

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

v.

Reliance Insurance Company,  
Defendant

No. 269 M.D. 2001

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Synagro Technologies, Inc.  
Petitioner,

v.

M. Diane Koken  
Respondent.

**MEMORANDUM OF LAW IN OPPOSITION TO SYNAGRO  
TECHNOLOGIES, INC.'S APPLICATION FOR RELIEF**

M. Diane Koken, the Insurance Commissioner of the Commonwealth of Pennsylvania, as Liquidator for Reliance Insurance Company ("Liquidator"), submits this Memorandum of Law in Opposition to Synagro Technologies, Inc.'s ("Synagro") Application for Relief.

Through its application, Synagro seeks to obtain an unlawful preference by attempting to compel the approval of a settlement which Synagro admits was never approved by the Rehabilitator (presently, the Liquidator) and to effectuate immediate payment on such a settlement. To the extent Synagro is asserting a claim based on a

wrongful failure to approve a settlement, the claim must be submitted in the liquidation proceeding. Synagro's application is an improper attempt to obtain an immediate distribution from Reliance's estate, thereby circumventing the mandatory proof of claim procedure. It is significant that even where it was alleged that there was a settlement that had been approved by the Rehabilitator, this Court previously rejected a petition to enforce such a settlement 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). Whatever remedy Synagro may have is provided for in the Pennsylvania Insurance Department, and Synagro is required to pursue its statutory remedy.

While the Liquidator is sympathetic to any hardship that the plaintiffs and Synagro may experience as a result of Reliance's liquidation, there are countless other plaintiffs and insureds who are equally so affected. It is therefore critical that each claimant receives equal and fair treatment and not gain a preference over other equally deserving claimants. The economic hardship of Reliance's liquidation must be shared equally and fairly.

### **BACKGROUND**

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

On October 3, 2001, this Court entered its Order ("Liquidation Order") declaring Reliance Insurance Company ("Reliance") insolvent and placing Reliance in liquidation pursuant to Pa. Stat. Ann. tit. 40, §§ 221.1 *et seq.* ("Pennsylvania Insurance Act"). Order at ¶ 2. The Liquidation Order appointed M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, and her successors in office, as Liquidator of Reliance ("Liquidator"). 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. 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.

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 statute, 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 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.

The Pennsylvania Insurance Act provides a remedy and procedure for anyone with a claim against Reliance. This includes policyholder claims, as well as general creditor and other claims. The statute requires that all such claims be made through the filing of a “proof of claim.” 40 Pa. Stat. §§ 221.37, 221.38. 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. 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. Synagro's Application for Relief**

On or about November 13, 2001, Synagro filed an application with this Court seeking to intervene in this action for the purpose of seeking approval or compelling the approval of a settlement in a case captioned, Jessica Tristan Lopez, et al. v. Nicky Lee Kramer, et al., No. 00-1-11, 337 pending in the District Court of Jackson County (“Lopez Case”). In its application, Synagro, while admitting that the proposed settlement had not been approved by the Rehabilitator, requests that this Court enter an order compelling the Liquidator to approve the settlement and directing the Liquidator to immediately fund such settlement. Synagro also requests that this Court permit it to fund the settlement by collecting reinsurance proceeds directly from Reliance’s reinsurers.

Synagro’s application is without merit and it should be denied for several important reasons. First, the application 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 required by the Pennsylvania Insurance Act. 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. Synagro should not be permitted to circumvent the statutory claims procedure by filing an application with the Court. Similarly, Synagro may not be permitted to recover the settlement proceeds directly from Reliance’s reinsurers. Proceeds of reinsurance are assets of the estate which is subject to the distribution priority and procedures set forth in the Pennsylvania Insurance Act. Synagro has alleged no relationship with Reliance’s reinsurers that would permit it to recover directly from these reinsurers under any theory. Second, even if the Liquidator were compelled to approve the settlement, an immediate and full payment on the settlement (either from the estate or through direct

recovery by Synagro from Reliance's reinsurers) would constitute an unlawful preference and would violate the Liquidator's statutory duties. Third, the immediate funding of the settlement would accord Synagro's claim super priority and would violate the distribution priorities mandated by the Pennsylvania Insurance Act. Synagro's application should be denied.

### ARGUMENT

**A. Synagro has a Remedy under the Pennsylvania Insurance Act which it must Pursue**

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

Synagro's application is a claim against Reliance which must be made and adjudicated in the proof of claim proceeding. Synagro may not circumvent the statute by filing an application 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). Here, Synagro filed its application 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.

It is significant that in a petition that was recently filed by a Reliance insured, Consolidated Freightways Corporation ("Consolidated Freightways"), to Enforce a Pre-Liquidation Settlement, this Court denied the petition and refused to enforce a settlement that was alleged to have been approved by the Rehabilitator on the ground that Consolidated Freightways has a remedy under the Pennsylvania Insurance Act. A copy of this Court's November 14, 2001 order is attached hereto as Exhibit "A." Here, Synagro does not and cannot even allege that the settlement was approved by the Rehabilitator. Instead, it admits that the Rehabilitator did not approve the settlement. Therefore, the factual bases for Synagro's application are even more attenuated than those set forth in the unsuccessful petition filed by Consolidated Freightways. Synagro's application should be denied.

**B. Reinsurance Proceeds are Assets of the Estate and Synagro may not collect such Proceeds directly from Reliance's Reinsurers**

Synagro's suggestion to fund the settlement by collecting directly through Reliance's reinsurers is improper and must be rejected. Pennsylvania courts have uniformly rejected such attempts and have held that insureds may not recover directly from the insurer's reinsurers. For example, in Vickodil v. Commonwealth of PA Insur. Dep't, 126 Pa. Commw. 390, 559 A.2d 1010 (1989), plaintiffs were judgment creditors who obtained a judgment of \$1.75 million from a tortfeasor insured by Northeastern Fire, who became insolvent after settlement. Northeastern Fire was reinsured by Scor. The court held that the

originally insured plaintiffs could not obtain any proceeds from the reinsurance agreements because reinsurance proceeds are assets of the insolvent insurance company. The court explained that:

Upon being ordered into liquidation, Northeastern Fire's assets, including the \$810,000 reinsurance proceeds owed by Scor to Northeastern Fire, became assets of the Northeastern Fire Estate...40 P.S. §221.3. As such, these proceeds were not directly distributable to the Vickodils... The claimant must file a claim with the liquidator of the estate of the insolvent insurer, who then acts under court direction to distribute the estate's assets in accordance with a statutorily ordered priority of claims.

Vickodil, 126 Pa. Cmmw. at 394, 559 A.2d at 1012, n.4 (Emphasis added). Synagro's suggestion to collect funds directly from reinsurance proceeds ignores and circumvents the strict and explicit statutory scheme for filing proofs of claims. Synagro may not bypass the statutory liquidation scheme and must follow the strict requirement for filing proofs of claim set out in 40 P.S. §221.1 *et seq.*

Similarly, in Mellon v. American Mut. Liab. Ins. Co., No. 3022, 1981 WL 207373, 5 Phila.Co.Rptr. 400 (Pa.Com.Pl. 1981), a lawsuit was brought against plaintiffs and was settled for \$40,000. In the interim period between the date of the accident and the date of settlement, the plaintiff's insurance company became insolvent. Plaintiffs attempted to recover from the reinsurers of their insurance company based on the theory that they were third party beneficiaries. In holding that the original insured could not collect from reinsurance proceeds, the court stated:

Because reinsurance primarily, if not exclusively, is intended to benefit the reinsured, it is apparent that reinsurance does not ordinarily confer any contractual rights upon the

original insured: the contract not being entered into for his benefit, he cannot attain the status of an intended beneficiary.

5 Phila.Co. Rptr. at 405. The court noted that “Pennsylvania decisions on this issue, although few in number, have consistently accorded with the general view precluding a direct action by an insured against the reinsurer.” Id. The court explained that “[t]he reinsurance proceeds are the asset of the reinsured which exist only as a result of the reinsured having entered into the reinsurance agreement,” Mellon, 5 Phila. Co. Rptr. at 419. The Supreme Court of Pennsylvania has adopted similar restrictions on the ability of an original insured to collect reinsurance proceeds. In Appeal of Goodrich, 109 Pa. 523, 2 A. 209 (1885), the Supreme Court of Pennsylvania held that “there is...no privity between the original insured and the reinsurer; the latter is in no respect liable to the former as a surety or otherwise; the contract of insurance and of reinsurance being totally distinct and disconnected.” Further, “the person originally insured has no equitable lien upon the sum of money due on the contract reinsurances, but that fund belongs to all the creditors of the insolvent company ratably.” Id.

The decisions in Vickodil and Mellon are absolutely consistent with well-established Pennsylvania law that recognizes the exclusive contractual relationship between an insurance company and their reinsurers and prevents original insureds from collecting against its insurance company’s reinsurer. See e.g., Reid v. Ruffin, 503 Pa. 458, 469 A.2d 1030 (1983) (“The reinsurer’s only obligations are toward the reinsured/original insurer and arise out of their contract. Because the [insured] is not privy to that contract and has no interest therein, no enforceable rights inure to [its] benefit therefrom.”); Schukyll Prods., Inc.

v. H. Rupert & Sons, Inc., 305 Pa. Super. 36, 40, 451 A.2d 229, 231-232 (1981). (“The law is clear, however, that there is no right of direct action against a reinsurer by any party except the reinsured. “[T]he ordinary contract of reinsurance operates solely between reinsured and reinsurer, and creates no privity whatever between reinsurer and the persons originally insured, the contract of insurance and that of reinsurance remain totally distinct and unconnected, and reinsurer is in no respect liable, surety or otherwise, to reinsured’s policyholders; and accordingly they have no right of action against reinsurer on the contract of reinsurance, nor have they any right of action against reinsurer to reform the policy.”) (citing near unanimous decisions of courts in other jurisdictions.)

The Pennsylvania Legislature, in adopting a statutory scheme relative to insolvent insurance companies, enacted Section 221.34 of the Pennsylvania Insurance Act which clearly encourages the payment of reinsurance proceeds to the insolvent reinsured, not to the original insureds. See Mellon, 5 Phila. Co. Rptr. at 420. Section 221.34 of the Pennsylvania Insurance Act which specifically addresses the liability of reinsurers provides that:

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer’s obligation to the insurer’s estate except when the reinsurance contract provided for direct coverage of an individual name insured and the payment was made in discharge of that obligation.

40 P.S. § 221.34. Therefore, unless the reinsurance contract provides for direct coverage of an insured, the liability of the reinsurer runs solely to the estate of the insolvent insurer.

Eastern Engineering & Elevator Co., Inc. v. American Re-Insurance Co., 309 Pa. Super. 578,

583, 455 A.2d 1235, 1237 (1981). Here, Synagro does not allege that the reinsurance contract provides for such direct coverage, and there is no basis for Synagro to collect reinsurance proceeds from Reliance's reinsurers.

None of Synagro's arguments have any merit. Synagro's spurious claim of "misleading conduct" on the part of Reliance and the Rehabilitator does not alter the fact that Synagro may not collect directly from Reliance's reinsurers. Similar allegations were made in Vickodil. In Vickodil, plaintiffs alleged "that the defendants purposefully and in bad faith delayed and avoided settlement." 126 Pa. Cmmw. at 395, 559 A.2d at 1012. However, in making their bad faith allegation, the Vickodils admitted that the reinsurance proceeds belonged to their insolvent insurance company, claiming that the acts of bad faith were perpetrated in order that the "Scor reinsurance proceeds would revert to the Northeastern Fire estate rather than flow directly to the Vickodils." Id. Synagro here makes the same allegations and admissions that were rejected in Vickodil.

Similarly without merit is Synagro's argument that the Liquidator is barred by the doctrine of equitable estoppel from refusing to conclude the settlement. The doctrine of equitable estoppel requires that "the party with the burden... establish two essential elements: inducement and reliance." Tryson v. Pennsylvania Ins. Dep't, No. 2574 C.D.2000, 2001 WL 1221681 \*2 (Pa. Cmmw. Oct. 16, 2001)(citation omitted). Further, the acts of the party that estoppel is being asserted against must, in some way, be misleading. See Storms ex rel Storms v. O'Malley, 779 A.2d 548 (Pa. Super. 2001) (elements of estoppel are (1) misleading words or conduct; (2) unambiguous proof of reasonable reliance upon the

misrepresentations; and (3) the lack of a duty to inquire on the party asserting the estoppel). The doctrine prevents a party from asserting that prior misleading words or conduct are currently not in existence.

As Synagro admits in its application, the proposed settlement was never approved. Synagro Technologies, Inc.'s Memorandum of Law in Support of its Petition for Limited Intervention and Application for Relief, p. 2 – 3. Synagro cannot satisfy the element of inducement based on “settlement” of a case that, by its own admission, was never finally settled. There is no enforceable settlement upon which Synagro may base its claim of inducement. It is also impossible for Synagro to satisfy the requisite element of reliance. There was no final settlement, and it is unreasonable for Synagro to have “relied” upon a settlement that was never approved and concluded. Synagro cannot satisfy the requisite elements for application of equitable estoppel.

**C. The Relief Sought by Synagro Would Constitute an Unlawful Preference**

Even if the Liquidator were compelled to approve the settlement in the Lopez Case, the Liquidator would be prohibited from paying the settlement as such payment would constitute a preference. The Liquidation Order, at paragraph 21, expressly prohibits any person from “obtaining of preferences, judgments, attachments . . . against Reliance assets, property . . . .” 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.

Any payment on the settlement in the Lopez Case would be a distribution of assets to pay immediately the claim of one policyholder in full and would constitute an unlawful preference. Synagro would receive a full recovery on its claim while other policyholders would receive a pro rata share of the distribution of Reliance's assets. 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.

None of Synagro's arguments support the enforcement of the settlement in the Lopez Case. Synagro apparently confuses the roles and functions of the statutory Rehabilitator and the Liquidator under 40 P.S. §221.1 *et seq.* While the Rehabilitator may be permitted to operate the insurer's business as a going concern and pay claims, the Liquidator is charged with a decidedly different duty. In 40 P.S. §221.23, entitled "Powers of

Liquidator,” the liquidator is given broad authority to “collect all debts and money due and claims belonging to the insurer which it is economical to collect... [and] to do such other acts as are necessary or expedient to collect, conserve or protect its assets or property...” 40 P.S. §221.23(6). See Pennsylvania Ass’n of Life Underwriters v. Foster, 147 Pa.Cmmw. 591, 600, 608 A.2d 1099, 1103 (1992) (“powers of a liquidator are very broadly delineated in section 523 [40 P.S. 221.23] and include authority to do such acts as may be necessary or expedient for the accomplishment of, or in aid of the purpose of, liquidation”); Foster v. Colonial Assurance Co., 668 A.2d 174, 184 (Cmmw. 1995), aff’d, Kaiser v. Colonial Assurance Co., 543 Pa. 626, 673 A.2d 922 (1996) (liquidator is granted broad powers to fix rights and liabilities of claims as of a date certain, and to do such acts as may be necessary or expedient to accomplish liquidation).

The role of the statutory Liquidator is to expediently effectuate liquidation. Synagro ignores the undisputed fact that this is a *liquidation* proceeding governed by specific statutory requirements. For example, the Pennsylvania Insurance Act requires that all claims against an insolvent insurance company be submitted through a “proof of claim.” 40 Pa. Stat. §§221.37, 221.38. The role and powers of the statutory Rehabilitator are irrelevant to any argument Synagro makes in this liquidation proceeding and any authority cited by Synagro dealing with rehabilitation is misguided.

**D. The Relief Sought by Synagro Would Violate the Distribution Priority Mandated by the Pennsylvania Insurance Act**

The relief Synagro seeks would also violate the distribution priority mandated by the Pennsylvania Insurance Act in that it would accord special priority to Synagro’s 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 any settlement in the Lopez Case would improperly elevate Synagro's claim to a priority equal to or higher than administrative expenses. In a case almost 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).

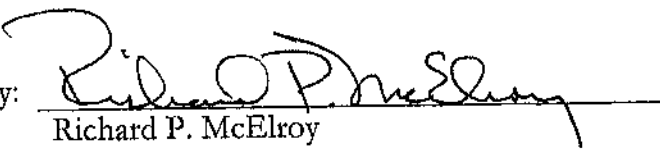
Here, Synagro's argument is even more tenuous as, unlike the plaintiff in Oxedine, Synagro cannot even allege that there is an approved settlement in the Lopez Case.

Moreover, even if the Liquidator were compelled to approve the settlement, the settlement would not provide Synagro's claim with special priority. The relief Synagro is seeking is clearly prohibited by statute.

WHEREFORE, the Liquidator respectfully requests that this Court deny Synagro's Application for Relief.

Respectfully submitted,

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November 26, 2001

## Exhibit A



**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the preceding Response in Opposition to Synagro Technologies, Inc.'s Application for Relief and accompany Memorandum of Law in Opposition to Synagro Technologies, Inc.'s Application for Relief was served this 26th day of November 2001, by first class mail, postage prepaid, upon the individuals listed in the attached Master Service List.



ANN E. KIM

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v.

Reliance Insurance Company

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

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