

Overview

This Court entered an order and guidelines for the enforcement of Article 5, Section 534 of the Insurance Department Act, 40 P.S. §221.34, establishing the process by which a reinsurer and/or an insured could apply for the approval of a direct payment of insurance. The Order sets forth the three criteria under which a request by reinsurers to pay claims directly to affected assureds would be granted. A direct access request will be allowed where the reinsurance contract creates a direct coverage obligation, the reinsurer has obtained the named insured's informed consent to the reinsurer's substitution of Reliance in the direct coverage relationship, and the reinsurer has submitted documentary proof of its unequivocal assumption of Reliance's coverage obligations to the insured. Herein, the Liquidator denied the BAIG Companies' request to pay claims directly based on the conclusion that BAIG failed to meet the guidelines set forth by the Court's Order as well as Act. BAIG disagreed, contending it was entitled to direct access to certain amounts payable under a series of agreements between BAIG and Reliance. Both parties argue that consistent with *Koken v. Legion Insurance Company*, 878 A.2d 51 (Pa. 2005), the relief they seek is available. The Liquidator argues that BAIG is not entitled to direct access and BAIG argues the contrary position. For purposes of the motions, all parties had to assert that material issues were not in dispute. The matter was assigned¹ to Referee LaVan. Referee LaVan granted BAIG direct access to reinsurance proceeds. The Liquidator has filed Objections to the decision of the Referee, asserting that the Referee erred as a

¹ 40 P.S. §221.41(b), directs that disputed claims shall be heard by Commonwealth Court or by a court-appointed referee who shall submit to Commonwealth Court findings of fact along with a recommendation); it is also used to assist in the resolution of certain discreet litigation which is in the form of actions initiated by the Liquidator.

matter of law in concluding that the reinsurance agreement herein allows BAIG direct access to reinsurance proceeds.

After review of the documents filed with this Court, and the decision issued by Referee LaVan, I accept Referee LaVan's findings but enter my own findings based on the record before the Referee.

This court finds that BAIG² Companies (BAIG) was³ Europe's largest specialist aviation insurer, and it was one of two leading underwriters for the Aircraft Builders Council (ABC). ABC has secured aviation liability insurance coverage from a pool of insurers subscribing through BAIG. ABC is represented by a Board of Trustees that promotes ABC's products liability insurance program (ABC Insurance Program). The ABC Board of Trustees is comprised of U.S. aviation and aerospace manufacturers, and it is supported by the Leading Underwriters, an American Brokers Committee, and a London Brokers Committee. ABC members negotiate individual policies, but the policies contain base or master wording (hereafter master wording) that is written by the ABC Board of Trustees, Brokers Committee, and Leading Underwriters. After agreeing to the master ABC wording, the Leading Underwriters accept a proportion of the risk that may be placed under the agreement. That is, each agrees to assume a portion of the overall limits for each insured. For the program periods 1995, 1996, 1997, and 1998, BAIG and ARIEL, Lloyd's Syndicate 48,⁴ were designated on the Master Slip⁵ as

² In 1990, BAIC, Aviation and General, the London Aviation Insurance Group, and the aviation offices of General Accident, the Commercial Union, and the Eagle Star combined to form BAIG, the British Aviation Group. That company became Europe's largest specialist aviation insurer.

³ In order to participate in a global market, in 2000 BAIG purchased AAU and now operates as the Global Aerospace Underwriting Managers, Inc.

⁴ ARIEL, Lloyd's Syndicate 48 is now ACE Global Markets.

⁵ "Master Line Slip" generally evidences the ABC master wording.

the Leading Underwriters on the ABC Insurance Program. The Leading Underwriters negotiate policies and resolve claims on behalf of the following insurers. The coordinating insurance broker that administered the ABC Program was David Hardy of Crawley Warren Co., Ltd.

Reliance first participated in the ABC Program as a following insurer in 1995. I further find that

1. Reliance was a direct subscriber, that is, insurer, for 3% of 100% of each risk placed in 1995, 1996 and 1997, and 2% of 100% of each risk placed in 1998; I reject the Referee's findings that Reliance was a direct subscriber for 1999;

2. BAIG participated as direct subscribers and subscribed to 17.5% of 100% of each risk placed under the ABC Program for the periods⁶ 1995, 1996, 1997, 1998. However, because BAIG was not licensed in 4 states, Connecticut, New Jersey, Massachusetts, and Michigan, BAIG could not directly insure the affected assureds in those states. Consequently, the affected assureds in those states became the subject of the reinsurance arrangement between BAIG and Reliance;

3. I find that Reliance acted as the fronting carrier for BAIG in respect to the policies issued in favor of the assureds in Connecticut, New Jersey, Massachusetts, and Michigan;

4. I find that David Hardy of Crawley Warren brokered a reinsurance arrangement between BAIG and Reliance;

5. I find that the reinsurance arrangement was memorialized in the following series of documents: Master ABC Wording, the declarations under each of the ABC assureds domiciled in Connecticut, Massachusetts, Michigan, and New Jersey, and the Cover Notes and that the documents all relate to the same subject matter, all relate to the same parties, all reference in each respective document that the document will be bound to the wording, language, terms and conditions of the Master Policy;

6. I find that the Master ABC Wording, the declarations under each of the ABC assureds domiciled in Connecticut, Massachusetts, Michigan, and

⁶ The policies issue for the 12 month period beginning December 1 of each year.

New Jersey, and the Cover Notes in their totality evidence the intent of the parties and as such the documents should be read together as a single contract;

7. I find that the reinsurance arrangement specifically the Cover Notes provided to Reliance detail that Reliance agreed to increase its subscription for policies issued in favor of ABC assureds domiciled in Connecticut, Massachusetts, Michigan, and New Jersey, to 17.5% which represents the commitment made by the BAIG Companies;

8. I find that BAIG brought Reliance into this contractual relationship;

9. Based on the Reinsurance Cover Notes⁷ provided to Reliance, I find that for the 12 months from December 1, 1995, 100% of the 17.5% part of Reliance's 20.5% participation was reinsured;

10. Based on the Reinsurance Cover Notes provided to Reliance, I find that for the 12 months from December 1, 1996, 100% of the 17.5% part of Reliance's 20.5% participation was reinsured;

11. Based on the Reinsurance Cover Notes provided to Reliance, I find that for the 12 months from December 1, 1997, 100% of the 17.5% part of Reliance's 20.5% participation was reinsured;

12. Based on the Reinsurance Cover Notes provided to Reliance, I find that for the 12 months from December 1, 1998, 100% of the 17.5% part of Reliance's 19.5% participation was reinsured;

13. I find that based on the reinsurance cover notes provided to Reliance, the BAIG Companies fully reinsured Reliance for the 17.5% of each risk placed under the ABC Program for the periods 1995, 1996, 1997, and 1998;

14. I find that it is uncontested that the Reinsurance Cover Notes contain no insolvency clause;

15. I find that that the Reinsurance Cover Notes contain no cut-through clause or direct payment clause;

16. I find that the Reinsurance Cover Notes establish that Reliance's obligation as a fronting carrier is completely covered under the

⁷ Cover notes reflect that insurance coverage has been affected.

reinsurance arrangement and that Reliance has no exposure with respect to the reinsurance arrangement;

17. I find that the Master ABC Wording contains a provision detailing which entity is to handle claims;

18. I find that the Master ABC Wording does not identify Reliance as the entity responsible to handle claims;

19. I find that there is no evidence establishing that Reliance had any duties or responsibilities under the reinsurance arrangement;

20. I find that Reliance did not have a relationship with the original assureds, Reliance did not settle claims directly, Reliance did not separately account with its reinsurer for any claims paid, and I infer from that lack of direct evidence that Reliance's participation in the reinsurance arrangement was limited to that of a mere fronting carrier;

21. I find that the Master ABC Wording, the declarations under each of the ABC assureds domiciled in Connecticut, Massachusetts, Michigan, and New Jersey, and the Cover Notes contain no direct language that evidences the intent of the parties relating to the reinsurers' obligations or policyholder's rights in the event of a direct insurers insolvency; however, I find that the conduct of the parties herein, that is, BAIG and Reliance, evidences the parties intent to by-pass Reliance in the resolution of claims related to the reinsurance arrangement;

22. I find that Reliance was also a following insurer in the ABC Program for a 3% participation for policies incepting in 1995, 1996, and 1997 and as such, that Reliance's liability exposure was limited by its 3% participation;

23. I find that Reliance was also a following insurer in the ABC Program for a 2% participation for the policy incepting in 1998 and as such, that Reliance's liability exposure was limited by its 2% participation;

24. I find that this matter is limited to the reinsurance arrangement and does not include the instances where Reliance was acting as a following insurer;

Conclusions of Law

In consideration of the above, I enter the following conclusions of law:

1. Reliance acted as the fronting carrier for BAIG in respect to the policies issued in favor of the assureds in Connecticut, Massachusetts, Michigan, and New Jersey;

2. I conclude that the Master ABC Wording, the declarations under each of the ABC assureds domiciled in Connecticut, Massachusetts, Michigan, and New Jersey, and the Cover Notes are a single contract hereinafter the reinsurance contract;

3. I conclude that based on the reinsurance contract and the conduct of the parties with respect to Reliance's participation as a fronting carrier, I conclude that BAIG paid and administered claims directly with insureds;

4. I conclude that Reliance did not act as a true reinsurer herein;

5. I conclude that Reliance's participation was limited to that of a fronting carrier and as such, that BAIG should be permitted direct access to reinsurance proceeds.

"The liability of the reinsurer is intended to run to the estate of the insolvent insurer for the eventual benefit of the insureds, and not directly to the policyholders of the insurer." *Eastern Engineering v. American Reinsurance Co.*, 455 A.2d 1235, 1237 (Pa. Super. 1983). Where, however, an insolvent insurance company acts as a mere pass-through and does not act as a true insurer, direct access to reinsurance may be allowed. Section 534 of the Act relating to reinsurer liability, directs 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 named insured and the payment was made in discharge of that obligation.

40 P.S. §221.34. Thus, direct payment is permitted where the reinsurance contract contains direct payment or “cut-through” language, or, whether the reinsurance was placed by the policyholder for the policyholder’s benefit. *Koken v. Legion Insurance Company*, 878 A.2d 51 (Pa. 2005). Additionally, recognizing that the relationship between the contractual parties extends beyond the written contract, the court in *Legion*, concluded that it was necessary to analyze the specific facts of each case to determine whether direct access to reinsurance proceeds should be permitted. Where there is a fronting reinsurance arrangement equity suggests that direct access be permitted. A front arrangement is not traditional insurance, as it places the front insurer in the position that it may collect a fee or premium without exposing itself to liability.

As was explained in *Ario v. Swiss Reinsurance and Tribune Review*, ___ A.2d ___ (Pa. Cmwlth. No. 269 M.D. 2001) (Slip Opinion December 31, 2007), “exposure” is an essential feature that distinguishes insurance and reinsurance. *Id.* Where there is reinsurance, the insured’s “exposure,” in full or in part, is insured by the reinsurer. *Id.*

To determine whether to allow direct access to reinsurance the factors considered are:

- 1) did the insurer take on any underwriting risk or act as a front;
- 2) did the insurer enter into the transaction in order to generate fees, and not premium;
- 3) did the ‘reinsurer’ function as a ‘direct insurer’ for the policyholder and was the claims handling process and the funding of claims the responsibility of the reinsurer;

4) did the policyholder facilitate the reinsurer's involvement;

5) did the equities favor the policyholder's claim to direct access.

Legion, 831 A.2d at 1234-1238.

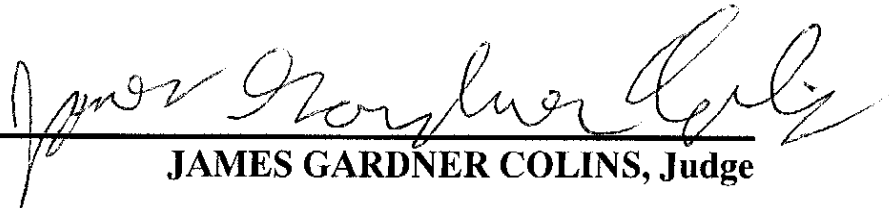
Sub judice, the undisputed evidence is that BAIG was directly responsible for the payment of the reinsurance claims. Under the reinsurance arrangement Reliance was to receive a certain sum of money for fronting business for BAIG. The evidence is that all claims were handled by BAIG. There is no evidence that Reliance processed claims or in any way was responsible for paying claims that arose under the reinsurance arrangement. While the contractual language does not contain a specific cut-through clause, the conduct of parties herein in the business dealings related this action, was such that equity demands granting BAIG direct access to the reinsurance proceeds.

Accordingly, the Court enters the following

ORDER

AND NOW this 4th day of January, 2008, the Liquidator's Objections to the decision of Referee LaVan are **OVERRULED**; the decision of Referee LaVan is **SUSTAINED**.

Further, the Liquidator is directed to forthwith serve a copy of this Memorandum Opinion and Order on all parties of record, and also, to serve all on the Master Service List. An affidavit that service has been effectuated shall be filed with this Court.


JAMES GARDNER COLINS, Judge