



**ORDER**

AND NOW, this 14<sup>th</sup> day of July 2005, the recommendation of the Referee that the proof of claim in the captioned matter be assigned a priority of (g) pursuant to Section 544 of the Insurance Department Act, 40 P.S. §221.44 is AFFIRMED.

*James G. Colins*

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**JAMES GARDNER COLINS, President Judge**

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Reliance Insurance Company,  
Defendant

: No. 269 M.D. 2001

**IN THE MATTER OF OBJECTIONS TO NOTICE OF DETERMINATION BY  
FACTORY MUTUAL INSURANCE COMPANY FOR PROOF OF CLAIM NUMBER  
2095337**

G. Alan Bailey, Esquire, duly appointed Referee in the Matter of Objection to Notice of Determination by Factory Mutual Insurance Company for Proof of Claim Number 2095337 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 Claim be assigned a priority (g) and in support thereof presents the following:

**FINDINGS OF FACTS**

**Background**

1. By Order of the Commonwealth Court of Pennsylvania ("Court") dated October 3, 2001 ("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 ("Liquidator") was appointed Liquidator of Reliance.
2. By Order of the Court dated September 9, 2002 ("Claims Filing Order") the Honorable James Gardner Colins, President Judge, established claims' filing procedures, claims' filing deadlines and dispute resolution procedures for claims.
3. Factory Mutual Insurance Company (referred to herein as "Claimant" or "Factory Mutual"), timely submitted Proof of Claim Number 2095337 ("POC") on December 23, 2003. The POC seeks a claim amount of \$220,522.50 under Policy Number NKA1630637, insured Coastal Transport Company.
4. On October 6, 2004 the Liquidator issued a Notice of Determination ("NOD") to Factory Mutual, setting a claim priority level of g<sup>1</sup> and valuing the claim at \$220,522.50.

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<sup>1</sup> The relevant language of 40 P.S. § 221.44(g) states:

(g) The following claims:

(3) Claims or portions of claims, payment of which is provided by other benefits or advantages recovered by the claimant.

5. On December 3, 2004 counsel for Factory Mutual timely filed, with the Court, an Objection to the Notice of Determination of the Liquidator Proof of Claim No. 2095337, asserting that the Liquidator incorrectly assigned this claim at priority level g, contending the claim should be a priority level b claim. There is no dispute regarding the claim's valuation.
6. On February 7, 2005 the Liquidator filed, with the Court, a response to Factory Mutual's Objection to the NOD.
7. By order of the Court dated March 22, 2005 the undersigned was appointed Referee to provide a recommendation to the Court regarding issues involving the POC filed by Factory Mutual and the Liquidator's denial thereof.<sup>2</sup>

### Facts

8. The following is a brief summary of the facts supporting the Claim:
  - a. Wesco Distribution, Inc. ("Wesco"), with property insurance provided by Factory Mutual as successor in interest to Arkwright Mutual Insurance Company, maintained an on-site (construction site) warehouse for electrical parts in Mission, Texas.
  - b. Coastal Transportation Company, Inc. ("Coastal"), with automobile liability insurance through Reliance Insurance Company ("Reliance"), transported gasoline and other fuel products to construction sites including the one where Wesco maintained its warehouse.
  - c. On March 16, 1999 a Coastal employee, while delivering gasoline to the Wesco construction site, caused a gasoline spill that ignited. The resulting fire destroyed the Wesco warehouse and its contents.
  - d. The total loss suffered by Wesco as a result of the fire was \$504,727.25. Wesco was paid by its insurer (Arkwright which subsequently merged into Factory Mutual) \$404,727.25 absorbing the \$100,000.00 deductible.
  - e. On March 12, 2001 Wesco and Factory Mutual, the subrogated property insurer, filed suit in the 131<sup>st</sup> District Court of Bexar County, Texas against various defendants including Coastal. Reliance retained counsel to represent Coastal.
  - f. Pursuant to discussions between the parties, the Bexar County lawsuit was settled on or about September 5, 2001. The terms of the settlement required a total payment from all defendants to plaintiffs Wesco and Factory Mutual of \$400,000.00, \$275,000.00 of that to be the responsibility of Coastal and its insurer

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<sup>2</sup> On October 2, 2003 the Liquidator filed an action against Factory Mutual seeking to recover approximately \$1.9 million as a preference under 40 P.S. §221.30. The Liquidator contends that, pursuant to 40 P.S. §221.31, Factory Mutual's claim should not be allowed or processed until Factory Mutual surrenders the preference of \$1.9 million. Factory Mutual disputes this position. In an effort to avoid possibly unnecessary costly litigation, the parties agreed that a Referee should be appointed to resolve Factory Mutual's Objection to the NOD. As such the parties entered into a Stipulation Regarding Appointment of a Referee whereby the only issues to be presented by the Referee would be: i) whether Factory Mutual's claim of \$220,522.50 is entitled to a class b or class g priority; and, ii) whether a \$25,000 deductible payment, made to Reliance (prior to the Liquidation) by insured Coastal as part of the underlying settlement of Factory Mutual's claim, should be treated as an asset of the Liquidation or as being held in trust by Reliance for Factory Mutual. This Stipulation Regarding Appointment of a Referee with the Liquidator's Withdrawal of Petition to Stay Appointment of a Referee as to POC 2095337 was filed with the Commonwealth Court on March 11, 2005.

Reliance. Wesco and Factory Mutual agree that of the \$275,000.00 due from Coastal/Reliance, \$220,522.50 is due to Factory Mutual.<sup>3</sup>

- g. Due to the Liquidation Order of October 3, 2001, Factory Mutual was never paid.

### The Conference

9. Pursuant to duly issued notice to counsel for the parties a conference, via telephone, was held in this matter on April 8, 2005. Counsel for Claimant, Thomas Brown, Esquire and Billy McGill, Esquire, counsel for the Liquidator, Kean McDonald, Esquire and this Referee participated in the conference.

10. Counsel for the parties acknowledged that this was a subrogation claim by Factory Mutual resulting from a settlement of the Bexar County lawsuit (see Facts supra), there was essentially no disagreement of the underlying facts that resulted in the claim, and that the objections to the claim and the objections to the claim determination were issues of law.

11. Pursuant to the request of the parties, a briefing schedule was established as follows:

- a. The Liquidator's brief shall be filed with the Referee on or before May 9, 2005.
- b. Claimant's brief shall be filed with the Referee on or before June 6, 2005.
- c. In the event counsel for the Liquidator wishes to file a reply brief, such brief shall be filed with the Referee within ten (10) days of the filing of Claimant's brief but in no event later than June 16, 2005.
- d. Upon receipt of all briefs, the Referee reserves the right to schedule oral argument on the issues.

### The Issues

12. In accord with the Stipulation Regarding Appointment of a Referee and the Liquidator's Withdrawal of Petition to Stay Appointment of a Referee this Referee limited review to the following issues

- a. Whether Factory Mutual's claim of \$220,522.50 is entitled to a class b or class g priority.
- b. Whether a \$25,000 deductible payment, made to Reliance (prior to the Liquidation) by insured Coastal as part of the underlying settlement of Factory Mutual's claim, should be treated as an asset of the Liquidation or as being held in trust by Reliance for Factory Mutual. As indicated below, this issue has been resolved by agreement of the parties.

13. Factory Mutual, as subrogee, argues that it assumes all the rights of its subrogor, and as such the claim maintains the status as third party claimant having a claim against Reliance for liability for injury to or destruction of tangible property as allowed under the Liquidation Statute 40 P.S. § 221.44(b) – a priority level b claim. However, Factory Mutual suggests that its subrogation rights, as Wesco's subrogee, is against Coastal, not Reliance. Factory Mutual

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<sup>3</sup> Factory Mutual, in its Objections to the NOD, indicated that Coastal paid Reliance \$25,000.00 as its responsibility of the \$220,522.50 settlement amount per the policy deductible requirements. Factory Mutual initially contended that Reliance was holding these funds as trustee for Coastal and therefore must pay the \$25,000.00 to Factory Mutual regardless of the priority level ultimately assigned to Factory Mutual's claim. Now however, premised on evidence provided by the Liquidator, Factory Mutual has agreed that the deductible should be treated the same as the remainder of the claim.

maintains that when the subrogation claim was resolved by settlement with Coastal, Factory Mutual became a judgment creditor of Coastal and a third party beneficiary of Coastal's policy with Reliance.

14. In support of its position, Factory Mutual relies upon the Minnesota case In the Matter of the Liquidation of National Family Insurance Corp., 603 N.W. 2d 668 (Minn. Ct. App. 1999) wherein the Minnesota Court of Appeals allowed the subrogation claim at a priority level that what would be analogous to a priority level b claim here.<sup>4</sup> Additionally, Factory Mutual contends that Texas law applies to issues related to its status as a judgment creditor against Coastal and a third party beneficiary of the Reliance liability policy.

15. Reliance counters that Factory Mutual, as a subrogee, stands in the shoes of the claimant, therefore the claim falls within the gambit of the 40 P.S. § 221.44(b) language providing that any portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, thus dropping Factory Mutual's claim to a priority level g.

16. As to the \$25,000, Reliance initially asserted that once Reliance was placed into Liquidation by the Commonwealth Court, the payment by Coastal, a reimbursement of the deductible, became an asset of the estate. However, in its brief supporting the Liquidator's POC classification, Reliance presented an affidavit of Angela Clemente, a Senior Claims Specialist for Reliance, stating that the \$25,000 deductible paid to Reliance by its insured, Coastal, was applied and paid to two other claimants of the March 16, 1999 accident prior to the settlement of the Wesco claim. Factory Mutual, in its Memorandum of Law in Response to the Liquidator's Determination of Proof of Claim Classification acknowledges that the \$25,000 deductible should be treated in the same manner as the remainder of the claim.

### Conclusions of Law And Discussion

This matter presents a statutory interpretation issue of what appears to be of first impression in Pennsylvania.<sup>5</sup> The statute involved, 40 P.S. § 221.44, provides the priority in

<sup>4</sup> In Liquidation of National Family, claimants there contended that their claims qualified as "loss claims" according to the plain language of section the Minnesota Liquidation Statute in two ways: (1) that their claims are "claims under policies or contracts of coverage for losses incurred including third party claims," and (2) that because "claims not covered by a guaranty association are loss claims," their subrogation claims, which are undisputedly not covered by Minnesota's guaranty fund, are therefore loss claims. The Court of Appeals decided the case on the second contention, finding that the claimants' subrogation claims against National Family were not covered claims under Minnesota's insurance guaranty association statutes. Even though the National Family's liquidators contended that public policy supports restricting subdivision 4 claims to "first and third party claimants under NFIC policies." The Court of Appeals determined that the Minnesota legislature implicitly rejected the Liquidators' argument by expressly allowing "all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies or contracts" to qualify as subdivision 4 loss claims. The Court found that nothing in subdivision 4 suggested that subrogation claims by insurance companies are categorically prohibited from being classified as loss claims, and refused to interpret the statute with such a limitation.

<sup>5</sup> The Reliance Liquidator, at the request of the Referee, advised that this issue, determination of a subrogee-insurer's priority level, has been heard by one other Referee, James C. Schwartzman, Esquire, In the Matter of Objections to Notice of Determination by Empire Fire & Marine Insurance Company Claim No. 1897578 ("Empire"); Referee Schwartzman filed his recommendations with the Commonwealth Court on April 15, 2005. Therein, Referee Schwartzman determined that Pennsylvania common law places the subrogee in the same position of the one whose rights and disabilities he is subrogated. As such, Referee Schwartzman held that Empire, as subrogee of its insured, had no greater rights than the subrogor, therefore Empire's claim was properly set by the Liquidator at priority level g. On May 16, 2005 the Honorable James Gardner Collins, President Judge entered an

which claims against a liquidated insurer are to be paid. § 221.44(b), the subsection at issue that provides for payment of loss claims, states:

(b) All 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, shall have the next priority. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values shall be treated as loss claims. **That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment made by an employer to his employee shall be treated as a gratuity.**  
[emphasis added]

40 P.S. § 221.44(g), defines priority level (g) as:

(g) The following claims:

(1) Claims under section 539(b) [40 P.S. §221.39(b)], to the extent that such claims were disallowed under that section.

(2) Claims filed late.

(3) Claims or portions of claims, **payment of which is provided by other benefits or advantages recovered by the claimant.**

[emphasis added]

Clearly, if the claimant was Factory Mutual's insured, Wesco, the exclusion of 221.44(b) would apply. However, the issue here is whether the exclusion set forth in 221.44(b) is applicable to the holder of a loss claim by virtue of a subrogation agreement.

Claimant's reliance upon In the Matter of the Liquidation of National Family Insurance Corporation, supra, is not persuasive. As Reliance correctly argues, the Minnesota Court of Appeals did not decide this case on the "other benefits or advantages" language that is the basis for Reliance's setting the Factory Mutual claim at priority level g. The Minnesota Court of Appeals' determination is premised upon language in the Minnesota Liquidation Act (allowing claims not covered by Minnesota's Insurance Guaranty Association statutes to raise to the level of a loss claim analogous to priority level b here) is not present in Pennsylvania's Liquidation Act.

As well, Factory Mutual's contention that its liquidation status somehow is altered when it became a judgment creditor of Coastal and a third party beneficiary of Coastal's policy with Reliance is rejected. Factory Mutual's claim arises because of its contractual subrogation agreement with Wesco. Attempting to insulate itself from the restrictions of 40 P.S. § 221.44(b) and (g) through Coastal, does not provide Factory Mutual with additional rights in the Reliance Liquidation. Assuming arguendo that, as Factory Mutual proposes, Texas law applies to its judgment against Coastal, Pennsylvania insurance insolvency law remains exclusively applicable

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order accepting Referee Schwartzman's recommendations. Factory Mutual strenuously argues that the Empire claim is factually different, therefore the recommendations of Referee Schwartzman are not applicable here.

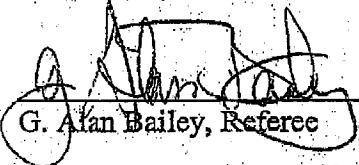
to Factory Mutual's Claim priority. Even applying the veil of judgment creditor/third part beneficiary, Factory Mutual's claim is (as Factory Mutual acknowledges) that of a subrogee.

As Referee Schwartzman concisely states In the Matter of Objections to Notice of Determination by Empire Fire & Marine Insurance Company Claim No. 1897578, "The common law doctrine of subrogation 'places the subrogee in the precise position of the one to whose rights and disabilities he is subrogated.' Allstate Ins. Co. v. Clarke, 527 A2d 1021, 1024 (Pa. Super. 1987)." We agree. Factory Mutual has the same right to pursue its claim against Reliance as does its insured, Wesco, but assumes no greater rights. As such, Factory Mutual is bound by the exclusion of 221.44(b). Further, after reviewing the written findings and conclusions of Referee Schwartzman, although there may be several factual distinctions involving the Empire claim, we find the issue to be indistinguishable with the instant matter, with the claimant there in the same position as Factory Mutual. Therefore, President Judge Collins' May 16, 2005 Order accepting the Referee Schwartzman's recommendations applies to Factory Mutual's claim. Factory Mutual's claim was correctly determined and set at priority level (g).

### CONCLUSION

WHEREFORE, For the reasons set forth above, the Liquidator's Notice of Determination properly assigned Factory Mutual's POC priority level (g) pursuant to Section 544 of the Insurance Department Act 40 P.S. § 221.44.

Respectfully Submitted

  
G. Alan Bailey, Referee



