

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHILA)
2005 MAY 16 P 2:20

M. Diane Koken,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
Plaintiff

v.

Reliance Insurance Company,
Defendant

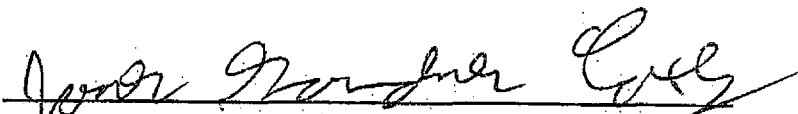
No. 269 M.D. 2001

IN RE: Order Approving Referee James C. Schwartzman's Recommendation
Muscat Insurance Co.; POC No. 2122512

ORDER

AND NOW, this 16 day of May 2005, upon consideration of Referee James C. Schwartzman's recommendation to affirm the Liquidator's assignment of priority (e) to the captioned proof of claim, the exceptions filed thereto, and the response to the exceptions, the exceptions are OVERRULED; the recommendation is ACCEPTED and the assignment of priority (e) to the captioned proof of claim is AFFIRMED.

The Liquidator is directed to serve a copy of this order upon those listed on the Master Service List.


JAMES GARDNER COLINS, President Judge

2004

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken,
Insurance Commissioner of the
Commonwealth of Pennsylvania,

Plaintiff

v.

No. 269 M.D. 2001

Reliance Insurance Company,

Defendant

v.

Muscat Insurance Company,

Objector.

**IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION
BY MUSCAT INSURANCE COMPANY
CLAIM NO. 2122512**

ORDER

AND NOW, this _____ day of _____, 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:

J.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. Diane Koken,
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Commonwealth of Pennsylvania,

Plaintiff

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No. 269 M.D. 2001

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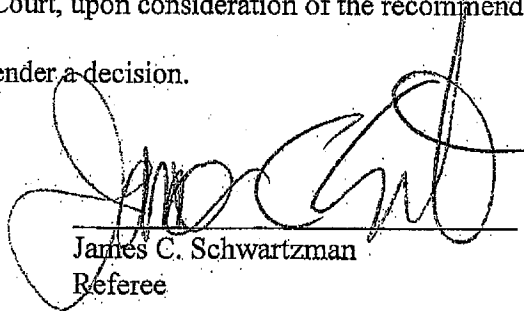
Muscat Insurance Company,

Objector.

**IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION
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CLAIM NO. 2122512**

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

v.

No. 269 M.D. 2001

Reliance Insurance Company,

Defendant

v.

Muscat Insurance Company,

Objector.

IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION
BY MUSCAT INSURANCE COMPANY
CLAIM NO. 2122512

James C. Schwartzman, Esquire, duly appointed Referee in the Matter of Objection to Notice of Determination by Muscat Insurance Company on Proof of Claim Number 2122512, 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. Muscat Insurance Company ("Muscat") filed a timely Proof of Claim Number 2122512 (the "POC"). ~~The POC sought reimbursement for losses arising out of various motor vehicle accidents, totaling \$11,141.00.~~

4. On September 21, 2004, the Liquidator issued a Notice of Determination ("NOD") to Muscat, 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.

5. On November 12, 2004, Muscat filed with the Court a Notice of Objection to the Liquidator's NOD.

6. On December 9, 2004, the Liquidator filed with the Court a response to Muscat'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 2, 2005, a telephone conference was held between counsel for the Liquidator, a representative of Muscat, 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 provided with an opportunity to file memoranda and reply memoranda in support of their

respective positions.

9. On February 2, 2005, Muscat submitted its Brief. On February 10, 2005, Muscat submitted additional comments.

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 18, 2005, Muscat submitted its Response to Liquidator's Memorandum of Law.~~

12. On February 28, 2005, the Liquidator, through its new counsel, submitted the Statutory Liquidator's Supplemental Response to Muscat Insurance Company's Objections to Statutory Liquidator's Notices of Determination.

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. § 221.44.¹ 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.*

¹Section 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. Muscat acknowledges that this is a contract for reinsurance, but contends that it should be given the same priority as a claim under a direct insurance policy. It contends (1) that no provision of the Pennsylvania explicitly excludes reinsurance policies from being assigned the same priority as direct insurance policy, *i.e.*, Priority Level (b)²; (2) that it is not a "general creditor" within the meaning of 40 P.S. § 221.44; (3) that the *Grode* decision, cited by the Liquidator, deals not with a reinsurance claim but a claim resulting from a surety contract and is,

²Section 544 of the Insurance Department Act, 40 P.S. § 221.44, defines Priority Level (b) as "[a]ll claims under policies for losses wherever incurred, including third party claims, and all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies."

therefore, distinguishable; (4) that the decisions of other jurisdictions are not controlling; (5) that Pennsylvania public policy is to protect *all* consumers of insurance, without distinction between direct insurance and reinsurance, and that in the absence of express policy language to the contrary, there should be no distinction made between direct insurance and reinsurance; (6) that the ultimate, indirect beneficiary of the reinsurance policy is the underlying insured who would ultimately benefit from the financial strength of the reinsurer in the form of better insurance rates and coverage; (7) that in the absence of a clear expression of legislative intent, the benefit of the doubt should go to the reinsurer; (8) that any discrimination between direct insurance and reinsurance is contrary to the "Natural Law;" (9) that any discrimination between direct insurance and reinsurance is a "Breach of Good Faith" which "cannot be recognized by any Law;" (9) that the law does not justify the use of premiums received from Muscat for the sole, exclusive benefit of a particular class of insureds; (10) that in an era of globalization, discrimination between direct insureds and reinsureds would dissuade international reinsurers from placing business with American companies; (11) that the laws of the United States should have an international perspective rather than a local perspective. Muscat urges the court to follow the decision of the intermediate appellate court in *Covington v. Ohio General Ins. Co.*, 2001 WL 1013126 (Ohio App. 2001), *reversed*, 99 Ohio St.3d 117, 789 N.E.2d 213 (2003), and argues that the cases relied upon by the Liquidator relate to a bygone era.

DISCUSSION

15. It is the duty of the court to discern the intent of the legislature from the various sources available to it. In this situation, where there are insufficient funds to satisfy all of the claimants, it is inevitable that some claimholder will be disappointed. However, that disappointment will not work to the benefit of Reliance, and certainly will not work to the benefit

of the Liquidator. Rather, claims must be assigned priorities so that those claimants that the legislature was *most* concerned to protect shall receive the maximum possible protection. There is no authority whatsoever for the suggestion that doubts should be resolved in favor of the reinsurer.

16. In determining the applicable law in this matter, the Court must be guided by the ~~statutory and, to the extent relevant, the common law of the Commonwealth of Pennsylvania. It~~ is not to be guided by some undefined "Natural Law" or by principles of international law or principles of comity. Nor is the Court permitted to usurp the legislative function to further any views it might hold as to what result might best benefit American business interests in the international community.

17. The unanimous authorities from other jurisdictions applying similar statutory provisions hold 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. 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).

18. While it is true that these cases are not controlling, the decisions are neither antiquated nor wrongly reasoned. To the contrary, their reasoning is persuasive and the decisions are consistent with Pennsylvania law and with all indicia of the intent of the Pennsylvania legislature.

19. There is an obvious rationale for a legislative choice to protect direct consumers of insurance over reinsureds. The former, whether they are individuals or corporate entities, are not members of the insurance industry, but private persons or businesses engaged in altogether different enterprises, who are seeking to protect themselves against the risks of living and/or doing business in our society. The latter are sophisticated members of the insurance industry ~~who have willingly assumed those risks from the direct insured, in exchange for premiums which~~ the reinsureds have set, and now wish to spread the risk further among other highly sophisticated members of the insurance industry, with whom they regularly deal and with whom they stand on a more equal footing than does the underlying insured.

20. The only case cited by Muscat in support of its position is that of the intermediate appellate court in *Covington v. Ohio General Ins. Co.*, 2001 WL 1013126 (Ohio App. 2001), which was reversed by that State's Supreme Court in a decision which is well reasoned and consistent with the decisions of seven other states. The Court should decline to follow the decision of the intermediate appellate court in *Covington*, which has no precedential effect even in the State of Ohio.

21. No other authority has been offered in support of Muscat's position.

22. The business of the insurer whose rehabilitation was at issue in *Grode* was described by the Commonwealth Court as consisting of reinsurance (60-70%), as well as a "large number" of surety bonds and a lesser amount of direct insurance. *Grode*, 132 Pa. Cmwlth. 196, 202, 572 A.2d 798, 800-01. This is not a basis for disregarding the Commonwealth Court's conclusion that "the equitable purpose of rehabilitation and liquidation is to protect *first of all* consumers of insurance." *Id.* at 203, n.5, 572 A.2d at 801, n.5.

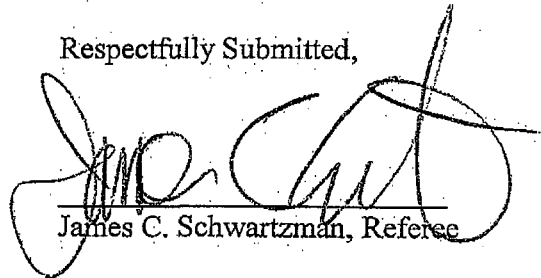
the lower policy classification applicable to general creditors.

31. Muscat'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 Muscat's Objection denied.~~

Respectfully Submitted,



James C. Schwartzman, Referee