

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

Brand Scaffold Services, Inc., Brand Scaffold
Builders, Inc. and Joe A. Gonzales,

Petitioners,

v.

M. Diane Koken

Respondent.

RECEIVED AND FILED
FOR THE COMMONWEALTH COURT
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**RESPONSE IN OPPOSITION TO BRAND SCAFFOLD SERVICES, INC.,
BRAND SCAFFOLD BUILDERS, INC. AND JOE A. GONZALES'
EMERGENCY MOTION TO INTERVENE AND TO ENFORCE RELIANCE
INSURANCE COMPANY'S POST REHABILITATION AND PRE-
LIQUIDATION SETTLEMENT AGREEMENT**

M. Diane Koken, the Insurance Commissioner of the Commonwealth of Pennsylvania, as Liquidator for Reliance Insurance Company ("Liquidator"), through her undersigned counsel, opposes the Emergency Motion of Brand Scaffold Services, Inc., Brand Scaffold Builders, Inc. and Joe A. Gonzales (collectively, "Brand Scaffold") to Intervene and to Enforce Reliance Insurance Company's Post Rehabilitation and Pre-Liquidation Settlement Agreement. Through its motion, Brand Scaffold seeks to obtain an

unlawful preference by enforcing a settlement that it alleges was reached prior to this Court's entry of the October 3, 2001 liquidation order and which would require the Liquidator to make an immediate payment of \$1 million dollars to the settlement. As discussed below, however, Brand Scaffold has not submitted a claim in the liquidation proceeding, and the Liquidator has not made a determination on Brand Scaffold's claim. Brand Scaffold's motion is nothing more than a premature and improper attempt to enforce the settlement agreement and to effectuate immediate payment of \$1 million on Brand Scaffold's claim, thereby circumventing the statutorily mandated proof of claim procedure. This Court recently rejected such an attempt on the ground that the petitioner has a remedy under the Pennsylvania Insurance Department Act, Pa. Stat. § 221.1 et seq. (see Exhibit "A" hereto). The Liquidator does not make any determination here with respect to Brand Scaffold's contention that the settlement agreement is enforceable. However, to the extent that there is a dispute over the enforceability of the agreement, that would be an issue to be determined in the claims filing process after a proper proof of claim is submitted.

BACKGROUND

A. This Court's Order Placing Reliance Insurance Company in Liquidation

1. On October 3, 2001, the Commonwealth Court of Pennsylvania entered its Order ("Liquidation Order") placing Reliance Insurance Company ("Reliance") in liquidation pursuant to Pa. Stat. Ann. tit. 40, §§ 221.1 et seq. ("Pennsylvania Insurance Act"). The Liquidation Order declared Reliance insolvent. Order at ¶ 2.

2. The Liquidation Order appoints M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, and her successors in office, as Liquidator of Reliance ("Liquidator").

3. The Liquidator is empowered and directed to take immediate possession of Reliance's property, business and affairs and to take such action as the interests of policyholders, creditors or the public may require.

4. As of the date of the Liquidation Order, the Liquidator is charged with a duty to marshal assets in order to maximize the assets of the estate and to protect the interests of all policyholders and creditors as a whole.

5. The Pennsylvania Insurance Act, which governs liquidation of insolvent insurers, expressly sets forth priority of claims and an order of distribution of claims in a liquidation. Pursuant to the Act, after administrative expenses and costs, claims for losses covered under policies of insurance are entitled to priority in distribution before claims of general creditors. 40 Pa. Stat. § 221.44. By statute, claims within each class must be paid in full before the members of the next class are paid. 40 Pa. Stat. § 221.44. The Pennsylvania Insurance Act thus requires a fair and equitable distribution of assets among claimants in the same class of priority and prohibits the Liquidator from preferring one claimant to another.

6. The Pennsylvania Insurance Act provides an exclusive remedy and procedure for anyone with a claim against Reliance. This includes policyholder claims, as well as general creditor and other claims. The Act requires that all such claims be made through the filing of a "proof of claim." 40 Pa. Stat. §§ 221.37, 221.38.

7. The statutory proof of claim procedure is exclusive and mandatory. The Liquidation Order expressly provides that "[n]o person shall participate in any distribution of the assets of Reliance unless such claims are filed and presented . . ." Order at ¶19. In recognition of the exclusivity of this claims procedure, the Liquidation Order and the Pennsylvania Insurance Act direct an indefinite stay of all actions against Reliance or the Liquidator. See 40 Pa. Stat. §221.26. The Liquidation Order provides that "[a]ll actions, arbitrations and mediations, against Reliance or the Liquidator shall be submitted and considered as claims in the liquidation proceeding." Id. The Pennsylvania Insurance Act

also provides that “[u]pon issuance of an order appointing the commissioner liquidator of a domestic insurer or of an alien insurer domiciled in this Commonwealth, no action at law or equity shall be brought by or against the insurer, whether in this Commonwealth or elsewhere, nor shall any such existing actions be continued after issuance of such order.” 40 Pa. Stat. §221.26.

8. The Liquidation Order, at paragraph 9, provides for the resolution of all claims against Reliance in a single forum – the Commonwealth Court – and directs the Liquidator to implement notice and procedures for filing claims against Reliance.

B. The Pre-Liquidation Settlement At Issue

9. On November 7, 2001, Brand Scaffold filed a motion with this Court seeking to intervene in this action for the purpose of enforcing a settlement it claims was reached in an action captioned, Joe A. Gonzales v. Brand Scaffold Services, Inc and Brand Scaffold Builders, Inc., 165th Judicial District, Harris County, Texas. In its motion, Brand Scaffold alleges that the settlement agreement was agreed to by the Rehabilitator prior to the entry of the Liquidation Order and is an enforceable contract. It seeks an order from the Court directing Reliance to pay \$1 million in contribution to the settlement.

10. Brand Scaffold’s motion should be denied for several reasons. First, the motion is a claim against Reliance which, as with any and all claims against Reliance, must be submitted and adjudicated in the proof of claims proceeding. As of this date, the Liquidator has not yet implemented a claims filing procedure although she anticipates that one will be implemented in due course. Brand Scaffold has not submitted a proper proof of claim pursuant to the statutory claims procedure and the Liquidator has not denied the claim. Accordingly, the claim is not ripe for adjudication by this Court. Second, an immediate and full payment on the settlement would constitute an unlawful preference and would violate the Liquidator’s duty to treat all policyholders and creditors fairly. Finally, the immediate

funding of the settlement would accord Brand Scaffold's claim super priority and would violate the distribution priorities mandated by the Pennsylvania Insurance Act.

ARGUMENT

A. Brand Scaffold has an Exclusive Statutory Remedy which it must Pursue

11. As alleged above, the Pennsylvania Insurance Act requires that all claims against Reliance be submitted through a "proof of claim." 40 Pa. Stat. §§ 221.37, 221.38. Under this statutory claims procedure, the Liquidator reviews all claims filed in the liquidation. 40 Pa. Stat. § 221.45(a). The Liquidator may deny or allow a claim, in whole or in part. If a claim is allowed, the claimant will be entitled to a pro rata distribution from Reliance's estate. If a claim is denied, the Liquidator is required to provide written notice of the determination to the claimant. 40 P.S. § 221.41(a). The claimant may then file objections with the court. *Id.* All disputed claims are ultimately resolved by the Commonwealth Court or by a referee appointed by the Commonwealth Court. 40 Pa. Stat. §221.41(b). The statutory claims process is mandatory and exclusive, and permits an orderly and fair distribution of Reliance assets in accordance with the distribution priority set forth in the Pennsylvania Insurance Act.

12. The Liquidator is prohibited from paying policyholder claims or claim judgments except through the statutory claims process. 40 Pa. Stat. § 221.44.

13. Brand Scaffold's motion to enforce the settlement agreement is a claim against Reliance which must be made and ultimately adjudicated in the proof of claim proceeding.

14. Brand Scaffold has a statutory remedy which it is required to pursue, and it may not circumvent the statute by filing a motion with this Court. Pennsylvania courts have uniformly held that where a remedy or method of procedure is provided by statute, such as here, the statutory remedy or procedure must be strictly pursued and exclusively applied.

Barton v. Northampton County, 19 A. 2d 263 (Pa. 1941); Harcourt v. General Accident Ins.

Co., 419 Pa. Super. 155, 615 A. 2d 71 (1992), appeal denied, 534 Pa. 648, 627 A.2d 179 (1993); Concerned Taxpayers of Beaver County v. Beaver County Bd. of Assessment Appeals, 462 A. 2d 347 (Pa. Cmwlth. 1983).

15. In a petition virtually indistinguishable from this one that was recently filed by Consolidated Freightways Corporation (“Consolidated Freightways”) to Enforce a Pre-Liquidation Settlement in the Reliance liquidation proceeding, this Court denied the petition without prejudice to any right Consolidated Freightways may have to pursue a remedy under the Pennsylvania Insurance Act. A copy of this Court’s November 14, 2001 order is attached hereto as Exhibit “A.” The facts underlying Brand Scaffold’s motion and Consolidated Freightways’ unsuccessful petition are indistinguishable and Brand Scaffold’s motion, too, should be denied.

B. Brand Scaffold’s Claim is Not Ripe as there has been no “Determination” on its Claim

16. Pursuant to the Pennsylvania Insurance Act and the Liquidation Order, the Commonwealth Court has “exclusive jurisdiction over all determinations of the validity and amount of claims against Reliance.” See 40 Pa. Stat. §§ 221.41, 221.45.

17. The Pennsylvania Insurance Act and the Liquidation Order contemplate that, before this Court adjudicates a claim, an appropriate proof of claim has been filed, the Liquidator has reviewed the claim and made an adverse determination on the claim and the claimant has filed objections to the determination with this Court. None of these preconditions have been met here.

18. Brand Scaffold filed its motion with this Court prior to filing a proof of claim and prior to a determination as to the validity and amount of its claim in the statutory claims process. Accordingly, Brand Scaffold’s motion is premature. Brand Scaffold’s claim is not ripe until such time that Brand Scaffold has filed an appropriate proof of claim and the Liquidator has denied the claim.

C. The Requested Payment Would Constitute an Unlawful Preference

19. The Liquidation Order, at paragraph 21, expressly prohibits any person from “obtaining of preferences, judgments, attachments . . . against Reliance assets, property”

20. Upon the entry of the Liquidation Order, the Liquidator is required by law to comply with the Pennsylvania Insurance Act and the Liquidation Order, and is charged with the responsibility to protect the interests of all policyholders. She may not, therefore, take any action that favors one policyholder over another, such as permitting a distribution of assets to pay immediately the claim of one policyholder in full.

21. Any payment on the alleged settlement in this case would be a distribution of assets to pay immediately the claim of one policyholder in full and would constitute an unlawful preference. Brand Scaffold would receive a full recovery on its claim while other policyholders would receive a pro rata share of the distribution of Reliance’s assets.

22. Pennsylvania courts have addressed the question of whether pre-liquidation settlements must be paid if that payment would contravene the governing statutory scheme and have held that they may not. See Panea v. Isdaner, 773 A. 2d 108, 2001 Pa. Super. LEXIS 429 (Pa. Super. April 10, 2001); Storms ex rel. Storms v. O’Malley, 779 A. 2d 548 (Pa. Super. 2001). In Panea and Storm, the court held that the principle that contracts must be enforced as written must give way to conflicting statutory provisions in Pennsylvania’s Property and Casualty Insurance Guaranty Association Act. Here, the enforcement of the settlement agreement would contravene the Liquidator’s duty to treat all policyholders fairly and her duty to distribute Reliance’s assets in accordance with the distribution priority required by the Pennsylvania Insurance Act.

23. The cases Brand Scaffold relies on in its motion, Commonwealth ex rel. Kelly v. Commonwealth Mut. Ins. Co., 450 Pa. 177, 299 A. 2d 604 (1973); Commonwealth ex rel. Sheppard v. Central Penn Nat’l Bank, 31 Pa. Commw. 190, 375 A.2d 874 (1977), are clearly inapplicable. In Central Penn National Bank, the Court simply held that a statutory

liquidator who brought an action based on the insurer's contract stood in the shoes of the insurer would be subject to counterclaims and defenses that were based on the contract. In Commonwealth Mutual Insurance Company, the Court held that the liquidator who, as the Insurance Commissioner, had approved a policy containing a one-year limitation on the imposition of certain liability, which was consistent with applicable law, could not completely ignore the policy provision and assess liability six years after the expiration of the policy. Brand Scaffold's reliance on Foster v. Philadelphia Manufacturers, 592 A.2d 131, 133 (Pa. Commw. 1991) is also misplaced. This case merely stands for the proposition that a liquidator of an insolvent insurer who brings a breach of contract action against a third party under the insurer's contract with the third party is bound by the arbitration provision contained in that contract. Unlike in Philadelphia Manufacturers, the Liquidator is not asserting contract based claims against Brand Scaffold. Rather, it is Brand Scaffold that is asserting a contract claim against the Liquidator. None of the cases cited in Brand Scaffold's motion involved payment on a settlement entered prior to a liquidation order. Further, none involved a situation such as that here where the relief requested of the Liquidator would violate her statutory duties and the governing statutory scheme. The Liquidator's immediate funding of the settlement agreement would violate the Pennsylvania Insurance Act and the Liquidation Order.

D. The Payment Would Violate the Distribution Priority Mandated by the Pennsylvania Insurance Act

24. The immediate funding of the settlement agreement at issue would also violate the distribution priority mandated by the Pennsylvania Insurance Act in that it would accord special priority to Brand Scaffold' claim. The Pennsylvania Insurance Act requires that the order of distribution of claims be in accordance with Section 221.44 which provides first priority to "costs and expenses of administration." The immediate funding of the settlement would improperly elevate Brand Scaffold' claim to a priority equal to or higher than

administrative expenses. In a case precisely on point, the Court of Appeals of Georgia, in Oxedine v. Commissioner of Insurance of North Carolina, 229 Ga. App. 604, 494 S.E. 2d 545 (1998), held that settlements that were reached during an insurer's rehabilitation proceeding did not constitute administrative costs and expenses in the insurer's liquidation proceeding and were not entitled to super priority under a Georgia statute which provided for a distribution priority similar to that in the Pennsylvania Insurance Act. The Court stated that:

we do not find it significant that the Georgia Commissioner of Insurance was a party to these agreements. Participation by the Commissioner of Insurance is an expected result from the nature of rehabilitation proceedings under OCGA § 33-37.11. If any action by the Commissioner of Insurance on a claim or lawsuit in a rehabilitation proceeding were sufficient to create claims with some special priority, then any claim against the insurer's estate, which arose from an action taken during a rehabilitation resulting in a settlement approved by the Commissioner of Insurance, would also have this same special classification. The effect of such a system would be to render meaningless the priority of claims established in [the statute].

494 S.E. 2d at 548. Further, in an analogous context, the Supreme Court of Pennsylvania has held that a policyholder who obtains a judgment against an insolvent insurer is not entitled to an elevated priority by virtue of the judgment. See Foster v. Mutual Fire, Marine & Inland Ins. Co., 531 Pa. 598, 614 A.2d 1086(1992); Davis v. Commonwealth Trust Co., 335 Pa. 387, 389, 7A.2d 3, 5(1939). Here, Brand Scaffold's alleged settlement does not entitle it to super priority.

25. The Liquidator's immediate funding of the settlement would be violative of the distribution priority mandated by law.

WHEREFORE, the Liquidator requests that this Court deny Brand Scaffold's
Emergency Petition to Intervene to Enforce Reliance Insurance Company's Post
Rehabilitation and Pre-Liquidation Settlement Agreement.

Respectfully submitted,

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IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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No. 269 M.D. 2001

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M. Diane Koken

Respondent.

ORDER

AND NOW, on this _____ day of _____, 2001, upon consideration of
Brand Scaffold Services, Inc., Brand Scaffold Builders, Inc. and Joe A. Gonzales' Emergency
Motion to Intervene and to Enforce Reliance Insurance Company's Post Rehabilitation and
Pre-Liquidation Settlement Agreement, the motion is hereby DENIED.

J.

Exhibit A

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the preceding Response in Opposition to Brand Scaffold Services, Inc., Brand Scaffold Builders, Inc. and Joe A. Gonzales' Emergency Motion to Intervene and to Enforce Reliance Insurance Company's Post Rehabilitation and Pre-Liquidation Settlement Agreement was served this 16th day of November 2001, by first class mail, postage prepaid, upon the individuals listed in the attached Master Service List and by hand delivery upon:

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Reliance Insurance Company

No. 269 M.D. 2001 (Commonwealth Court of Pennsylvania)

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