

THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN,  
Insurance Commissioner of the  
Commonwealth of Pennsylvania,

Plaintiff,

v.

RELiance INSURANCE COMPANY,

Defendant.

LEXINGTON INSURANCE COMPANY,

Petitioner,

v.

M. DIANE KOKEN,  
Insurance Commissioner of the  
Commonwealth of Pennsylvania,

Respondent.

Docket No. 269 M.D. 2001

Before the Honorable James  
Gardner Colins,  
President Judge

Assigned to Referee Edward S.  
Finkelstein, Esquire

2001 SEP 27 P 1:28

RECEIVED AND FILED  
COMMONWEALTH COURT  
OF PA (PHILLA)

**STATUTORY LIQUIDATOR'S REPLY BRIEF  
IN SUPPORT OF HER MOTION TO STAY LEXINGTON  
INSURANCE COMPANY'S CUT-THROUGH PROCEEDINGS**

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her official capacity as Statutory Liquidator of Reliance Insurance Company ("Reliance"), submits this Reply Brief In Support of her Motion to Stay the Cut-through Proceedings initiated by Lexington Insurance Company for approval of direct payment of reinsurance proceeds arising from the reinsurance agreement entered into between Reliance and Lexington. In opposing the Liquidator's Motion, Lexington evinces a desire to expend as much resources as necessary to litigate this case in an uncertain legal landscape, even though such

efforts will not bring this case to a conclusion sooner than if the case was stayed until related cases before the Supreme Court<sup>1</sup> that will guide its resolution can be decided. This Court has discretion to impose a more efficient, sensible process on this case by staying it until the Supreme Court has decided the other cases involving cut through applications.

**I. THIS COURT CAN STAY THE CASE IF THE RESOLUTION OF THE SUPREME COURT CASES MAY RESOLVE IT**

In its brief, Lexington argues that this Court can stay this case only if the Supreme Court cases will have a *res judicata* effect on this proceeding. This Court's discretion to stay a case is not so narrowly constrained. A "trial court has the inherent power to stay the proceedings in one case during the pendency of another case which *may* resolve . . . the case which has been stayed." Gwynedd Properties v. Bd. of Supervisors, 635 A.2d 714, 718 (Pa. Commw. 1993)(emphasis added). A court is permitted to issue a stay pending the resolution of independent proceedings which bear upon the case. National Shopmen Pension Fund v. Folger Adam Security, Inc. 274 B.R. 1, 3 (D.C.D.C. 2002). The disposition of the Supreme Court cases clearly bears upon this case and does have the potential to resolve this dispute.

The gravaman of the Liquidator's argument in both Supreme Court Appeals is that 40 P.S. § 221.34 must be applied as written, to require that, *inter alia*, direct payments be allowed only when the reinsurance contracts provide for direct coverage of individual named insureds. In both cases on appeal to the Supreme Court, this Court has allowed direct payments, despite the fact that the reinsurance contracts do not identify individual named insureds, by looking to evidence outside the contracts to support its ruling. *Koken v. Reliance Insurance*

---

<sup>1</sup> *Koken v. Reliance Insurance Company: In Re: Baptist Health South Florida Inc. objection to the Liquidator's denial of a direct payment request; Palm Springs General Hospital objection to the Liquidator's denial of a direct payment request; the Exceptions to the Report of Referee James Schwartzman*, (Docket No. 60 MAP 2004) ("Reliance Appeal") and *Koken v. Legion Insurance Company*, (Consolidated Docket Nos. 204, 205, 211 and 212 MAP 2003) ("Legion Appeal") (collectively the "Supreme Court Appeals").

*Company*, 846 A.2d 167, 170, 172 (Pa. Commw. Ct. 2004); *Koken v. Legion Insurance Company*, 831 A.2d 1196, 1236-39, 1247-48 (Pa. Commw. Ct. 2003). In this case, it is also undisputed that no insureds are identified in the reinsurance contract between Lexington and Reliance. Therefore, Lexington has urged the Court and Referee to allow it to use extrinsic evidence to satisfy Section 221.34. (See Lexington Insurance Company's Memorandum of Law in Support of Its Objections To the Liquidator's Denial of Direct Payment Request And Petition For Review at 7 filed with this Court on December 2, 2003).

On Friday, September 24, the Court requested oral argument in the *Legion* appeal on the following question, which will likely determine the merits of Lexington's position:

Whether the Commonwealth Court erred in allowing four policyholders direct access to reinsurance funds due and owing to the insolvent insurer, based on the concept of third-party beneficiary status, in violation of the requirement of the Insurance Department Act of 1921 that reinsurance be paid to the Liquidator to be available for all creditors and policyholders and in contravention of the plain language of the reinsurance contracts at issue.

Exhibit A hereto (emphasis added).<sup>2</sup> If the Supreme Court answers this question in the affirmative, ruling, as the Liquidator urges, that direct payments be allowed only when the reinsurance contract contains language providing for direct coverage of an individual named insured it will likely dispose of Lexington's claim.<sup>3</sup>

---

<sup>2</sup> This Order answers Lexington's question about whether there would be oral argument in the *Legion* appeal. Lexington Brief at 7 n.2

<sup>3</sup> Lexington incorrectly states that neither party has relied upon either *Legion* or *Baptist Health* (the two Supreme Court Appeals). In argument to the Referee, Lexington has explicitly relied on those cases in support of its argument that it should be allowed to use extrinsic evidence in support of its direct payment request, precisely the common issue between those appeals and this proceeding that justify a stay. (See Letter from Brian T. Guthrie, Counsel for Lexington, to Referee Finkelstein, dated July 9, 2004, at 1 attached as Exhibit B to the Liquidator's Opening Brief) ("[*Koken v. Reliance* and *Koken v. Legion*] permit the use of extrinsic evidence to interpret a reinsurance contract."). The Liquidator has not cited those cases because, respectfully, it believes those cases were wrongly decided, and should be reversed by the Supreme Court.

**II. LEXINGTON'S ARGUMENT OPERATES FROM THE FALSE PREMISE THAT ITS CLAIMS WILL BE RESOLVED EARLIER IF NO STAY IS ISSUED**

Lexington's opposition to a stay depends on the premise that it will be prejudiced if the Court stays the case because it will delay "the day when Lexington's claims will have to be resolved." Lexington Brief at 11. What Lexington ignores, however, is that even if the Referee ruled in favor of Lexington, and his Recommendation is adopted by this Court, that disposition would be immediately appealed to the Supreme Court, thus triggering the automatic supersedeas. PA. R. APP. P. 1736. That appeal will fall in the queue behind the Supreme Court Appeals, thereby effectively postponing a final disposition between the parties as long as if this proceeding was stayed. In the meantime, the parties' and Court's resources would have been expended applying legal precepts that may be overturned.

**III. THE PROCESS GAS STANDARD DOES NOT CONTROL THIS CASE**

Lexington argues that the standard used in the Supreme Court's decision in Pennsylvania Public Utility Commission v. Process Gas Consumers Group, 502 Pa. 545, 467 A.2d 805 (1983), control this case. In the next breath, however, Lexington admits that Process Gas deals with the stay of a court's final order providing for relief to a party while the opposing party appeals the decision, a completely different context than is presented here.<sup>4</sup> Here, the Court is not dealing with a request by a party to postpone the day when a court's judgment will be imposed against it, but simply the pace of ongoing litigation that, because of the automatic supersedeas, will not in fact be resolved any faster by pressing forward while the relevant law is

---

<sup>4</sup> The only authority that Lexington cites for the proposition that Process Gas should also be applied to requests to stay litigation while related cases are being addressed is a Montgomery Court of Common Pleas case (Cherry v. Zucker)'s reference to an unreported Superior Court decision. Lexington Brief at 11. There is simply no way to discern from that reference how the Process Gas was applied in that case.

still being determined than if a stay is issued until the Pennsylvania Supreme Court clarifies the controlling law.

#### **IV. A STAY WILL PROMOTE THE OBJECTIVES OF THE INSURANCE ACT**

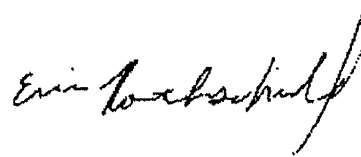
One stated purpose of Sections 221.1-.63 of the Insurance Act, dealing with insurance insolvencies, is the “enhanced efficiency and economy of liquidation, through clarification and specification of the law, to minimize legal uncertainty and litigation.” 40 P.S. § 221.1(c)(iii). This Court has discretion to further this objective by ensuring that cut through proceedings be decided only when the law governing them has been clearly determined. This Court has already approved three stays of similar proceedings until the Supreme Court Appeals are decided. While, as the Liquidator acknowledged in its opening brief, those stays were agreed to by the parties requesting cut throughs, the same bases were asserted by the parties in requesting a stay that the Liquidator asserts here: the most efficient, economical, and sensible process for resolving contested cut through proceedings is to await the resolution of the Supreme Court appeals.

V. CONCLUSION

For the reasons stated above, and in the Liquidator's opening brief in support of its Motion to Stay, the Liquidator respectfully requests that the Court order a stay of this proceeding until the Supreme Court Appeals are decided.

Respectfully submitted,

PEPPER HAMILTON LLP



---

DEBORAH F. COHEN  
(Attorney I.D. No. 21538)  
ERIC ROTHSCHILD  
(Attorney I.D. No. 71746)  
KASSEM L. LUCAS  
(Attorney I.D. No. 85851)

3000 Two Logan Square  
18<sup>th</sup> and Arch Streets  
Philadelphia, PA 19103-2799  
(215) 981-4000

Attorneys for Plaintiff  
M. Diane Koken, Insurance Commissioner  
of the Commonwealth of Pennsylvania, in her  
official capacity as Statutory Liquidator of  
Reliance Insurance Company

Dated: September 27, 2004



**CERTIFICATE OF SERVICE**

I hereby certify that on September 27, 2004, I caused true and correct copies of the foregoing Proposed Order and the Statutory Liquidator's Reply Brief in Support of Her Motion to Stay Lexington Insurance Company's Cut-Through Proceedings to be served on the following:

**Via Electronic Mail and First Class Mail**

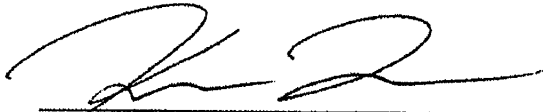
Brian T. Guthrie, Esquire  
Drinker, Biddle & Reath LLP  
One Logan Square  
18th & Cherry Streets  
Philadelphia, PA 19103

**Via Electronic Mail and First Class Mail**

Edward S. Finkelstein  
700 Green Street  
Harrisburg, PA 17102-3015

**Via Notice of Filing**

Master Service List

  
\_\_\_\_\_  
KASSEM L. LUCAS, Esquire