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.	:	

REPLY IN SUPPORT OF PRELIMINARY OBJECTIONS OF M. DIANE KOKEN

M. Diane Koken, in her official capacity as Statutory Liquidator of Reliance Insurance Company (In Liquidation) ("Liquidator), pursuant to Pennsylvania Rule of Civil Procedure 1028 and Pennsylvania Rule of Appellate Procedure 106, hereby submits her Reply in Support of Preliminary Objections of M. Diane Koken to the Petition to Intervene of Golder Associates Corporation ("Golder").

I. INTRODUCTION

Golder's Petition to Intervene is not legally sufficient. Golder cannot establish that it has any legally enforceable interest in Reliance's reinsurance agreements, and even if it did, Golder's interests are adequately protected by the proof of claim and/or direct access process. In fact, Golder concedes that it cannot meet the test necessary to establish a right to direct payment of reinsurance under 40 P.S. § 211.34, and as set out below, it has not and cannot establish such a right under *Koken v Legion Ins. Co.*, 831 A.2d 1196 (Pa. Commw. Ct. 2003),

aff'd per curiam, No. 204 MAP 2003, 2005 WL 1684428 (PA. July 19, 2005) (hereinafter referred to as "*Legion*"). Golder also should not be permitted to circumvent the legal procedures available and required for all claimants by intervening as opposed to proceeding under this Court's Direct Access Guidelines which adequately protect Golder's interests, if any, to Reliance's reinsurance proceeds. For these reasons, Reliance's Preliminary Objections should be granted, and Golder's Petition should be stricken in its entirety.

II. ARGUMENT

Golder's arguments in opposition to the Liquidator's Preliminary Objections boil down to two equally unavailing points. First, Golder argues that its Petition and Application for Relief fall squarely within *Legion*. Second, Golder argues that it is not required to proceed under the Direct Payment Guidelines because its request for direct payment is based on *Legion* and not 40 P.S. § 221.34.

A. Golder's Application for Relief Does Not Fall Squarely Within Legion

Golder misreads the *Legion* court's conclusion that certain circumstances create an exception to the general rule that reinsurance proceeds must become assets of the estate of an insolvent insurer:

> the general rule...is just that, a general rule that applies in the traditional insurer/reinsurer context. The general rule makes little sense, however, where following it will turn upside down the contractual arrangements established by the Policyholder Intervenors for providing for their liability risks.

831 A.2d. at 1234. The *Legion* court was very explicit about the factors that create an exception to the general rule:

> ...the reinsurer, not [insurer], bears 100% of the underwriting risk, and the reinsurer was chosen by the policyholder...The Policyholder Intervenors, through their consultants and agents, chose their reinsurers as the intended source of their coverage. The

> fronting company was the last party to the transaction; its identity was not even known until after the reinsurance was placed and all material terms were decided by the Policyholder Intervenors and their reinsurers.

831 A.2d at 1240. Accordingly, the key factors that the *Legion* court considered were:

(1) the reinsurer bore 100% of underwriting risk;

(2) absence of claim adjustment responsibility by the insurer; and

(3) the reinsurance was placed by the policyholder, not the insurer, for the policyholder's benefit.

Id. at 1247.

1. ECS Re did not bear 100% of the underwriting risk.

As to the first *Legion* factor, the only reinsurance agreement which covers the Lummi Claim, is the ECS Reinsurance Agreement. Under the ECS Reinsurance Agreement, ECS Re's participation varied, but was never 100%, and with respect to the Lummi Claim was 30% of each loss not to exceed $2 million plus allocated expenses. Accordingly, no argument could be made the ECS Re bore 100% of the underwriting risk.

Recognizing that the exception to 40 P.S. § 221.34 created by the *Legion* court was only intended to apply to a narrow subset of 100% reinsurance agreements, which the ECS Reinsurance Agreement is not, Golder attempts to create coverage for the Lummi Claim under the Portfolio Transfer Agreement, which is a 100% reinsurance agreement. Golder argues that the "the Portfolio Transfer Agreement raises questions as to the flow of premium monies, and as to the scope of the Portfolio Transfer Agreement." (Golder Memo in Opposition at 5). However, these "questions" are answered by the express language of the Portfolio Transfer Agreement. According to the express terms of the Reinsuring Clause of the Portfolio Transfer Agreement, the Lummi Claim is outside the scope of the agreement:

> [Reliance] agrees to cede to [NAC Re] and [NAC Re] agrees to accept from [Reliance] 100% of [Reliance's] Net Retained Liability, as outlined in Exhibit A, for each occurrence on or after October 1, 1999 for all occurrence based Policies; for each claim made on or after October 1, 1999 for all claims made based Policies; and/or for each loss discovered on or after October 1, 1999 for all losses discovered Policies, for all Ultimate Net Loss and all Loss Expense.

In other words to be covered by the Portfolio Transfer Agreement, the claim had to be made before October 1, 1999 because the Lummi Claim arises under a claim-made policy. Golder made the Lummi Claim on August 12, 1999. Accordingly, the Lummi Claim is not covered by the Portfolio Transfer Agreement, and the flow of premium monies does not expand the scope of the Portfolio Transfer Agreement to cover the Lummi Claim.[1]

2. Reliance had claims adjustment responsibility for the Lummi Claim.

As to the second *Legion* factor, Golder attempts to convert Reliance's managing general agent Environmental Compliance Services, Inc. ("ECS Services") into ECS Reinsurance Company, Ltd. ("ECS Re"), in order to argue that Reliance had no claim adjustment responsibility under the Reliance Insurance Policy. That ECS Services and ECS Re are affiliated entities does make them one and the same. More importantly, a managing general agent, by definition is an agent of the insurance company, in this case Reliance, for purposes of managing all or part of the insurance business of an insurer. *See* 40 P.S. § 322.1 (defining managing general agent under the Pennsylvania Insurance Code). Therefore, the fact that Reliance used a managing general agent does establish an absence of claim adjustment responsibility by

[1] As to the flow of premium monies, the Portfolio Transfer Agreement only provides as follows:

> (1) the pro-rata portion of Additional Premiums (less Ceding Commission) for the period after October 1, 1999 shall be due to Reinsurer and (2) the pro-rata portion of Additional Premiums relating to the period before October 1, 1999 shall be retained by [Reliance].

Reliance; to the contrary and under well-established principles of agency law, it establishes that all contact with ECS Services regarding the Reliance Insurance Policy and the Lummi Claim was contact with Reliance through its agent.

Golder also erroneously states that Golder's relationship with ECS, and complete lack of relationship with Reliance of Illinois, demonstrates just how different its relationship was from that of the typical policyholder." (Golder Memo in Opposition at 8) (emphasis supplied). All of Golder's "evidence" at best establishes a relationship with ECS Claim Administrators, Inc., ("ECS Claim") and not with ECS Re. *See* Exhibit A-G of the Marzzarella Affidavit attached to Golder's Application for Relief. Again, contact with ECS Claim is contact with Reliance, though its claim agents. This point is made clear by ECS Claim in the February 8, 2000 reservation of rights letter cited to by Golder, where ECS Claim states it was working on behalf of Reliance. *See* Exhibit C to Application for Relief. ("As you are aware, we have been retained by Reliance Insurance Company of Illinois ("Reliance") to investigate [the Lummi Claim], which has been submitted as a claim for coverage on behalf of [Golder]."). Under basic concepts of agency law, Reliance's use of agents to adjust the Lummi Claim only reinforces that all contact was with Reliance, through its agents. It does not establish a relationship between Golder and ECS Re.

3. Golder did not place the reinsurance agreements in question.

As to the third *Legion* factor, Golder has not, nor could it establish an evidentiary record that Golder and ECS came together to create the reinsurance relationship or that Reliance, the insurer, was the "last party to the transaction," as was the case with the four policyholder intervenors in *Legion*. *Id.* at 1240. Significantly, the *Legion* court emphasized that the reinsurance programs considered in *Legion* were put together by the policyholder –interveners

themselves (or a broker on their behalf), for the policyholders' own benefit. This was the case for all four policyholder intervenors. *See e.g. Legion,* 831 A.2d at 1209 ("Pulte has provided for its general liability claims through a program of its own design that involves...direct negotiation and purchase of reinsurance for Pulte's sole benefit . . ."); *id,* at 1211-12 (the American Psychiatric Association ("APA") offered its members an opportunity to participate in its professional liability insurance program, delivered through a risk purchasing group, Psychiatrists' Purchasing Group, Inc., which, on behalf of the doctors, purchased coverage—via a reinsurance arrangement—for the APA members); *id* at 1215 ("[to] cover the liabilities arising from its medical transportation and fire prevention services, Rural/Metro has arranged for automobile, professional and general liability insurance...[and with the help of a reinsurance intermediary, purchased its reinsurance coverage directly from Transatlantic Reinsurance Company]"); *id* at 1218 ("American and Aon make joint presentations to the aviation insurance marketplace...Aon negotiates with insurers...and then provides American with its recommendation on the coverages that American should bind"). Therefore, the lack of Golder's involvement in the placement of the reinsurance for which it seeks direct access is fatal to its Petition to Intervene and Application for Relief.

B. Golder's Request for Direct Access to Reinsurance Falls Within the Processes Already Established By This Court Even if the Request is Not Based on Section 221.34.

As this Court is well aware, in the Reliance Estate policyholder requests for direct access to reinsurance, even when not based on Section 221.34, are still handled within the framework established by the Direct Access Guidelines adopted by this Court. Indeed, the two Reliance direct access cases relied on by Golder, *Koken v. Reliance Ins. Co.*, 846 A.2d 167, 171 (Pa. Commw. Ct. 2004) ("*SCPIE*") and *Koken v. Reliance Insurance Company*, No. 269 M.D.

2001, (Pa. Commw. October 5, 2005) ("*Lexington*"), were considered within the framework established by the Direct Access Guidelines even though the specific requirements of 40 P.S. § 221.34 were not met. Under that framework, a request for direct access initially is made to the Liquidator. If the request is denied, objections may be filed. During the objection process consideration is given to whether either the requirements of 40 P.S. § 221.34 and/or the *Legion* factors are met. For example, in *Lexington*, this Court, in ruling on an objection to the Liquidator's denial of a request for direct access, denied direct access because there was an absence of a direct relationship between the insured and the reinsurers as required by *Legion*. Therefore, notwithstanding Golder's assertion to the contrary, the Direct Access Guidelines do apply "where Golder's right to reinsurance monies is based on Golder's [alleged] relationship with ECS." (Golder Memo in Opposition at 11). Likewise, as reflected by the Pennsylvania Supreme Court's recent decision in the SCPIE matter, the Direct Access Guidelines afford Golder the opportunity for a *Legion* type evidentiary hearing. Accordingly, Golder's interests will be protected without intervention.

III. CONCLUSION

For the foregoing reasons, M. Diane Koken, in her official capacity as Statutory Liquidator of Reliance (In Liquidation) respectfully requests that this Court deny the Petition to Intervene and sustain the Liquidator's Preliminary Objections.

Dated: January 4, 2006

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on January 4, 2006, a true and correct copy of the Reply in Support of the Preliminary Objections of M. Diane Koken was served by first class mail, postage prepaid, to the following:

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I hereby certify that, on January 4, 2006, a Notice of Filing, in compliance with the Commonwealth Court's Order of April 1, 2004 was faxed to the Master Service List

Michael Olsan