IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, Plaintiff v. Reliance Insurance Company, Defendant v. SOL Insurance Limited Objector.	:	No. 269 M.D. 2001

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IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION BY SOL INSURANCE LIMITED CLAIM NO. 1959160

ORDER

AND NOW, this 21st day of April, 2005, after consideration of the Report and Recommendation of the Referee and any exceptions filed, the Court hereby adopts the Referee's Report and Recommendation attached hereto.

BY THE COURT:

James R. Kelley, J.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, Plaintiff v. Reliance Insurance Company, Defendant v. SOL Insurance Limited Objector.	:	No. 269 M.D. 2001

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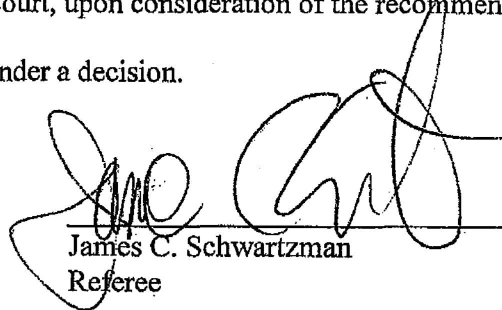
NOTICE TO PARTIES

Specific exceptions to this recommended decision must be filed with the Court within 20 days of the mailing date of this decision. Those exceptions should be accompanied by a brief supporting memorandum of law. Any response to those exceptions must be filed with the Court within 27 days of the mailing date of this decision, and should also be accompanied by a brief supporting memorandum of law. The Court, upon consideration of the recommended decision and of any exceptions and responses, will render a decision.



James C. Schwartzman
Referee

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania,	:	
Plaintiff	:	No. 269 M.D. 2001
v.	:	
Reliance Insurance Company,	:	
Defendant	:	
v.	:	
SOL Insurance Limited,	:	
Objector.	:	

IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION BY SOL INSURANCE LIMITED CLAIM NO. 1959160

James C. Schwartzman, Esquire, duly appointed Referee in the Matter of Objection to Notice of Determination by SOL Insurance Limited on Proof of Claim Number 1959160, hereby recommends to the Honorable James Gardner Colins, President Judge of the Commonwealth Court of Pennsylvania, that the Liquidator's Notice of Determination be approved and the Objection be denied, and in support thereof presents the following:

FINDINGS OF FACT

Procedural History

1. By Order of the Commonwealth Court of Pennsylvania (the "Court") dated October 3, 2001 (the "Liquidation Order"), Reliance Insurance Company ("Reliance") was found to be insolvent and placed into liquidation. M. Diane Koken, Insurance Commissioner of the

Commonwealth of Pennsylvania (the "Liquidator"), was appointed Liquidator of Reliance.

2. By Order of the Court dated September 9, 2002 (the "Claims Filing Order"), the Honorable James Gardner Collins, President Judge, established claims filing procedures, claim filing deadlines and dispute resolution procedures for claims.

3. SOL Insurance Limited ("SOL") filed a timely Proof of Claim Number 1959160 (the "POC").

4. On June 24, 2004, the Liquidator issued an Amended Notice of Determination ("NOD") to SOL, assigning Priority Level (e) to the POC, citing Section 544 of the Insurance Department Act, 40 P.S. § 221.44. The NOD further indicated that it appeared unlikely that there would be sufficient funds available to make payments to any class with priority below (b) and that, therefore, the claim would not be evaluated at the time the NOD was issued.[1]

5. On August 19, 2004, SOL filed with the Court a Notice of Objection to the Liquidator's NOD.

6. On September 17, 2004, the Liquidator filed with the Court a response to SOL's Objection to the NOD.

7. On December 20, 2004, pursuant to this Court's prior Order of September 9, 2002, the undersigned was appointed as Referee to hear objections, to submit findings of fact, where appropriate and necessary, and to issue a recommended decision in this matter.

8. On February 1, 2005, a telephone conference was held between counsel for the Liquidator, a representative of SOL, and the Referee. At the conclusion of the conference, the Parties agreed that there was no need for an evidentiary hearing, but that each side would be

[1]This Amended Notice of Determination superseded the Notice of Determination which had been issued April 8, 2004. The original notice had also assigned Priority Level (e) to the Claim, but had proceeded to value and allow the Claim in the amount of $3,998.26.

provided with an opportunity to file memoranda and reply memoranda in support of their respective positions.

9. On February 9, 2005, SOL submitted its Brief.

10. On February 11, 2005, the Liquidator filed its Memorandum of Law in Support of Liquidator's Determinations of Proof of Claims Classification.

11. On February 16, 2005, SOL submitted its Response to Liquidator's Memorandum of Law.

12. The Liquidator has not filed a reply memorandum, but on February 23, 2005, submitted complete copies of (1) the "Energy Package Reinsurance" contract entered into between Reliance and Sol and (2) the Confirmation of Reinsurance.

Summary of Parties' Positions

13. The Liquidator contends that the POC was appropriately assigned Priority Level (e) because the underlying agreement is an agreement for reinsurance, which the Liquidator contends is the claim of a general creditor under 40 P.S. § 221.44.[2] The Liquidator acknowledges that there is no Pennsylvania case law directly on point, but cites case law from other jurisdictions unanimously holding that claims arising out of reinsurance contracts must be classified as a lower priority than claims under direct insurance policies. *Covington v. Ohio General Ins. Co.*, 99 Ohio St.3d 117, 789 N.E.2d 213 (2003); *Swiss Re Life Co. v. Gross*, 479 S.E.2d 857 (Va. 1997); *In re Sussex Mutual Ins. Co.*, 694 A.2d 312 (N.J. Super. 1997); *In re Liquidation of Reserve Ins. Co.*, 524 N.E.2d 538 (Ill. 1988); *Pioneer Annuity Life Ins. Co. v. National Equity Life Ins. Co.*, 765 P.2d 550 (Ariz. App. Ct. 1988); *North Carolina v. Beacon Ins.*

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[2]Section 544 of the Insurance Department Act, 40 P.S. § 221.44, defines Priority Level (e) as "claims under nonassessable policies for unearned premium or other premium refunds and claims of general creditors."

Co., 359 S.E.2d 508 (N.C. App. 1987); *Neff v. Cherokee Ins. Co.*, 704 S.W.2d 1 (Tenn. 1986); and *Foremost Life Ins. Co. v. Department of Insurance*, 409 N.E.2d 1092 (Ind. 1980). The Liquidator contends that the rationales underlying those decisions are equally applicable in this Commonwealth, *to wit*: (1) that the Commonwealth's public policy is to protect consumers of direct insurance; (2) that there is a distinction between contracts of reinsurance and policies of insurance; and (3) that the legislature did not specifically include reinsurers in the higher priority assigned to claims under policies for losses, indicating a legislative intent to include reinsurers in the lower policy classification applicable to general creditors. The Liquidator further argues that the Pennsylvania authority which does exist is consistent with the reasoning of courts in other jurisdictions and, in particular, that the purpose of the Insurance Department Act is to protect the interests of the insureds, creditors and public in general, and that policyholders are the Commonwealth's greatest concern when distributing the assets of an insolvent insurance company. *See* 40 P.S. § 221.1(c); *Foster v. Rockwood Holding Co.*, 632 A.2d 335 (Pa. Commw. 1993); *Grode v. Mutual Fire Marine & Inland*, 572 A.2d 798 (Pa. Commw. 1990)

14. SOL concedes that a claim under a contract for reinsurance would be appropriately assigned Priority Level (e), but contends that the agreement at issue here is not a reinsurance agreement, but rather a direct policy of insurance. SOL contends that it is the captive insurance company of its parent, Nabors Corporate Services, Inc. ("Nabors"), and that it writes insurance exclusively to cover the risks of Nabors and its subsidiaries. It contends that elements necessary to establish a "reinsurance" agreement are not present here. Specifically, SOL asserts that (1) there is privity between Nabors and the Underwriters in that Nabors, through its broker, allegedly had final approval of the terms and conditions of the agreement and the premium; (2) Nabors is a party to the policy, named as the original insured and given the right to cancel the

policy for non-payment of claims; (3) claims and loss payments are to be made by the Underwriters directly to Nabors' broker, who then pays Nabors directly, SOL never actually receiving or paying out funds; (4) because Nabors is specifically named in the policy, it has an interest in the same; and (5) because SOL provides no insurance and takes no risk, there is no "spreading of the risk." Therefore, SOL contends that it is a "policyholder of Reliance Insurance Company" and that, as such, it should be assigned Priority Level (b).[3]

The Agreement at Issue

15. The insurance contract at issue is titled "Energy Package Reinsurance." It is identified, throughout the contract document, as "Reinsurance."

16. Section 32(b) of the contract specifically provides that wherever, in the contract, the words "Assured" or "Insured" are used, the words "Reassured" or "Original Assured" are to be substituted therefor.

17. Section 32(c) of the contract specifically provides that wherever the words "Underwriter" or "Insurer" are used, the word "Reinsurer" is to be substituted therefor.

18. Section 32(d) of the contract specifically provides that wherever the word "Insurance" is used, the word "Reinsurance" is to be substituted therefor.

19. The Certificate of Insurance was issued by John L. Wortham & Son, L.L.P., and states that that entity has procured insurance from the Underwriters for SOL Insurance Limited. Nowhere in the contract documents is it suggested that John L. Wortham & Son, L.L.P. was acting on behalf of, or procuring insurance for, Nabors.

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[3]Section 544 of the Insurance Department Act, 40 P.S. § 221.44, defines Priority Level (b) as "all claims under policies for losses wherever incurred, including third party claims, and all claims against the insurer for liability for bodily injury or injury to or destruction of tangible property."

20. The contract document (§ 1) specifically identifies the Reassured as SOL Insurance Limited.

21. The contract document (§ 2) specifically identifies Nabors as the "Original Assured," but does not purport to make Nabors a party to the contract.

22. The Confirmation of Reinsurance clearly indicates that this is "Package Reinsurance" and repeatedly refers to this as "reinsurance" and identifies Reliance asa "Reinsurer."

DISCUSSION

23. The only issue in dispute is whether the contract at issue here is a direct policy, or a contract for reinsurance. SOL concedes that if it is a contract for reinsurance, then its claim would be properly assigned Priority Level (e).

24. The contract, on its face, states that it is a contract for reinsurance and it is clear that, in all aspects, the policy operates as a policy for reinsurance. SOL's attempts to argue otherwise must fail. Nabors is not a party to the contract, and does not stand in privity with Reliance. Nabors has no contractual rights under the Policy, and Reliance is in no respect liable to Nabors. The mere fact that SOL is a captive insurance company of the underlying insured does not give it any special rights. Neither does Nabors' identification as the "Original Insured" distinguish this from other contracts for reinsurance. While it is true that this particular reinsurance contract covers specific, identified risks, that is not a basis for treating it differently than other, broader reinsurance contracts.

25. This contract is an agreement designed to protect SOL against the risk which it assumed when it agreed to insure Nabors. Nabors, on the other hand, chose to insure itself through a captive insurance company, and took the risks associated with doing so.

26. This conclusion is consistent with the authorities defining "reinsurance." *See, e.g., Reid v.* Ruffin, 469 A.2d 1030, 1033, 503 Pa. 458 (Pa. 1983); Eastern *Engineering & Elevator Co., Inc. v. American Re-Insurance Co.*, 455 A.2d 1235, 1236 (Pa. Super. 1983) and authorities cited therein; *Schuylkill Products v. H. Rupert & Sons*, 451 A.2d 229, 231-32 (Pa. Super. 1982),.

CONCLUSIONS OF LAW

27. Pursuant to Sections 1 and 32(b) of the contract document, all references to the "Assured" are to SOL, and not to Nabors.

28. SOL, and not Nabors, is identified as the "Reassured" and, therefore, the provision requiring the "Assured" (substitute "Reassured") to pay all premiums under the agreement applies only to SOL.

29. There is no basis for the assertion that Nabors is in privity with the Underwriters.

30. There is no basis for the assertion that Nabors is a party to the contract at issue.

31. The fact that Nabors is identified as the Original Insured does not make it a party to the contract.

32. There is no basis for the assertion that Nabors has any right to cancel the contract for non-payment of claims. That right rests solely with the "Assured," which is SOL.

33. The fact that Nabors is identified in the contract as the Original Insured does not give it an interest in the contract.

34. The contract does not provide coverage for Nabors' exposure. To the contrary, it provides coverage for SOL's exposure, as an insurer, for the underlying risks.

35. There is no obligation under the contract for Reliance to make payment unless and until SOL becomes liable, under its direct policy with Nabors, to make payment for a loss. All

such payments are to be made payable to SOL/Nabors pursuant to Section 2 of the contract. The fact, if true, that SOL does not actually issue a check and receive subsequent reimbursement is not relevant.

36. There is no basis for the assertion that SOL provides no insurance and takes no risk. To the contrary, it is undisputed that SOL exists for the purpose of insuring Nabors and has provided insurance to Nabors for these risks. It is SOL, and not Nabors, that is at risk for the insolvency of Reliance or any other underwriter in the group.

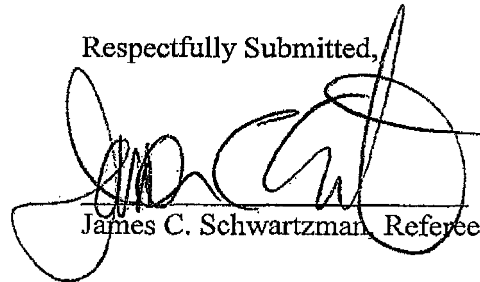
37. The policy at issue is a policy for reinsurance.

38. SOL's claim has been properly assigned Priority Level (e) pursuant to Section 544 of the Insurance Department Act, 40 P.S. § 221.44.

CONCLUSION

WHEREFORE, for the reasons set forth above, it is recommended that the Liquidator's Notice of Determination should be approved and SOL's Objection denied.

Respectfully Submitted,



James C. Schwartzman, Referee