?

2. Did the trial court err in approving the Rehabilitator's plan notwithstanding that the plan and his actions constituted an unauthorized liquidation, rather than a rehabilitation?

This court reviews these issues *de novo*. *Harris v. Northbrook Condominium II*, 44 A.3d 293, 298 (D.C. 2012) (violation of procedural due process rights is a constitutional question reviewed *de novo*); *In re N.N.N.*, 985 A.2d 1113, 1118 (D.C. 2009) (questions of law and constitutional procedural due process claims are reviewed *de novo*).

II. INTRODUCTION

Appellant DCHSI is a creditor and the sole shareholder of Chartered, an HMO. Since 1987, Chartered has been an incumbent to the District of Columbia Department of Health Care Finance Medicaid/Alliance contract (DHCF Contract). Servicing that contract has, for over twenty-five years, been Chartered's only business. Chartered, in turn, is DCHSI's only source of revenue.

On October 19, 2012, the Superior Court (Judge Rufus King) entered a consent order subjecting Chartered to rehabilitation because Chartered had suffered a depletion of capital reserves. This depletion, however, was caused by the District's refusal to pay amounts due for services it mandated that Chartered provide to high-risk populations that were not included in the existing rate structure.

This proceeding has been a rehabilitation in name only; Chartered is being improperly liquidated in violation of statute and the Rehabilitation Order. Since the rehabilitation

proceeding commenced, DCHSI has been aggrieved by the Rehabilitator's violations of his duties and limited powers under the Rehabilitation Act and Rehabilitation Order. In addition, the Rehabilitator also has breached direct representations he and other District regulators made to induce DCHSI to consent to Chartered's rehabilitation. Almost as soon as the rehabilitation began, the Rehabilitator unilaterally, secretly, and improperly began putting Chartered out of business, thus threatening DCHSI's existence. The Rehabilitator's conduct in impermissibly liquidating Chartered should be considered in view of the fact that the Deputy Rehabilitator in charge of the rehabilitation is infected with a disabling conflict — his brother was Chartered's Chief Operating Officer from December 2007 to September 2011 and as COO was directly responsible for conduct under review, including matters directly relating to the depletion of Chartered's capital.

The Superior Court (Judge Melvin Wright) then approved the Rehabilitator's conduct at a status hearing that was convened for the purpose of resolving a minor disagreement over the briefing schedule for DCHSI to oppose the Rehabilitator's plan. DCHSI was given no notice that the merits would be addressed, let alone decided; DCHSI was not permitted to brief the important issues at stake, to take discovery, or to provide evidence. Nor was DCHSI permitted to cross-examine the Rehabilitator's witnesses or otherwise test his evidence, because the court accepted the Rehabilitator's factual assertions without requiring any testimony and other evidence.

This extreme result of liquidating Chartered was entirely unnecessary, particularly given the limited purpose for which Chartered was subjected to rehabilitation in the first instance. Chartered was forced into rehabilitation because it suffered a depletion of capital reserves when its sole customer, the District of Columbia, withheld payments that were due and owing under the DHCF Contract. The District has refused to pay at least $62 million (plus interest) in costs it unilaterally mandated that Chartered incur. Having withheld substantial payments, the District then complained that Chartered's capital levels (unsurprisingly) had diminished and on that basis

forced Chartered into rehabilitation. Since the rehabilitation commenced, the Rehabilitator's conduct has not been directed to solving Chartered's limited capital depletion, but instead to driving Chartered and its owner out of business and allowing AmeriHealth Mercy (AmeriHealth), a competitor, to take over Chartered's operations. Like the Rehabilitator, the District and its regulators are deeply conflicted; they are driving Chartered and DCHSI out of business while they are withholding money the District owes to Chartered under the DHCF Contract that would more than solve any capital deficit and weakening Chartered's ability to collect.

Given these pervasive conflicts, the trial court overseeing Chartered's rehabilitation should have scrutinized the Rehabilitator's conduct with particular care. The Rehabilitator, however, evaded judicial scrutiny by implementing key steps in his plan to liquidate Chartered in secret. Once the Rehabilitator finally gave after-the-fact notice and brought the largely-implemented plan before the trial court, that court deferred entirely to the Rehabilitator's conduct without affording DCHSI a meaningful opportunity to be heard and without requiring or permitting an evidentiary record to support the determinations required by law. Chartered's due process and substantive rights were violated.

The key events giving rise to this appeal are:

- The District, at Chartered's expense, hired Dan Watkins, a Kansas lawyer who now is Chartered's Rehabilitator,[1] months before the rehabilitation proceeding was filed.

Mr. Watkins in turn hired Faegre Baker Daniels (Faegre) as his law firm. The regulators did not disclose to Chartered, but Chartered subsequently learned, that: (1) Mr. Watkins is the brother of Chartered's recent Chief Operating Officer, whose decisions and conduct are under review and related to the capital depletion, and (2) Faegre was representing direct competitors of Chartered with interests at stake in this proceeding, including the company, AmeriHealth, to which the

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[1] By law, the Commissioner of the DISB is the Rehabilitator. He appointed Mr. Watkins as his special deputy to carry out the Rehabilitator's powers; here, "the Rehabilitator" refers to both the Commissioner and his deputy unless context requires otherwise.

Rehabilitator ultimately gifted Chartered's assets. Chartered strenuously objected when it discovered these conflicts. The government, however, rejected Chartered's objections on the obviously incorrect theory of the Attorney General's ethics office that Mr. Watkins (and Faegre) had no conflict *with the District*; their conflict, though, was and is *with Chartered.*

- The regulators obtained DCHSI's consent to the rehabilitation — Chartered's articles of incorporation require that board actions be approved by DCHSI — under false pretenses. The regulators promised DCHSI that the Rehabilitator would be transparent and consult with and inform DCHSI, and would bid to maintain the DHCF Contract that Chartered had held for over twenty-five years. Once the rehabilitation proceeding commenced, however, the Rehabilitator secretly carried out his plan to liquidate Chartered while keeping DCHSI in the dark and refusing DCHSI's repeated requests for information about matters key to Chartered's fate.

- The Rehabilitator was appointed on October 19, 2012 under the Rehabilitation Order entered by Judge King. The Rehabilitator's duties, as well as the limits of his powers, are defined by statute and the Rehabilitation Order. The Rehabilitator operates "under the general supervision of the Court," and has the duty "to take such action as deemed necessary or appropriate to reform and revitalize Chartered." 1-AA-9.[2] He was to "submit a plan of rehabilitation of Chartered for Court approval, if one is feasible" and, if he determines one is not, to "submit a report to the Court which states the basis for such determination." 1-AA-10. If the Rehabilitator "determines that reorganization ... *or other transformation* ... is appropriate" (emphasis added), then he "shall prepare a plan" and apply to the court for its approval; "after any notice and hearings the court may prescribe, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified." D.C. Code § 31-1312 (e). In no event, however, was the Rehabilitator permitted to transform Chartered without preparing a plan, applying for approval on notice and obtaining the court's prior permission. Moreover, the

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[2] Record citations are to the three-volume Appellant's Appendix ("AA") filed with this court on April 29, 2013, in the form: *volume*-AA-*page(s)*.

Rehabilitator could not *liquidate* Chartered without *first* petitioning the court and proving through an adversary process that reasonable efforts to rehabilitate been undertaken and further rehabilitation efforts would be futile or increase the risk of loss to creditors or the public. *Id.* at § 31-1314(a).

- The Rehabilitator never genuinely attempted to rehabilitate Chartered. Instead, from the outset he implemented a plan to put Chartered and its owner out of business. The Rehabilitator implemented key elements of this plan without disclosure and without seeking or obtaining advance court approval, and without even making a passing effort at exhausting his obligation to attempt to rehabilitate Chartered. This liquidation was unauthorized, unjustified, and unlawful. Chartered has been left a shell entity with no income, no operations, no employees, no furniture, and no prospects. To have lawfully pursued liquidation — indeed, even to pursue a transformation of Chartered short of liquidation — the Rehabilitator was required *first* to prepare a plan, give notice, seek court approval, and justify the extraordinary steps he took with competent evidence.

- The Rehabilitator retained an investment banker for the purported purpose of exploring an outright sale of Chartered, but the process was designed to fail. On Friday, November 9, 2012, the investment banker solicited interested parties concerning Chartered's "potential acquisition and recapitalization." 2-AA-463. Responses were due by 5 p.m. November 14, 2012, just two business days after the letter was sent (over Veterans Day weekend), and the responses required detailed financial and other information that would have been all but impossible to assemble so quickly. The letter clearly stated that any bid must be *binding*, and that the bidder must support *Chartered's* bid for the new the DHCF Contract.

- The Rehabilitator subsequently admitted that by the week of November 26, 2012 he had abandoned any pretense of trying to sell Chartered and had decided to enter into a *non-binding* letter of intent with AmeriHealth and to work with AmeriHealth "to complete a response to the [Medicaid/Alliance] RFP *in [AmeriHealth's] name* (utilizing key Chartered personnel and experience in the response) and to negotiate a definitive agreement with [AmeriHealth]." 1-AA-

16 (emphasis added). The Rehabilitator, however, did not disclose this plan or seek prior court approval.

- On November 30, 2012, the Rehabilitator, without notice or court approval, caused Chartered to enter into an agreement to provide its "resources, assets, and know-how in support of" competitor AmeriHealth's bid for the award of the DHCF Contract, in exchange for $5 million to be paid if AmeriHealth "is chosen as a Service Provider under the RFP and commences operations thereunder." 2-AA-468.

- On December 1, 2012, the Rehabilitator, again without notice or court approval, caused Chartered to enter into a *non-binding* letter of intent with AmeriHealth to transfer all of Chartered's operating assets to AmeriHealth *without payment of additional consideration*; the $5 million payment required under the November 30, 2012 letter agreement is the only payment AmeriHealth ever agreed to make.

- Only when the December 3, 2012 bidding deadline for the DHCF Contract passed did the Rehabilitator reveal — and then only through a posting on the Department of Insurance, Securities and Banking's (DISB) website — that Chartered had not bid to keep its only source of income (the DHCF Contract), but instead had been required by the Rehabilitator to commit its full resources to supporting competitor AmeriHealth's bid on that contract.

- Beginning soon after the rehabilitation commenced, DCHSI repeatedly asked the Rehabilitator for the cooperation and input the regulators had promised to induce DCHSI to consent to the rehabilitation. The Rehabilitator refused each request. In mid-January, DCHSI threatened to involve the court and only then did the Rehabilitator agree to produce unspecified documents upon execution of a confidentiality agreement, the negotiation of which stretched until February 22, 2013. Not coincidentally, on the same date the confidentiality agreement was signed, the Rehabilitator filed a petition seeking expedited approval of the asset transfer to AmeriHealth and his "rehabilitation" plan. 1-AA-12. This petition, however, was filed only after the Rehabilitator already secretly had implemented the essential elements of his liquidation plan without notice or court approval, including abandoning efforts to solve Chartered's capital

depletion, offering terms to AmeriHealth not made available to other interested parties, prohibiting Chartered from bidding on the DHCF Contract, and supporting AmeriHealth's bid for the DHCF Contract, all to the exclusion of other available *rehabilitating* options.

- DCHSI immediately called opposing counsel to seek an agreed briefing schedule for DCHSI's opposition to the plan and proposed asset transfer. 1-AA-228. Among other things, DCHSI needed time to digest the over 120-page asset transfer agreement, which the Rehabilitator previously had refused to disclose despite DCHSI's repeated requests. The District refused DCHSI's request to file its brief on March 12, 2013 (after DCHSI's counsel returned from out-of-country travel), but did agree that DCHSI could file on March 6 (when DCHSI's counsel would be out of the country). DCHSI immediately on February 22 filed an opposition to the request for an expedited hearing and asked the court to "enter a reasonable briefing schedule ..., with DCHSI's response to be due March 12, 2013, and a bearing to be scheduled the week of March 19, 2013." 1-AA-229. DCHSI stated it would be available for "a conference, by person or by telephone, *to discuss scheduling* this afternoon or the week of February 25, 2013." *Id.* (emphasis added). The District opposed, asking the court to approve the petition without permitting any opposition, but stating that any opposing brief by DCHSI should be filed by March 6 with a hearing the week of March 11. 1-AA-232-33.

- The Superior Court (Judge Melvin Wright) set a status conference for March 1, 2013. At that status hearing, the court did not set a briefing schedule, but instead ruled on the merits without briefing or competent evidence. The court expressly rejected DCHSI's argument that consideration of the merits of a plan that would put Chartered and DCHSI out of business should not be made without briefing and an evidentiary record to support the Rehabilitator's unsworn and untested factual assertions. Based on those mere assertions, however, the court at the status hearing held that the asset transfer and purported rehabilitation plan were fair and equitable, even though there was no evidence, for example, of the value of the assets that were transferred. 1-AA-294. (DCHSI promptly filed a motion to stay pending appeal and for injunction, with supporting facts, which the court denied without hearing. 2-AA-298-668, 914.)

As a matter of law, the Rehabilitator's obligation was to use all reasonable efforts to rehabilitate Chartered — to obtain additional capital and keep Chartered in business. Chartered had real value, if only the Rehabilitator had permitted Chartered to bid on the DHCF Contract as it was poised to do. But the Rehabilitator never made a genuine effort to rehabilitate; rather, he engaged in secret, unapproved conduct to put Chartered and DCHSI out of business. The Rehabilitator's actions define a liquidation, the "process of converting assets into cash," and are antithetical to a rehabilitation, the "process of reorganizing a debtor's financial affairs ... so that [it] may continue to exist as a financial entity." Black's Law Dict. 1080, 1451 (9th ed. 2009); *see also* 43 Am. Jur. 2d Insurance § 99. In doing so unilaterally and without prior court approval, and without first having made all reasonable efforts to rehabilitate, the Rehabilitator violated the Rehabilitation Act and the Rehabilitation Order. He did so without giving creditors and parties in interest the opportunity to be heard. The trial court erred by approving this conduct, and doing so without notice or the meaningful opportunity to be heard that due process requires. The Rehabilitator also violated Chartered's governing corporate documents, which the Rehabilitation Order did not supplant.

Liquidation was improper. The Rehabilitator flouted the statutory requirements and the Superior Court failed to oversee the Rehabilitator and provide a fair and open process consistent with the fundamental requirements of our adversary system. Reversal is necessary and respectfully urged.

III. STATEMENT OF FACTS

A. Chartered, an HMO dependent on the DHCF Contract, is taken over by a rehabilitator

Chartered is a licensed HMO that since 1987 has been an incumbent to the DHCF Contract, which is Chartered's only business and source of income. 1-AA-2-3, 14. DCHSI, Chartered's landlord, is a creditor and its sole shareholder; Chartered is DCHSI's sole source of revenue. 2-AA-349. Under Chartered's articles of incorporation, "[n]o action of the Board of

Directors shall take effect unless it has been approved by the unanimous vote of the outstanding shares entitled to vote." 2-AA-372.

Chartered was serving over 100,000 members a month under the DHCF Contract. 1-AA-376. Over twenty-five years of operating the DHCF Contract, Chartered developed "a significant provider network incorporating primary, urgent and emergency care health services," giving "both Medicaid and Alliance beneficiaries ... access to the full range of health care services they may need to address their medical needs." *Id.*

In 2011, DHCF and DISB focused oversight on Chartered due to concerns over Chartered's diminished capital reserves. As reflected in Chartered's audited financial statements, Chartered had the following capital reserves (net worth) from 2004 to 2011: $11,843,556 (2004); $15,945,518 (2005); $20,717,538 (2006); $21,312,995 (2007); $21,059,187 (2008); $13,656,951 (2009); $17,444,611 (2010); $5,949,445 (2011). 2-AA-393 n.3, 412-13 n.3, 430 n.3, 454 n.8; 1-AA-34.

Chartered's capital became depleted because the District wrongfully failed to pay Chartered over $62 million that the District unilaterally required Chartered to incur by forcing Chartered to accept on its rolls new, high-risk populations that had not been included in the existing capitation rates, and otherwise by paying rates that were not actuarially sound, contrary to the requirements of the DHCF Contract.[3] *E.g.*, 1-AA-57.

In spring 2012, the DISB Commissioner and DHCF Director began to apply substantial political pressure on Chartered and DCHSI. First, they insisted that DCHSI's sole shareholder, Jeffrey Thompson, step down as chairman of Chartered's board of directors. Second, they insisted that DCHSI agree to sell Chartered. Bowing to that pressure, Mr. Thompson stepped

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[3] *See* 3-AA-588 (noting that "[t]he projections [used in establishing capitation rates for July 2010–April 2011] ... do not consider the additional enrolment related to the coverage expansion up to 133% of the federal poverty level (FPL)"); 3-AA-615 (Rates Effective May 2012, noting that "childless adults were added ... effective July 2010 for individuals up to 133% the [FPL]" and those with "incomes between 134% and 200% of the FPL [] were enrolled ... effective December 2010").

down as chairman of Chartered's board and DCHSI agreed to pursue the sale of Chartered. *E.g.*, 2-AA-380; 3-AA-903.

As part of its regulatory oversight, on or about May 24, 2012, the District retained, at Chartered's expense, Kansas lawyer Daniel Watkins, who later became the Special Deputy to the Rehabilitator, and Faegre Baker Daniels (Faegre), a law firm to represent him, to conduct an examination of Chartered. 1-AA-12, 22, 2-AA-518, 542. Chartered initially agreed, but subsequently learned that Mr. Watkins and Faegre had irreconcilable conflicts of interest with Chartered that the regulators had not disclosed and vigorously objected. 2-AA-518-19. The Deputy Rehabilitator's brother, Robert Watkins, was Chartered's Chief Operating Officer from December 2007 to September 2011 and was directly responsible for conduct and decisions subject to the Rehabilitator's review (e.g., rate-setting, contract negotiations and pharmacy management), including actions having a direct impact on the capital depletion the Rehabilitator was to cure. 1-AA-266; 2-AA-518-19. For its part, Faegre represented direct competitors of Chartered in the District market (including AmeriHealth, for which it is a registered lobbyist) that had expressed interest in acquiring Chartered and in competing for the DHCF Contract; those clients would be advantaged if Chartered went out of business. 2-AA-519, 526, 528.

The government rejected Chartered's objections, stating that the Attorney General's office had reviewed the allegations and determined that the Deputy Rehabilitator had no conflict *with the District of Columbia* and that the rehabilitation proceeding was directed to prospective measures, not to the review of past actions. 2-AA-519-26 (detailing facts showing conflicts and demonstrating error in District's conflicts analysis; under D.C. Code § 31-1405 and Rule 1.7 of the D.C. Rules of Professional Conduct, the analysis should have focused on conflicts with the "person subject to examination," i.e., Chartered, not merely with the District itself). The government never addressed the Deputy Rehabilitator's and Faegre's direct conflicts *with Chartered* (and the Superior Court ignored those conflicts in rendering the rulings on appeal).

In October 2012, the DISB Commissioner and the DHCF Director approached Chartered's board to seek its consent to submit Chartered to rehabilitation. 2-AA-513. Under Chartered's articles of incorporation, such consent required DCHSI's approval. The regulators represented to DCHSI that the Rehabilitator would cause Chartered to bid on the new DHCF Contract in its own right, and would provide information to and cooperate and consult with DCHSI. Indeed, the Rehabilitator agreed to confirm this in writing, but said he could not do so until after the consent rehabilitation petition was filed. 2-AA-346; 3-AA-806-07. Both Chartered and DCHSI consented to a rehabilitation. (The Rehabilitator never delivered on the promised written confirmation that he would keep DCHSI informed and consult with DCHSI, despite repeated requests. 3-AA-807.) Shortly after the rehabilitation was filed, the Rehabilitator in public testimony again repeatedly stated that Chartered would bid on the new DHCF Contract. 2-AA-561-62.

The court (Judge King) entered the Rehabilitation Order on October 19, 2012. 1-AA-8. Although the Rehabilitation Act requires that the "compensation of the special deputy [and] counsel ... be fixed by the Commissioner, with the approval of the court," D.C. Code § 31-1312 (a), the Rehabilitator has never sought court approval for the compensation of the Deputy Rehabilitator or his counsel; indeed, the Rehabilitator disclosed in his May 17, 2013 Fourth Status Report filed in the Superior Court that he has incurred over $3.1 million in legal and consultant fees, all of which were incurred without the approval of the court, a further abuse of the Rehabilitator's limited powers.

B. Rather than rehabilitate Chartered, the Rehabilitator begins to liquidate it

The Rehabilitator went through truncated motions of trying to sell Chartered, but the effort was designed to fail. The Rehabilitator recognized that "Chartered required a new Medicaid contract with the District to be a viable acquisition candidate." 1-AA-14. The current DHCF Contract was to expire on April 30, 2013 (although it subsequently was extended to July 2013, as has been common practice throughout Chartered's twenty-five year history with the

Medicaid/Alliance contract). The bidding process on the new five-year DHCF Contract was to begin in early November 2012 (the "Medicaid/Alliance RFP"), with initial proposals due by December 3, 2012. 1-AA-13, 243. The DHCF Director told the Rehabilitator that Chartered was eligible to bid on the DHCF Contract, but he further imposed unwritten conditions on Chartered's bid: DHCF would not select Chartered unless it had a new owner and was out of rehabilitation when DHCF made award recommendations to the District Council. 1-AA-14.

On Friday, November 9, 2012, an investment banker the Rehabilitator retained solicited interested parties "to respond to a preliminary request for information in connection with ... a potential acquisition and recapitalization of [Chartered]" (Chartered RFP). 2-AA-463. Responses to the Chartered RFP were due by 5 p.m. November 14, 2012, two business days after the letter was sent (over Veterans Day weekend), and "a limited number" of responders then would be selected to continue in the process and submit a binding letter of intent by December 1, 2012. 2-AA-464.

In that short period, bidders were required to submit "a detailed response" setting forth: (1) the bidder's ability to fund an estimated $30 million in capital with the expectation that "any Transaction will be effected via the sale of 100% of the issued share capital of [Chartered]" and (2) "proposed sources of financing," including a "summary financing plan" and "the names and contact information of proposed third-party funding sources or partners and the steps and timing required to secure the necessary funds." 2-AA-464. Bidders also would have to submit "a *binding letter of intent* prior to [Chartered] submitting a response to the [Medicaid/Alliance] RFP" and identify all due diligence required "prior to executing a *binding letter of intent*" on December 1. *Id.* (emphasis added; also requiring bidders to agree to Chartered's response to the Medicaid/Alliance RFP). Requiring that the letter of intent be binding was important; it ensured that if one transaction partner was selected to the exclusion of others, the selected partner was committed to the deal. That was the only way adequately to protect Chartered's providers, enrollees, employees, and shareholder.

DCHSI has not been afforded the opportunity to take discovery, but the Rehabilitator represents that he quickly narrowed the field down to two possible transaction partners for Chartered: AmeriHealth and an unnamed entity that "had comparable financial strength" to AmeriHealth. *See, e.g.*, 3-AA-679 (¶ 25(a)-(b).) The unnamed possible partner was rejected for lack of "experience operating a Medicaid HMO" (*id.*), but this fundamentally missed the point: Chartered needed an infusion of capital, not Medicaid HMO experience, which Chartered had in abundance. In fact, as discussed below, Chartered's experience is in effect what AmeriHealth purchased and relied on to prepare its own bid and ultimately to run its business in the District.

The Rehabilitator subsequently disclosed that by the week of November 26, 2012 he had abandoned efforts to find capital for Chartered in favor of transferring Chartered's assets to AmeriHealth. *E.g.*, 1-AA-16. Thus, despite his duty to "take such action as deemed necessary or appropriate to reform and revitalize Chartered" and his power "to accept new or renewal business or extension of Chartered's contracts" (1-AA-8-9), and the representations and promises that he would do so (2-AA-346, 561-62; 3-AA-806-07), the Rehabilitator proceeded to dismantle Chartered without *first* "submit[ting] a report to the Court which states the basis" for his determination that rehabilitation was futile (1-AA-10) , and without DCHSI's knowledge or consent.[4]

On November 30, 2012, the Rehabilitator secretly entered into an agreement with AmeriHealth whereby Chartered agreed to provide its "resources, assets, and know-how in support of [AmeriHealth's own RFP bid]" in exchange for $5 million, to be paid if AmeriHealth "is chosen as a Service Provider under the [Medicaid/Alliance] RFP and commences operations thereunder." 2-AA-468. Then, also without notice or court approval, the Rehabilitator on December 1, 2012 executed a *non-binding* letter of intent with AmeriHealth to transfer Chartered's operating assets to AmeriHealth. 1-AA-78.

[4] Chartered's governing documents, which remain in effect, require that DCHSI approve all board actions. *See* 2-AA-372; D.C. Code § 31-1310 (9) (insurer's willful violation of its articles of incorporation or bylaws constitutes grounds for rehabilitation).

Contrary to the terms required in the Chartered RFP directed to prospective buyers, AmeriHealth did not submit a binding letter of intent, did not agree to recapitalize Chartered, did not approve a response by Chartered to the Medicaid/Alliance RFP, and did not provide $30 million in financing to Chartered. 3-AA-719-22. There is no evidence that other bidders were extended the same opportunity to bid on terms contrary to those announced in the Chartered RFP; indeed, the Rehabilitator has never disclosed the other bids, and the court did not permit discovery or require evidence so that AmeriHealth's offer could be evaluated. Nor has the Rehabilitator presented any evidence concerning the fair value of Chartered's assets, which AmeriHealth received without additional payment beyond what it had already agreed to pay for Chartered's cooperation and experience in the November 30, 2012 letter agreement. 2-AA-468.

Again without notice or court approval, the Rehabilitator prevented Chartered from responding to the Medicaid/Alliance RFP. Instead, the Rehabilitator compelled Chartered to assist AmeriHealth in making its own proposal, a fact later disclosed through a posting on DISB's website on December 3, 2012, the bidding deadline. 1-AA-472; 3-AA-806-07.

Thus, less than six weeks after the rehabilitation proceeding commenced, the Rehabilitator had abandoned even the appearance of attempting to rehabilitate Chartered, and had fully launched his plan to put Chartered and DCHSI out of business, all without notice and without prior court approval.

C. DCHSI unsuccessfully protests the DHCF bidding process

After learning that Chartered did not bid on the Medicaid/Alliance RFP, DCHSI filed a bid protest before the District of Columbia's Contract Appeals Board. 2-AA-517-33. DCHSI sought to have the Medicaid/Alliance RFP canceled and resolicited based on the Rehabilitator's and Faegre's conflicts of interest and illegal restraints of trade and collusive bidding. 2-AA-527-30. The District successfully moved to dismiss the bid protest on jurisdictional and standing grounds. 2-AA-535, 579.

D. The Rehabilitator's First Status Report attempts to justify prior, unauthorized actions to liquidate Chartered

On January 11, 2013, the Rehabilitator filed his First Status Report, claiming that one of his "overarching goals" was to "preserve any residual value for Chartered's shareholder." 1-AA-13, 14 (acknowledging "Chartered required a new Medicaid contract with the District to be a viable acquisition candidate"). The report attempted to justify his unapproved liquidating actions.

The Rehabilitator referenced the DHCF's position that Chartered would not win the DHCF Contract unless it had a new owner and emerged from rehabilitation before the contract award recommendations were made to the District Council. 1-AA-14. The Rehabilitator accepted those unwritten conditions without question, even though he recognized that Chartered needed to win the contract to remain in business and "be a viable acquisition candidate." *Id.* The Rehabilitator cited other general concerns about Chartered's prospects for winning, even though Chartered had been awarded the contract repeatedly for over twenty-five years. *Id.* The Rehabilitator also raised concerns about Chartered's finances, based on stale information as of December 31, 2011 (1-AA-15-16); Chartered's financial statement as of September 30, 2012, prepared under the Rehabilitator's direction, showed substantial improvement notwithstanding the District's continuing failure to pay over $62 million due, as discussed below. 1-AA-74-76.

The Rehabilitator took the position that his plan represented "the best alternative for achieving value for Chartered under the circumstances." 1-AA-16. This ignored that the plan depended entirely on the hope that AmeriHealth would win the DHCF Contract; if Chartered did not win the contract, among other things, Chartered's business would fail and over 160 employees would be out of work. If, instead, the Rehabilitator simply had permitted Chartered to submit a timely bid in its own name, the Rehabilitator would have had substantially more time to find a better *rehabilitation* alternative for Chartered, including other sources of capital or other possible buyers. The Rehabilitator instead unilaterally imposed a death sentence on Chartered and DCHSI.

E. The Rehabilitator's Second Status Report seeks an order approving the transfer of Chartered's assets to AmeriHealth

On February 22, 2013, the Rehabilitator filed his Second Status Report and a petition seeking expedited approval to transfer Chartered's principal assets to AmeriHealth. 1-AA-55. The Second Status Report discusses Chartered's financial results as of September 30, 2012, showing Chartered's capital reserves had increased to $9 million, up 50% from $5.9 million at year-end 2011. 1-AA-56. The Rehabilitator also explained that the District owes Chartered $62 million plus interest (rather than the mere $32 million booked as of September 30, 2012) because the District mandated that Chartered serve a high-risk population but had not paid the increased costs and otherwise reimbursed Chartered based on actuarially unsound rates, in violation of the DHCF Contract. 1-AA-56-57. See *supra* note 3.

Accepting the Rehabilitator's accounting, Chartered's capital at September 30, 2012 based on the $62 million claim (without interest) would increase by $30 million from the $32 million claim then booked, and thus was over $39 million. This is substantially in excess of Chartered's capital in any prior year, when its DHCF Contract was continually renewed.

The Rehabilitator also sought expedited approval of an agreement to transfer Chartered's operations and associated assets to AmeriHealth. That agreement would consummate the Rehabilitator's decimation of Chartered and, in turn, DCHSI. 2-AA-349. In effect, the agreement contemplated the transfer of Chartered's operating assets to AmeriHealth for no consideration; the only payment required of AmeriHealth was the $5 million it on November 30, 2012 agreed to pay for Chartered's assistance in preparing and supporting AmeriHealth's response to the Medicaid/Alliance RFP. 2-AA-468. AmeriHealth was required to make that payment even if the asset transfer did not close, so long as AmeriHealth won the contract (it did) and "commenced operations thereunder" (it has). *Id.* AmeriHealth thus received Chartered's assets for no additional payment. The gifted assets include not only the inheritance of the existing DHCF Contract and provider contracts, but also Chartered's phone numbers and trade name, computer systems, membership rolls, accounting records, certain intellectual property

rights, furniture, equipment, supplies, machinery, tools, vehicles and office equipment, claims data, price lists, supplies and sales records, financial and accounting records and more; in short, all assets necessary to operate Chartered's business. 1-AA-96-97. The Rehabilitator offered no evidence listing all the assets transferred, their value or why he did not extract additional consideration from AmeriHealth for them, and the trial court rejected DCHSI's request that such proof be required. 1-AA-281-87; 2-AA-308.

The asset transfer agreement was subject to numerous closing conditions, which gave AmeriHealth immense flexibility to walk away (1-AA-134-36), but the Rehabilitator did not negotiate any "fiduciary out" or similar provision to give Chartered even the ability to solicit or consider better offers. 1-AA-136-37. That the Rehabilitator completely abandoned his obligations to Chartered is shown by the fact that, if AmeriHealth had decided to walk away, Chartered would have been left with no source of income, no ability to pay its employees, and an impeded ability to collect the more than $62 million owed by the District.

The Rehabilitator's report admitted that his next step would be to "wind down Chartered's remaining operations," marshal the remaining assets and apply those assets to outstanding liabilities — all hallmarks of liquidation. 1-AA-62; 2-AA-586. Even without a record developed through discovery, evidence, and cross-examination, it is clear that the goal from the outset was to put Chartered and DCHSI out of business and transfer Chartered's operations to another entity.[5] Unencumbered by having to produce evidence that could be tested

[5] As such, the Rehabilitator did the political bidding of D.C. Council member David Catania, who formerly chaired the Council's Health Committee and who stated less than a week into the rehabilitation proceeding: "It's finished, as far as I'm concerned. There just is simply no way [Chartered] resurrects itself from receivership." *See* Tom Howell Jr., Chartered Health Plan's Finances Draw Scrutiny, Washington Times, Oct. 25, 2012, at http://m.washingtontimes.com/news/2012/oct/25/chartered-health-plans-finances-draw-scrutiny/?page=all; *see also* Mike Debonis, Health Plan Takeover in DC Eases Concerns but Doesn't Erase Them, Washington Post, Oct. 22, 2012, available at http://www.washingtonpost.com/local/dc-politics/health-plan-takeover-in-dc-eases-concerns-but-doesnt-erase-them/2012/10/22/333d15c4-1c8d-11e2-9cd5-b55c38388962_story.html (quoting Council member Catania as stating — only three days after the proceeding was filed — that "[t]his receivership is the epitaph for Chartered").

through the adversary process, the Rehabilitator prevailed merely by asserting that his plan is "fair and equitable for all parties concerned" and that it is the "best way to [] preserve residual value, if any, for Chartered's sole shareholder" as well as other creditors and parties in interest. 1-AA-64.

F. The trial court approved the transfer of Chartered's assets to AmeriHealth and the Rehabilitator's plan in violation of due process

In response to the Rehabilitator's February 22, 2013 motion to, in effect, liquidate Chartered on an expedited basis, DCHSI sought a briefing schedule, first from the District and then from the trial court. The District agreed that DCHSI could file a brief by March 6, 2013, but refused DCHSI's request to accommodate counsel's travel outside the country by filing less than a week later, on March 12. 1-AA-229. DCHSI immediately on February 22 filed an opposition to the expedited hearing request, seeking "a reasonable briefing schedule" whereby DCHSI could address the merits by March 12, 2013 (after counsel returned from a short trip out of the country), with a hearing the week of March 19, 2013. 1-AA-229. DCHSI stated it would be available for "a conference, by person or by telephone, *to discuss scheduling* this afternoon or the week of February 25, 2013." *Id.* (emphasis added). The District opposed and asked the court to rule in its favor without allowing any opposition, but proposed that any brief by DCHSI should be filed by March 6 (when it knew DCHSI's counsel was out of the country), with a hearing the week of March 11. 1-AA-232-33.

The Superior Court (Judge Wright) set a status conference for March 1, 2013 in response to DCHSI's request "to discuss scheduling." At that hearing, the court immediately converted the status/scheduling hearing into a hearing on the merits (1-AA-246) and instructed DCHSI that "you better give me something right now because you may not have an opportunity to brief this." 1-AA-251. DCHSI repeatedly objected that it had not been given any notice of a merits hearing, that it was prepared to discuss scheduling but not the merits, that a factual record was required and that, in addition to permitting a substantial violation of the Rehabilitation Act and Rehabilitation Order, the court was violating DCHSI's due process rights. 1-AA-246, 251, 253-

54, 256-57, 262, 269-70, 279-82, 284. The court nevertheless entered a decision on the merits based on the Rehabilitator's untested and non-evidentiary assertion that the asset transfer and purported rehabilitation plan were fair and equitable. The Rehabilitator did not provide, and the trial court did not require, any facts showing that the consideration supposedly paid for Chartered's assets was fair or even what the assets were worth. Nor did the Rehabilitator offer, or the court require, evidence to assess what other parties that had expressed interest in buying Chartered were willing to offer or why the others were rejected. The Rehabilitator asserted that the agreement was "negotiated in good faith and at arm's length by professionals and advisors who vigorously advocated the interests of their respective clients" (1-AA-58), but no evidence of this was presented or required either. Indeed, the agreement was negotiated under the cloud of substantial conflicts by the Rehabilitator and his counsel; the interests of Chartered's creditors and its shareholder therefore were not adequately represented.

DCHSI filed a motion for stay and an injunction, with supporting facts, including affidavits from two fact witnesses and an expert in insurer insolvency matters. The court denied the motion without hearing. 2-AA-298-668, 914. DCHSI timely appealed. 3-AA-920.

MedStar, a significant Chartered creditor, also moved to intervene in the rehabilitation proceedings to object to the Rehabilitator's plan. But the court denied intervention, an order also now on appeal to this court.

IV. ARGUMENT

The court approved the AmeriHealth transaction and the Rehabilitator's largely-implemented "rehabilitation" plan at a status conference that DCHSI requested to establish a briefing schedule. DCHSI, creditors and other interested parties were not provided notice of a merits hearing. And DCHSI was not permitted to file any substantive opposition, take discovery, or present an evidentiary record. The notion that the plan is fair and equitable is belied by the fact that the transaction leaves Chartered with no ability to conduct business or satisfy its lease obligations to DCHSI. 1-AA-13-36. DCHSI is left owning a shell company with liabilities and

a lease that Chartered now has breached, and Chartered now must attempt to collect on its claim against the District after the contract has been transferred, such that DHCF has even less incentive to pay Chartered. 1-AA-59-60. DCHSI suffered a denial of due process that this court should correct.

In addition to serious procedural error, there was significant substantive legal error as well. The Rehabilitator's proposed plan for Chartered's fate was, in fact, no "rehabilitation" at all, but instead an unwarranted, unapproved, and unlawful liquidation.

A. The trial court denied DCHSI due process by converting a scheduling status conference into a hearing on the merits without notice and before DCHSI could properly prepare

DCHSI was denied procedural due process. The same day the Rehabilitator petitioned for expedited approval of the proposed asset transfer to AmeriHealth (1-AA-55-227), DCHSI requested the opportunity to file a merits brief objecting to the proposed plan, pointing out that the Rehabilitator had withheld the details of the plan until he filed the expedited approval petition. 1-AA-228-29. The Rehabilitator argued that although "some inconvenience to DCHSI is inevitable" (1-AA-233), there was an urgent need for a quick ruling. Then, at what was supposed to have been a status conference to set a briefing schedule, the court entered a final order on the merits. *E.g.,* 1-AA-246 (court goes directly to the merits), 251 (Court: "Well, you better give me something right now because you may not have an opportunity to brief this."). Yet the Court's order — a signed version of the Rehabilitator's proposed order (*cf.* 1-AA-69-71 *with* 1-AA-294-96) — states that the hearing was a "status conference" (1-AA-295) and never even notes that DCHSI appeared and attempted to object and seek briefing, let alone that creditors were not given notice or permitted the opportunity to appear. DCHSI was not afforded due process to contest the Rehabilitator's proposed plan.

Where, as here, the government acts to deprive a party of property, the constitutional guarantee of due process requires that judicial procedures be fundamentally fair. *Fuentes v. Shevin*, 407 U.S. 67, 81 (1972) (procedures must "minimize substantively unfair or mistaken

deprivations" by enabling parties to contest the basis on which the state proposes to deprive them of protected interests); *In re Estate of Delaney*, 819 A.2d 968, 991 (2003). The basic requirements of due process are notice and the opportunity to be heard "at a meaningful time and in a meaningful manner." *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965). Yet DCHSI was deprived of notice that the status conference would become the hearing on the merits. As a result, DCHSI was deprived of meaningful notice and then any meaningful opportunity to be heard: The court required DCHSI to state its case immediately, without the benefits of such due processes as discovery, briefing, testimony, and the opportunity to cross-examine any witnesses offered in support of the Rehabilitator's assertions. *E.g.*, 1-AA-251, 284.

Fair notice means being apprised of the pendency of the proceeding and the opportunity to participate; valid notice must enable the recipient to determine what is being proposed and what must be done to prevent a deprivation of his interests. *Goldberg v. Kelly*, 397 U.S. 254, 267-68 (1970); *In re Gault*, 387 U.S. 1, 33 (1967) (notice must be given sufficiently in advance of scheduled court hearings to allow a reasonable opportunity to prepare for the hearing); *District of Columbia v. Jones*, 442 A.2d 512, 521 (D.C. 1982) (recognizing that without prior notice of what the hearing will be about, a party would be unable to marshal evidence and prepare his case so as to benefit from the hearing). Although due process is "flexible" depending on the circumstances presented (*Jordan v. Jordan*, 14 A.3d 1136, 1159 (D.C. 2011)), the bedrock test for fair notice is reasonableness. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314-15 (1950); *Richard Milburn Pub. Charter Alternative High Sch. v. Cafritz*, 798 A.2d 531, 542 (D.C. 2002) ("the Constitution requires notice and opportunity for hearing appropriate to the nature of the case"). What happened here was neither fair nor reasonable.

DCHSI's counsel had no notice whatsoever that the status conference — intended to set a briefing schedule — would become the trial on the merits. *Jones, supra*, 442 A.2d at 522 (the notice requirement of due process requires being informed before the hearing about the manner in which it would be conducted). Once that became apparent at the hearing, DCHSI's counsel

repeatedly pointed out the due process problem and requested an opportunity to provide briefing (as well as noting how the trial court lacked any sort of evidentiary record on which to base a ruling). *E.g.*, 1-AA-246, 250-54, 256, 259, 262-63, 266, 268, 270, 280-81, 284. Thus, this is not an instance where counsel failed to seek a continuance or failed to ask to file an opposition (e.g., *Delaney, supra*, 819 A.2d at 991), but instead is an instance where the trial court recognized the issue and simply proceeded anyway, converting a status conference into a merits hearing. That alone is a denial of due process. *See, e.g., Batton v. City of Jasper*, 354 Fed. App'x 400, 400-02 (11th Cir. 2009) (reversible error to make merits ruling at a status conference rather than hold an evidentiary hearing); *A.C. v. State Florida*, 23 So. 3d 826 (Fla. App. Ct. 2009) (due process requires actual notice and time to prepare; more notice is necessary for an evidentiary hearing than a status conference); *Wilkins v. Cooper*, 890 N.E.2d 868, 873-74 (Mass. App. Ct. 2008) (denial of due process to convert status conference into merits hearing). Converting a status conference into a merits hearing fails to provide meaningful notice and that improper notice necessarily deprived DCHSI a meaningful opportunity to present its case.

Fair procedures are especially crucial when there are disputed factual issues. Although there is no absolute right to discovery in all contexts, the Supreme Court has observed that "where governmental action seriously injures an individual, and the reasonableness of the action depends on fact findings, the evidence used to prove the Government's case must be disclosed to the individual so that he has an opportunity to show that it is untrue." *Greene v. McElroy*, 360 U.S. 474, 496 (1959), quoted with approval in *Goldberg, supra*, 397 U.S. at 270. This rule is particularly applicable here, where the Rehabilitator withheld information from DCHSI notwithstanding repeated promises by the Rehabilitator and requests by DCHSI on at least November 2, 9, 16, 23 and 30, 2012, December 5 and 12, 2012, and January 11 and 15, 2013. 3-AA-805, 811. The only information provided was given the same day the Rehabilitator filed his petition, and it was almost entirely the same information filed in court. This effectively denied DCHSI any opportunity to develop or rebut the Rehabilitator's factual assertions.

In evaluating procedural due process claims — reviewed *de novo* (*N.N.N.*, *supra*, 985 A.2d at 1118) — this court uses a balancing test, considering the importance of the private interest at stake, the risk of an erroneous deprivation through the procedures used, the probable value of additional safeguards and the government's interest in the process given. *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976); *Jordan*, *supra*, 14 A.3d at 1159.

Here, the private interest at stake is of enormous significance, as it effectively means the difference between "life or death" for Chartered and DCHSI. *E.g.*, *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 543 (1985) (recognizing "severity of depriving a person the means of livelihood" in the due process context); *Cafritz*, *supra*, 798 A.2d at 543 (government action that effectively puts a party out of business is a significant private interest).

The procedure used — converting a status/scheduling conference, without notice, into a merits hearing only one week after the filing of the seminal substantive petition concerning a transaction that had been negotiated for three months — created a substantial and unnecessary risk of an improper deprivation. DCHSI came to court for a status hearing to set a briefing schedule, but the court conducted a merits hearings without notice and thus made the most important decision in the proceeding without the benefit of the adversary processes our system relies on to ensure fair and sound results. That is especially true because the evaluation of the fairness of the Rehabilitator's proposal was entirely dependent of factual assertions that had never been tested through discovery, and were not required to be presented in the form of competent evidence and thus were not subject to meaningful contest, including through cross-examination. This was compounded by the fact that the Rehabilitator, in violation of the Rehabilitation Act and Rehabilitation Order, had already secretly implemented key elements of his liquidation plan before he sought court approval, just as he had incurred over $3 million in legal fees and expenses without court approval. The lack of due process afforded here guaranteed that the court would not be fully and fairly informed, and maximized, rather than minimized, the possibility of an erroneous decision. A sparse, one-sided record does not ensure

full and reasoned consideration of all material facts and issues. *See Karpova v. Snow*, 497 F.3d 262, 270-71 (2d Cir. 2007) (due process is not satisfied if court acts "on a one-sided or incomplete record"); *Washington v. Cameron*, 133 U.S. App. D.C. 391, 396, 411 F.2d 705, 710 (D.C. Cir. 1969) ("court cannot rely merely on the one-sided and challenged record").

Finally, the alleged governmental interest does not justify the lack of due process. DCHSI had requested very little time to allow for further preparation (DCHSI sought a hearing for March 19 [1-AA-229]), but even that was denied. The Rehabilitator acted hastily on the basis that speed was necessary to respond to alleged exigencies. In fact, there were no circumstances so exigent as to justify denying DCHSI an opportunity to analyze the long-requested transaction information and respond accordingly. *See Goldberg*, *supra*, 397 U.S. at 268 (in certain cases, "fairness would require a longer time be given" to avoid a due process violation; the opportunity to be heard is important in cases where parties challenge decisions based on "incorrect or misleading factual premises").

The Rehabilitator argued (1) that the DHCF Contract would expire on April 30 — but in fact the contract deadline could be extended (as has been common practice for the Medicaid/Alliance contract over the past twenty-five years) – and (2) that the closing of the AmeriHealth transaction therefore had to occur by April 1 to ensure a smooth transition. 1-AA-233. But neither of those "deadlines" explains why holding a substantive hearing on March 19 would not have satisfied all legitimate concerns. The District's contracting deadlines were extended as a matter of course, and were within the District's own power to extend. There could have been no legitimate concern regarding Chartered's ability to continue to provide services

during this short period; Chartered continued to operate through April without harm.[6] Even the Rehabilitator proposed a hearing "in the week of March 11." *Id.* No one expected a merits hearing at the March 1 status conference. Rushing the proceedings served only to allow the Rehabilitator to push through his plans without scrutiny and to prejudice DCHSI and other creditors. Neither the government, the court nor the public would have suffered any measurable burden or material cost had the court simply used the status conference to set a briefing schedule as intended. Conversely, no legitimate benefit was secured by rendering an important merits decision through these improper procedures.

Rehabilitations involve complicated financial and other facts. Justice is not served by unnecessarily expedited approvals without the benefit of carefully prepared opposition. The procedures used here resulting in the order approving the Rehabilitator's plan were unfair and prejudicial violations of due process. This court should reverse.

B. The trial court erroneously approved the Rehabilitator's illegal actions

The purpose of Chartered's rehabilitation proceeding was for the Rehabilitator — acting within Chartered's articles of incorporation — to devise a way to rehabilitate Chartered by restoring its capital reserve. 1-AA-2 (Rehabilitator's mandate was to "reform and revitalize," i.e., rehabilitate, Chartered); D.C. Code § 31-1312 (c). Yet here, the Rehabilitator ignored the requirements and limitations imposed by the Rehabilitation Act and Rehabilitation Order and Chartered's governing documents, and instead set out to destroy Chartered and DCHSI by unilaterally implementing an illegal liquidation.

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[6] The record demonstrates that Chartered could have continued to operate. Chartered's most recent financial statements as of the March 1, 2013 hearing (i.e., as of September 30, 2012) showed that Chartered earned pre-tax operating profits of $6.7 million in the first nine months of 2012. 3-AA-766. Chartered's pre-tax net income was $728,224 because of an unexplained one-time write-off of $6 million, *id.* ("premium balances charged off"), but even so Chartered was profitable. Chartered was earning approximately $33.4 million in monthly revenues and had $10 million in cash or cash equivalents on hand. 3-AA-765-66. Thus, the record demonstrated that Chartered would be able to meet its financial obligations to providers and enrollees during any such extended period.

1. The Rehabilitator improperly liquidated Chartered

The Rehabilitator was first obligated to attempt a rehabilitation — "to reform and revitalize Chartered" — before deciding it should be liquidated. 1-AA-9-10; D.C. Code § 31-1312 (c); *Consedine v. Penn Treaty Network Am. Ins. Co.*, 63 A.3d 368, 440, 446-47 (Pa. Commw. Ct. 2012); *Kueckelhan v. Fed. Old Line Ins. Co. (Mutual)*, 444 P.2d 667, 674 (Wash. 1968) (rehabilitator's "primary duty" is "to conserve and restore the company to viable status"). Nonetheless, the Rehabilitator jumped directly to liquidation, and effected liquidating steps without court approval. 3-AA-749, 753-54.

All aspects of a rehabilitation proceeding are subject to court supervision. The Rehabilitation Act (like the Rehabilitation Order) vests title to Chartered's assets in the Rehabilitator, but he is constrained to "administer [the assets] under the general supervision of the court." D.C. Code § 31-1311 (a). Significantly, the Rehabilitation Act requires that "[i]f the rehabilitator determines" that any "transformation of the insurer is appropriate," he must "prepare a plan to effect the changes" and apply to the court "for approval of the plan." *Id.* § 31-1312 (e). Then, "after any notice and hearings the court may prescribe, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified," as necessary for the court to find the plan "fair and equitable to all parties concerned." *Id.* Beyond that, before a rehabilitator may take steps to liquidate an insurer, he first must obtain an order of liquidation based on a showing that "further attempts to rehabilitate [the] insurer would substantially increase the risk of loss to creditors, policyholders, or the public, or would be futile." *Id.* § 31-1314 (a).

The Rehabilitator implemented a series of undisclosed and unapproved actions that left Chartered with no source of income, transferring to AmeriHealth all of Chartered's providers, enrollees, employees, and operating assets. All of the steps the Rehabilitator took appear to have been designed to ensure that Chartered would not be rehabilitated when rehabilitation was well within reach. The Rehabilitator took all of these critical steps without providing notice or

seeking prior court approval. The Rehabilitation Act could not be more clear that this is an impermissible liquidation. *Id.* In support of this conclusion, DCHSI provided with its reply brief on its motion for stay and injunction (3-AA-723) an affidavit from a foremost expert on insurance receiverships, Greg Serio, who as the former Superintendent of the New York State Insurance Department served as the statutory receiver of more than 70 impaired insurers. 3-AA-745-46. Mr. Serio explained the court's critical role in serving as a check on a receiver's powers, and thus the obligation of the receiver to report frequently to the court and disclose his actions and plans for the evaluation of all interested parties and the court. *Id.* at 750. From his review of the record (such as it was), Mr. Serio concluded that the Rehabilitator had failed in numerous respects to inform the court and the interested parties of critical information and thus violated the standards of conduct in a rehabilitation proceeding. *Id.* at 751 ("the Rehabilitator fell well short of complying with his duties by merely filing two status reports, the first of which contained little meaningful information, after he already had implemented decisions that effectively implemented a liquidation").

Mr. Serio described the Rehabilitator's decision not to bid on the new DHCF Contract as "a game changing decision" that required prior notice to interested parties and prior court review, and was "based on reasoning that is deeply flawed an [sic] inconsistent with the universal objectives of rehabilitation." *Id.* at 752. In fact, in view of Chartered's massive claim against the District, which the Rehabilitator filed and thus necessarily must "have determined in good faith ... has merit," in Mr. Serio's vast experience "no insurer would be liquidated or otherwise deprived of its ongoing business" in the circumstances here. *Id.*

But, even if these actions did not constitute a liquidation, they certainly constituted a transformation of Chartered from an active business with over 150 employees into an empty shell with no operating assets, no employees, and no revenues even to satisfy its lease payment obligations to DCHSI. The statute is absolutely clear that the Rehabilitator could not do this without the advance permission of the court: "[i]f the rehabilitator determines" that any

"transformation of the insurer is appropriate," he must "prepare a plan to effect the changes" and apply to the court "for approval of the plan." *Id.* § 31-1312 (e); *see also id.* ("If the plan is approved, the rehabilitator shall carry out the plan."). At a minimum, the Rehabilitator was required to obtain Court approval *before* effecting such a transformation. The Rehabilitator, however, unilaterally implemented transformative decisions.

Even if, as the Rehabilitator claims, there had been no practical alternative — and there were alternatives, as Chartered could have bid on the DHCF Contract and then negotiated from a position of strength, and there were other bidders about which the Rehabilitator has disclosed no information — he had no authority to take these actions before seeking and obtaining court approval. Indeed, the Rehabilitator told the D.C. Council on October 25, 2012 that there were "many well capitalized, experienced companies and people who appear to see value in Chartered as a going concern." *See* 2-AA-514. To allow time for that interest to play out, the Rehabilitator could have had Chartered bid itself, or asked his counterpart from DHCF, with whom he had worked hand-in-hand for six months leading to Chartered's and DCHSI's consents to rehabilitation, to extend the time period of the bidding process. The District, after all, controlled every aspect of this situation — it caused and had the ability to cure the capital deficit; it controlled the process to raise capital or find a buyer; it could give assurance to potential investors or purchasers about Chartered's prospects; it controlled the new DHCF Contract and the bid and award process; and it controlled the timing of the rehabilitation. Mr. Serio observed that the Rehabilitator "gave up his best leverage to assume maximum value for Chartered when he decided to not put in a bid for the DHCF Medicaid contract." 3-AA-755; *see also id.* at 756 ("[a] prudent and independent Rehabilitator would not have given away such valuable time and leverage by deciding not to enter a bid from Chartered"). There was no legitimate basis for rushing to a death sentence for Chartered and DCHSI.

In fact, if the Rehabilitator had allowed Chartered to respond to the Medicaid/Alliance RFP, he could have filed a bid protest and obtained an automatic stay of the bidding process (*see*

Contract Appeals Board Rule 304.1) and, that failing, asked this court to intervene in aid of its own jurisdiction over this proceeding. *See, e.g., District of Columbia v. Group Ins. Admin.*, 633 A.2d 2, 15 (D.C. 1993).

By allowing Chartered to file its own response to the Medicaid/Alliance RFP, the Rehabilitator could have pursued negotiations with AmeriHealth and with other interested parties from a position of strength — as a company that not only had tremendous goodwill in the community based on over twenty-five years of successfully serving the District's Medicaid/Alliance population, and experienced and capable employees, but also had the prospect, if the District paid what it owes or with a good purchaser or investor, of once again securing the DHCF Contract. *See* Debonis, *supra* (quoting Sharon Baskerville, Executive Director of D.C. Primary Care Association, a non-profit health action and advocacy organization, stating that notwithstanding the concerns about DCHSI's owner Mr. Thompson, "People in the community ... don't know or care who Jeff Thompson is; they just know that when they go to get their health care, it's there.").

Instead, the Rehabilitator conducted a two-day bidding process, at the end of which he took a company that is owed over $62 million by the District and abandoned its entire business and rejected any efforts to find new capital. He put Chartered's resources and expertise to work in supporting competitor AmeriHealth's own bid for the DHCF Contract for $5 million. He then entered into a *non-binding* letter of intent with AmeriHealth under which AmeriHealth would be gifted the entirety of Chartered's operations for no additional consideration beyond that AmeriHealth already committed to pay for Chartered's expertise supporting AmeriHealth's bid (to be paid regardless whether the asset agreement closed so long as AmeriHealth won the DHCF Contract). The Rehabilitator never offered evidence to support his conclusion that the deal struck with AmeriHealth was the best option, of what other entities expressed interest and why they were rejected, or that the assets were sold for fair value.

A recent decision from Pennsylvania, which like the District of Columbia has adopted the National Association of Insurance Commissioners Model Act, demonstrates that a rehabilitator's legal duty is to exhaust all reasonable possibilities of rehabilitation before seeking permission to pursue liquidation, and that the Rehabilitator's actions here fall well short of what is required. *See Consedine, supra*, 63 A.3d at 446-47. In *Consedine*, the court denied the rehabilitator's motion to convert a consented-to rehabilitation into a liquidation proceeding. The rehabilitator had submitted a preliminary rehabilitation plan that called for an effort to obtain from certain states actuarially-justified premium rate increases that were necessary to fund anticipated future claims. *Id.* at 390. Absent such rate increases, the insurers would be able to satisfy their obligations to insureds for some time, but would be unable to fund all anticipated future claims, rendering them technically insolvent. *Id.* at 374-75. The rehabilitator committed to submit a formal rehabilitation plan, but two days before it was due he filed motions to liquidate the two insurers. *Id.* at 375-76. The court permitted the insurers' shareholder to take discovery and contest the liquidation petition. *Id.* at 376.

After trial, the court ruled in favor of the shareholders, finding that the rehabilitator had failed to meet his burden under the Pennsylvania statute (which is materially identical to the Rehabilitation Act) to prove "'that continued rehabilitation would "substantially increase the risk of loss to creditors, [policyholders], or the public, or would be futile."'" *Consedine, supra*, 63 A.3d at 440 (*quoting Koken v. Legion Ins. Co.*, 831 A.2d 1196, 1230 (Pa. Commw. Ct. 2003) (*quoting* 40 Pa. Stat. Ann. § 221.18 (a))); *see also* D.C. Code § 31-1314 (a). This standard sets a high barrier between rehabilitation and liquidation, because liquidation "is a remedy of last resort" and the rehabilitator may not petition for liquidation unless he has reasonable cause to believe that one of the two elements of the liquidation standard is satisfied. *See Consedine*, 63 A.3d at 440 (*quoting Koken*, *supra*, 831 A.2d at 1230).

The court held that the rehabilitator failed to satisfy the liquidation standard based on facts remarkably similar to the facts here, and for reasons that apply directly here: The

rehabilitator had "not undertaken a meaningful effort to rehabilitate the Companies and, to the contrary, ha[d] acted to frustrate rehabilitation" and had "abandoned [rehabilitation] in its nascency." *Consedine, supra*, 63 A.3d at 375, 380. The rehabilitator had terminated his efforts to obtain rate increases just four months into the proceeding "without the knowledge or approval of the Court." *Id.* at 392. The rehabilitator also had refused to appeal adverse "decisions of state regulators to disapprove actuarially justified premium rate increase filings." *Id.* at 393.[7] The rehabilitator concluded that rehabilitation was futile without developing a rehabilitation plan, instead "look[ing] for reasons to be excused from that duty." *Id.* at 458. The rehabilitator failed to give due regard to the fact that "[d]uring a rehabilitation, the impaired insurer operates under the protection and direction of the Court" and focused on the wrong facts by having his decisions turn on the insurers' capitalization levels, despite the fact that satisfying the insurer's obligations to policyholders, "not surplus, is paramount." *Id.* at 459. The court ordered that the rehabilitator "shall develop a plan of rehabilitation of the Companies, in consultation with the [shareholder]." *Id.* at 461.

So too here, the Rehabilitator terminated efforts to rehabilitate before informing or seeking the approval of the court, and began to liquidate without ever making a meaningful effort to rehabilitate. The Rehabilitator abdicated his duty to rehabilitate by blocking Chartered from bidding on the new DHCF Contract, quickly rejecting other bidders and collusively devoting Chartered's resources to supporting competitor AmeriHealth's bid based only on a *non-binding* letter of intent, where other interested parties were required to commit to more stringent terms, including a *binding* letter of intent. The Rehabilitator then entered into the asset agreement with

[7] No deference is owed to a rehabilitator's decision when, as here, the court "'must apply specific statutory standards to the evidence presented.'" *Consedine, supra*, 63 A.3d at 440 (*quoting Koken*, *supra*, 831 A.2d at 1232); *see also Atl. Seaboard Corp. v. Fed. Power Comm'n*, 131 U.S. App. D.C. 291, 297, 404 F.2d 1268, 1274 (D.C. Cir. 1968) (courts defer to agency's decisions only "insofar as they are supported by substantial evidence and are not inconsistent with the statute"); *Robinson v. Bradshaw*, 92 U.S. App. D.C. 216, 220, 206 F.2d 435, 439 (D.C. Cir. 1953) (although deference is the norm, "nevertheless, when convinced that the evidence, with the statute, requires a different result we must not refuse a remedy").

AmeriHealth conditioned on AmeriHealth winning the contract, giving AmeriHealth what amounts to a free option on Chartered's key assets. This exposed Chartered to the possibility that, if AmeriHealth did not prevail on its bid, Chartered would be left with no contract, no business, no income stream and no hopes of finding a new buyer, and the members, providers, creditors, and public would be left out in the cold. This was irresponsible and contrary to the very interests the Rehabilitator was duty bound to protect.

The Rehabilitator's duty was to devote his full attention to preparing a robust bid on the Medicaid/Alliance RFP *for Chartered* while negotiating with AmeriHealth *and others*; if necessary, to seek an extension of the deadlines for the Medicaid/Alliance RFP from his fellow regulators at DHCF or from the Contract Appeals Board or this court, *see Consedine*, 63 A.3d at 392 (rehabilitator should have appealed adverse decisions denying rate increases); and to extend the Chartered RFP deadlines to permit a fair, reasonable and competitive bidding process. Indeed, the Rehabilitator should have challenged the Medicaid/Alliance RFP outright, given inherent flaws that were raised in the Bid Protest.[8] The DISB and DHCF regulators here, as in *Consedine*, have focused on the alleged inadequacy of Chartered's surplus, when it is the service of the Medicaid population that "is paramount" — and Chartered could continue to serve its enrollees and pay its providers. *See id.* at 459. Moreover, all these facts must be considered in view of the fact that Chartered's reported risk-based capital shortfall arises almost entirely from DHCF's underpayments and can be corrected by DHCF taking appropriate action to pay its debt to Chartered. In this regard, DCHSI's expert, Mr. Serio, explained that the District itself suffered from an usual and extreme conflict, because "it appears this whole proceeding has the effect of putting a major creditor of the District government in the weakest possible position to collect from the government." 3-AA-758. This "pervasive conflict," at a minimum, created a duty on

[8] For example, there was an amendment on November 29, 2012, requiring bids two business days later (December 3), including a special clause applying a prevailing wage and fringe benefit law even though that law is not applicable to Medicaid contracts. *See* 2-AA-562-63.

the part of the Rehabilitator "to seek court guidance and permission ever more than the usual case." *Id.*

The Rehabilitator himself described his plan as a "wind down" of Chartered's assets. 1-AA-62. Chartered's entire business was to service the DHCF Contract; thus, when the Rehabilitator decided to "no-bid" the contract, he effectively put Chartered, and thus DCHSI, out of business. 3-AA-750-51. The Rehabilitator's effort to characterize his decision not to allow Chartered to bid as an exercise of managing Chartered's business is merely wordplay: Chartered's only business was the contract; abandoning the contract killed Chartered.

Stripping Chartered of all continued operations, operating assets, and sources of income is at the very least a "partial liquidation." Note also that in cases like *In re Rehabilitation of American Investors Assurance Co.*, 521 P.2d 560, 561 (Utah 1974), cited by the Rehabilitator in the trial court (3-AA-685), the new company assumed "all of the assets and liabilities" of the old one. Here, however, AmeriHealth is *not* assuming all assets and liabilities of Chartered, and instead, the Rehabilitator has dissected Chartered's assets — a hallmark of liquidation.

In short, the Rehabilitator violated the Rehabilitation Act's requirements by unilaterally converting the rehabilitation proceeding into a liquidation. The Rehabilitator ignored his legal obligation to seek prior court approval to liquidate Chartered. The Rehabilitator had no authority unilaterally to abandon rehabilitation in its nascency and to begin to liquidate without exhausting good-faith efforts to rehabilitate Chartered. It is clear that the Rehabilitator lacked authority to take any steps to transform or liquidate Chartered without first affording the court a meaningful opportunity to assess the Rehabilitator's written plan with adequate notice to interested parties such as DCHSI. *See* D.C. Code § 31-1312 (e). Instead, the Rehabilitator improperly treated liquidation as a first resort and began to implement a liquidation plan on his own without notice or court approval.

2. The Rehabilitator violated DCHSI's rights by ignoring Chartered's articles of incorporation

In addition to violating the Rehabilitator's duty to reform and revitalize Chartered, the Rehabilitator's sale process and the AmeriHealth agreement also violated principles of corporate law. When the Rehabilitator exercises the powers of directors, which he is given under D.C. Code § 31-1312, he should exercise them in a manner consistent with the duties of directors of the insurer which, under established corporate law, include an obligation to act in the best interests of the Company. *See, e.g., Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

Under Delaware corporate law, directors effecting a sale or transformation under circumstances comparable to those presented here have fiduciary obligations to terminate a deal and accept a new proposal that offers better terms for stockholders.[9] *See, e.g., Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 939 (Del. 2003). In addition, when a company is to be sold, the directors' primary objective must be to secure the transaction offering the best value reasonably available for the stockholders — and they must exercise their fiduciary duties to further that end. *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). The Rehabilitator exercised the powers of Chartered's board of directors in negotiating the AmeriHealth agreement, without obtaining the consent of Chartered's sole shareholder, DCHSI, as required by Chartered's articles of incorporation. The Rehabilitator's failure to negotiate a "fiduciary out" provision and to seek better offers were not in the best interests of Chartered and violated the duty of the directors to secure the best value reasonably available to DCHSI. *Id.* Although the Rehabilitator also must satisfy statutory duties to policyholders and the public, nothing inherent in his existing obligation to act in the best interests of the company would have presented a conflict. To the contrary, had the Rehabilitator acted in Chartered's best interests and in accord with the duties a director owed Chartered and DCHSI in

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[9] This court commonly follows Delaware corporate law on issues such as directors' fiduciary duties. *E.g., Daley v. Alpha Kappa Alpha Sorority, Inc.*, 26 A.3d 723 (D.C. 2011); *Behradrezaee v. Dashtara*, 910 A.2d 349 (D.C. 2006).

this context, it would have maximized the value of the transaction, thereby assuring maximum benefit to creditors and DCHSI without any harm to the public.

In sum, under the Rehabilitation Act, a rehabilitation order does not nullify the rights of shareholders. To the contrary, the Rehabilitation Act recognizes that shareholders have protectable rights. *See, e.g.*, D.C. Code § 31-1304 (court may prevent any action that might lessen the value of the insurer's assets or prejudice shareholder rights); *id.* § 31-1305 (c) (owners obligated to cooperate in rehabilitation, but that "shall not be construed to abridge otherwise existing legal rights"); *id.* § 31-1316 (b) ("the rights of [the insurer's] shareholders" are fixed when liquidation order entered) (emphasis added). The Rehabilitator's authority over Chartered did not empower him to amend or abrogate Chartered's governing corporate documents.[10] Yet the Rehabilitator ignored Chartered's governing documents and DCHSI's rights. The Rehabilitator's actions taken on behalf of the board — all part of a decision to quit Chartered's business and support the transition of that business to competitor AmeriHealth — all required approval by DCHSI. Chartered and DCHSI consented to (and the Rehabilitation Order required) a rehabilitation, not to liquidation. The Rehabilitator overstepped his powers, and the Superior Court's ruling incorrectly excused the Rehabilitator's conflicts and improper conduct.

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[10] For example, when a rehabilitator, purportedly exercising the authority of the board of directors to amend the bylaws of two insurers in rehabilitation, gave herself the power to consent to liquidation, the court found that the rehabilitator exceeded her authority. *See Koken*, *supra*, 831 A.2d at 1226-27. Although a rehabilitator assumes the board's "'full power to direct and manage' and to 'deal with the property and business of the insurer,'" the rehabilitator must direct those powers "but to one end; to achieve a successful rehabilitation." *Id.* at 1227 (quoting Pennsylvania statute).

V. CONCLUSION

This court should reverse the trial court's order approving the Rehabilitator's reorganization plan in its entirety. That order is an improper liquidation order obtained through a denial of procedural due process and in violation of the Rehabilitation Act and the Rehabilitation Order.

June 10, 2013

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