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Commissioner of the Commonwealth
of Pennsylvania, acting in his Official
Capacity as Statutory Liquidator of Reliance
Insurance Company (In Liquidation).

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO,
Insurance Commissioner of the Commonwealth
of Pennsylvania,

Plaintiff,

v.

RELiance INSURANCE COMPANY,

Defendant.

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RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHILA)

*In re: Underwriting Members of Syndicates 79, 456, 1215, 2999, 47, 204, 219, 484, 858, 2488,
435, 623, 2623, 839, 1007, 1212, 376, 1096, 205, 250, 1173, 1038, 1207, Zurich Re
(UK) Ltd., and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance
Company Limited)*

RESPONSE OF JOEL S. ARIO,
INSURANCE COMMISSIONER OF THE COMMONWEALTH
OF PENNSYLVANIA, ACTING IN HIS OFFICIAL CAPACITY AS STATUTORY
LIQUIDATOR OF RELiance INSURANCE COMPANY (IN LIQUIDATION),
IN OPPOSITION TO COUNTERCLAIM DEFENDANTS' PRELIMINARY OBJECTIONS

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania,
acting in his Official Capacity as Statutory Liquidator of Reliance Insurance Company (In
Liquidation) (the "Liquidator" or "Reliance"), by and through his undersigned counsel, hereby
submits his Response in Opposition to the Preliminary Objections of Underwriting Members of
Syndicates 79, 456, 47, 204, 219, 484, 435, 623, 839, 1007, 1212, 1096, 205, 250, Zurich Re

(UK) Ltd. and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited) (collectively, "Counterclaim Defendants") and states as follows:

1. Admitted.

2. Admitted.

3. Admitted. By way of further answer, Reliance asserted Counterclaims only against the Plaintiffs/Counterclaim Defendants that have failed to pay amounts due and owing to Reliance under these Reinsurance Agreements. The remaining Plaintiffs do not presently owe any money to Reliance under these Reinsurance Agreements and, therefore, Reliance did not assert Counterclaims against them.

4. Admitted.

5. Paragraph 5 states conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

6. Paragraph 6 states conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

7. Paragraph 7 states conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

8. Paragraph 8 states conclusions of law to which, no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

9. Paragraph 9 states conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

10. Paragraph 10 states conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this paragraph are not deemed conclusions of law, the allegations are denied.

11. Reliance incorporates by reference its responses to Paragraphs 1 through 10.

12. Admitted. By way of further answer, Count II is Reliance's breach of contract claim against Underwriters of Syndicates 79, 456, 435, 623, 839, 1007, 1212, 1096, 205, 250 and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited). In addition to the averments in support of its breach of contract claim, in Count II, Reliance also asserted additional averments with respect to the implied covenant of good faith and fair dealing which is part of Reliance's breach of contract claim. These averments are set out in Paragraphs 82, 87, 88 and 90.

13. Admitted.

14. Deny only the averments set out in the last sentence of Paragraph 14. By way of further answer, Count II is Reliance's breach of breach of contract against Underwriters of Syndicates 79, 456, 435, 623, 839, 1007, 1212, 1096, 205, 250 and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited). It includes additional averments with respect to the implied covenant of good faith and fair dealing that are set out in Paragraphs 82, 87, 88 and 90 for which Reliance seeks the recovery of both compensatory and consequential damages. New York law, not Pennsylvania law, applies to this claim and New

York law permits the recovery of compensatory, as well as consequential, damages for breach of contract, including the breach of the duty of good faith and fair dealing. *See Bi-Economy Market, Inc. v. Harleystown Insurance Company of New York*, 886 N.E.2d 127, 132 (N.Y. 2008); *see also Pansia Estates, Inc. v. Hudson Insurance Company*, 886 N.E.2d 135 (N.Y. 2008).

Therefore, Count II should not be dismissed. In its Preliminary Objection to Count II, Counterclaim Defendants only challenge Reliance's averments for breach of the implied duty of good faith and fair dealing and its request for an award of consequential damages, not the breach of contract claim itself. However, Counterclaim Defendants request that, if the Court grants its Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

15. Denied. The Pennsylvania Supreme Court has never ruled on whether there is an independent cause of action for breach of the implied duty of good faith and fair dealing, *see Ash v. Continental Insurance Company*, 593 Pa. 523, 533 (Pa. 2007), and Reliance has not pleaded this cause of action. By way of further answer, New York law, not Pennsylvania law, applies to this claim and New York law permits the recovery of compensatory, as well as consequential, damages for breach of contract, including the breach of the duty of good faith and fair dealing. *See Bi-Economy Market, Inc. v. Harleystown Insurance Company of New York*, 886 N.E.2d 127, 132 (N.Y. 2008); *see also Pansia Estates, Inc. v. Hudson Insurance Company*, 886 N.E.2d 135 (N.Y. 2008). Therefore, Count II should not be dismissed. In its Preliminary Objection to Count II, Counterclaim Defendants only challenge Reliance's averments for breach of the implied duty of good faith and fair dealing and its request for an award of consequential

damages, not the breach of contract claim itself. However, Counterclaim Defendants request that, if the Court grants its Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

16. Denied. The averments in the first sentence of Paragraph 16 state conclusions of law to which no responsive pleading is required. To the extent that any allegations contained in this sentence are not deemed conclusions of law, the allegations are denied. By way of further answer, Reliance incorporates by reference its responses to Paragraphs 14 and 15. In its Preliminary Objection to Count II, Counterclaim Defendants only challenge Reliance's averments for breach of the implied duty of good faith and fair dealing and its request for an award of consequential damages, not the breach of contract claim itself. However, Counterclaim Defendants request that, if the Court grants its Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

17. Denied. By way of further answer, the factual averments that are incorporated by reference into Count II set out with great specificity the factual basis for Reliance's breach of contract claim and are more than sufficient to put Counterclaim Defendants on notice of the basis for Reliance's breach of contract claim so that they can prepare their defense.

18. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraph 17.

19. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraph 17.

20. Denied. By way of further answer, Reliance has not and does not intend to assert a separate claim for breach of contract, including breach of the implied covenant of good faith and fair dealing against the Plaintiffs and Counterclaim Defendants that are not named as Counterclaim Defendants in Count II. Therefore, they cannot be prejudiced if Reliance's breach of contract claim set out in Count II against the other Counterclaim Defendants is permitted to go forward.

21. Denied. By way of further answer, In its Preliminary Objection to Count II, Counterclaim Defendants only challenge Reliance's averments for breach of the implied duty of good faith and fair dealing and its request for an award of consequential damages, not the breach of contract claim itself. However, Counterclaim Defendants request that, if the Court grants its Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

22. Reliance incorporates by reference its responses to Paragraphs 1 through 21.

23. Admitted.

24. Admitted.

25. Denied. By way of further answer, Reliance set out with great specificity the losses that are due and owing which are assets to the Reliance Estate that Counterclaim Defendants have failed to turn over. Specifically, in Paragraph 57, Reliance alleged that: “Counterclaim Defendants have refused to reimburse Reliance for over \$7 million in claims that Reliance paid on Counterclaim Defendants’ behalf before Reliance was placed in liquidation, and for almost \$7 million in claims paid since Reliance was placed in liquidation.” *See also* Paragraphs 94 and 95. Moreover, the specific amounts owed by each of the Counterclaim Defendants are set out in charts contained in Paragraphs 63-68. Therefore, Count III should not be stricken for lack of specificity.

26. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraph 25.

27. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraph 25.

28. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraph 25.

29. Denied.

30. Denied. By way of further answer, parties are permitted to assert alternative legal theories. *See DTK Ventures, L.P., v. Russo*, 2006 WL 2988463 at *5 (Pa. Com. Pl. Aug. 21, 2006). Count III is an alternative legal theory which, if successful, affords Reliance the right to recover not only its unpaid balances, but also its attorneys’ fees, costs and other damages over and above those sought in Counts I and II. Because, Count III is an alternative legal theory that does not duplicate Counts I and II, it should not be dismissed.

31. Denied. By way of further answer, this Court has the inherent power to enforce its own Order. *See Lindsey v. Lindsey*, 492 A.2d 396, 398 (Pa. Super. 1985). There is no requirement that the Liquidation Order provide for an award of damages if the Order is violated. To the contrary, the Court has the power to fashion an appropriate remedy. *See, e.g., Goodman v. Goodman*, 556 A.2d 1379, 1392 n.8 (Pa. Super. 1989); *Rhoades v. Pryce*, 874 A.2d 148, 152 (Pa. Super. 2005). Therefore, Count III states a cause upon which relief can be granted and should not be dismissed.

32. Reliance incorporates by reference its responses to Paragraphs 1 through 31.

33. Denied as stated. By way of further answer, Reliance seeks attorneys' fees, costs, and such other and further relief as the Court may deem just, equitable and proper.

34. Admitted.

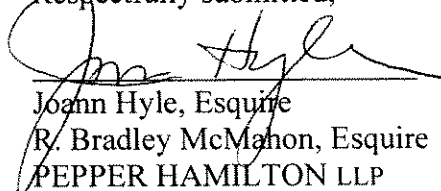
35. Denied. By way of further answer, attorneys' fees may be awarded for breach of the Liquidation Order. *See Goodman*, 556 A.2d at 1392 n. 8; *Rhoades*, 874 A.2d at 152.

36. Denied. By way of further answer, Reliance incorporates by reference its response to Paragraphs 35.

37. Denied.

WHEREFORE, for the foregoing reasons, Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, acting in his Official Capacity as Statutory Liquidator of Reliance Insurance Company (In Liquidation), respectfully requests that this Court overrule Counterclaim Defendants' preliminary objections to Count II, Count III of the Counterclaim and Reliance's request for an award of attorneys' fees. Counterclaim Defendants request that, if the Court grants its Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

Respectfully submitted,



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In his official capacity as
Statutory Liquidator of Reliance
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Dated: December 15, 2008

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JOEL S. ARIO, Insurance
Commissioner of the Commonwealth
of Pennsylvania, acting in his official
capacity as Statutory Liquidator of Reliance
Insurance Company (In Liquidation).

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO,	:
Insurance Commissioner of the Commonwealth	:
of Pennsylvania,	:
	: NO. 269 M.D. 2001
Plaintiff,	:
	:
v.	:
	:
RELIANCE INSURANCE COMPANY,	:
	:
Defendant.	:
	:

In re: Underwriting Members of Syndicates 79, 456, 1215, 2999, 47, 204, 219, 484, 858, 2488, 435, 623, 2623, 839, 1007, 1212, 376, 1096, 205, 250, 1173, 1038, 1207, Zurich Re (UK) Ltd., and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited)

MEMORANDUM OF LAW IN SUPPORT OF RESPONSE OF JOEL S. ARIO,
INSURANCE COMMISSIONER OF THE COMMONWEALTH OF
PENNSYLVANIA, ACTING IN HIS OFFICIAL CAPACITY AS STATUTORY
LIQUIDATOR OF RELIANCE INSURANCE COMPANY (IN LIQUIDATION), IN
OPPOSITION TO COUNTERCLAIM DEFENDANTS' PRELIMINARY OBJECTIONS

Joel S. Ario, Insurance Commissioner of Commonwealth of Pennsylvania, acting
in his Official Capacity of Statutory Liquidator of Reliance Insurance Company (In Liquidation)

(the “Liquidator” or “Reliance”) asserted five Counterclaims against some¹, but not all, of the plaintiffs,² for breach of contract (Count I), breach of contract, including breach of the implied covenant of good faith and fair dealing (Count II), breach of the Order of Liquidation (Count III), Unjust Enrichment (Count IV) and Declaratory Judgment (Count V).³ In response, Counterclaim Defendants have preliminarily objected to Counts II and III of Reliance’s Counterclaim for failure to state a claim or, in the alternative, as not pleaded with sufficient factual specificity. They also request that Reliance’s request for an award of consequential damages, attorneys’ fees and costs be stricken.

In Counts II and III Reliance properly pleaded viable claims for breach of contract, including breach of the implied covenant of good faith and fair dealing, and for breach of this Court’s Liquidation Order. As for the sufficiency of its factual averments, even a cursory review of the Counterclaims confirm that they are supported by detailed and very specific factual averments that are more than sufficient to put Counterclaims Defendants on notice of the claim such that they can prepare their defense. Therefore, Counterclaim Defendants’ Preliminary Objections to Counts II and III should be denied. Even if the Court were to grant Counterclaim Defendants’ Preliminary Objection to Count II for breach of contract, including breach of the implied covenant of good faith and fair dealing, it should not strike Count II (as Counterclaim

¹ Reliance asserted Counterclaims against Underwriting Members of Syndicates 79, 456, 47, 204, 219, 484, 435, 623, 839, 1007, 1212, 1096, 205, 250, Zurich Re (UK) Ltd. and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited) (collectively, “Counterclaim Defendants”).

² Some of the plaintiffs, specifically Underwriting Members of Syndicates 1215, 2999, 858, 2488, 2623, 376, 1173, 1038 and 1207, do not presently owe Reliance money on the Reinsurance Agreements at issue in this case and, therefore, Reliance has not asserted any claims against them. They also have not joined in the Preliminary Objections and instead filed their Answer to New Matter on November 24, 2008.

³ Counterclaims Defendants have not challenged Counts I, IV or V of Reliance’s Counterclaims.

Defendants request), but rather the Court should permit Reliance to replead Count II as a simple breach of contract claim.

As for Reliance's claims for consequential damages, attorneys' fees and costs, these are damages that properly can be awarded to Reliance if it prevails on Counts II and/or III. Therefore, Counterclaim Defendants' preliminary objection seeking to strike those damages also should be denied.

I. Matter Before The Court

On November 24, 2008 Counterclaim Defendants filed three preliminary objections to the Counterclaim filed by Reliance.

II. Statement Of Issues Involved

A. DOES COUNT II OF RELIANCE'S COUNTERCLAIM, ALLEGING THAT CERTAIN COUNTERCLAIM DEFENDANTS BREACHED THE CONTRACT, INCLUDING BREACH OF THE IMPLIED DUTY OF GOOD FAITH AND FAIR DEALING, STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED AND HAS IT BEEN PLEADED WITH SUFFICIENT FACTUAL SPECIFICITY?

SUGGESTED ANSWER: YES

B. DOES COUNT III OF RELIANCE'S COUNTERCLAIM, ALLEGING THAT COUNTERCLAIM DEFENDANTS HAVE BEACHED THIS COURT'S ORDER OF LIQUIDATION, STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED AND HAS IT BEEN PLEADED WITH SUFFICIENT FACTUAL SPECIFICITY?

SUGGESTED ANSWER: YES

C. HAS RELIANCE PROPERLY STATED A CLAIM THAT SUPPORTS ITS RIGHT TO RECOVER ATTORNEYS' FEES, COSTS, AND CONSEQUENTIAL DAMAGES?

SUGGESTED ANSWER: YES

III. Statement Of Facts

Reliance has described fully and with great specificity the factual basis for its Counterclaim. Therefore, it will only briefly summarize the key facts here.

In the early 1990's, Reliance and AUSCO, an insurance program manager, agreed to implement a program in which AUSCO would identify non-profit corporations with which it had contacts that were interested in purchasing insurance (the "Program"). The Program included a reinsurance component under which Counterclaim Defendants agreed to accept a portion of the premium for the Reliance policies that AUSCO underwrote, bound and issued. Correspondingly, Counterclaim Defendants agreed to pay their share of the losses that Reliance paid with Counterclaim Defendants' approval or that of their agent AUSCO. *See* Counterclaim, ¶ 49 at 12. The Program incepted on December 31, 1992, ran for twelve months and was renewed annually each year until December 31, 1998. The Program ran for a 24 month period from December 31, 1998 to December 31, 2000. *See* Counterclaim, ¶ 50 at 12. The agreement was memorialized through documents that are referred to in the reinsurance industry as "cover notes" ("Reinsurance Agreements"). The Reinsurance Agreements provide that, subject to certain conditions, AUSCO was "authorized to bind insurance and reinsurance on behalf of Underwriters." Reliance ceded the risks to Counterclaim Defendants through AUSCO who was authorized to bind risks on behalf of Counterclaim Defendants. *See* Counterclaim, ¶ 51 at 12-13.

Pursuant to the Reinsurance Agreements, AUSCO bound risks and issued Reliance policies. Reliance has paid or credited Counterclaim Defendants for all premiums due and owing to them on the policies written under the Program. Reliance has requested, but Counterclaim Defendants have failed to provide, documentation to support their allegation that they have not received premium that is due and owing to them. *See* Counterclaim, ¶ 56 at 14.

Before Reliance was placed in liquidation, Counterclaim Defendants, through their designated representative listed in the Reinsurance Agreements, or their agent AUSCO,

controlled how claims were handled, including making coverage determinations, setting reserves and approving payments in all cases before Reliance had paid the claim. As for claims that were pending when Reliance was placed in liquidation, Counterclaim Defendants and/or AUSCO had already made coverage determinations and set reserves for them. *See* Counterclaim, ¶ 57 at 14. After Reliance was placed in liquidation by this Court's October 3, 2001 Liquidation Order, AUSCO transferred the claim files to state guaranty associations which, by operation of law, are now responsible for handling and settling claims. *Id.* Paragraph 7 of this Court's Order of Liquidation required all entities possessing property of Reliance to return such property to the Liquidator. *See* Counterclaim, ¶ 93 at 23.

Beginning in November 2002, Reliance repeatedly demanded payment from Counterclaim Defendants for the losses that Reliance paid with Counterclaim Defendants' approval or that of their agent AUSCO. Reliance also provided updated bills and followed up by repeatedly requesting payment from Counterclaim Defendants but Counterclaim Defendants have refused to pay. *See* Counterclaim, ¶ 62 at 15. Specifically, Counterclaim Defendants have refused to reimburse Reliance for over \$7 million in claims that Reliance paid on Counterclaim Defendants' behalf before Reliance was placed in liquidation, and for almost \$7 million in claims paid since Reliance was placed in liquidation. *See* Counterclaim, ¶ 57 at 14. This action followed.

IV. Argument

A. Standard Of Review

The parties agree that Counterclaim Defendants face a heavy burden with regard to their argument that Counts II and III of the Counterclaims should be dismissed, i.e., they must show that, as a matter of law, Reliance has no right to recover. This argument, "in the nature of a demurrer test[s] the legal sufficiency of the complaint." *Sexton v. PNC Bank*, 792 A.2d 602, 604

(Pa. Super. Ct. 2002). “The question ... is whether, on the facts averred, the law says with certainty that no recovery is possible.” *Mistick Inc. v. Northwestern Nat'l Cas. Co.*, 806 A.2d 39, 42 (Pa. Super. Ct. 2002) (citation omitted). In ruling on preliminary objections, all well-pleaded allegations must be accepted as true and any doubt must be resolved in favor of the non-moving party. *See Howard v. Commonwealth*, 957 A.2d 332, 334 n.2 (Pa. Commw. Ct. 2008) (citation omitted). Because Reliance has pleaded all of the essential elements of its claims, including its right to recover consequential damages, attorneys’ fees and costs, the Court should overrule all of Counterclaim Defendants’ Preliminary Objections. With regard to factual averments, they only need to be sufficiently specific to put the defendant on notice of the claim so that the defendant is able to prepare its defense. *Feigley v. Dept. of Corrections*, 872 A.2d 189, 196 (Pa. Commw. Ct. 2005). Here, the factual averments far exceed this minimum requirement so these Preliminary Objections also should be overruled.

B. Counts II and III of Reliance’s Counterclaim State Claims For Which Relief May Be Granted.

1. Count II

Counterclaim Defendants challenge Count II because they contend that Reliance is treating its claim for breach of contract, including breach of the implied covenant of good faith and fair dealing, “as an independent ground for liability against the Counterclaim Defendants.” *See* Counterclaim Defendants’ Br. at 6-7. As support, they cite two unreported opinions applying Pennsylvania law that are neither on point nor controlling. *Id.*, citing *Gaffer Ins. Co. Ltd. v. Discover Reinsurance Co.*, No. 3:07-CV-00580, 2007 WL 2972580 (M.D. Pa. 2007) and *Mercy Health System of Southeastern Pennsylvania v. Metropolitan Partners Realty LLC*, No. 03046 Nov. Term 2001, Control 111961, 2003 WL 21904583, *2 (Pa. Com. Pl. 2003).

Gaffer is a ruling by the federal district court for the Middle District of Pennsylvania in which the court held that Pennsylvania does not recognize a separate claim for breach of the implied covenant of good faith that is independent and distinct from a breach of contract claim. *See Gaffer*, 2007 WL 2972580 at *9. Here, of course, Count II is a breach of contract claim that also includes breach of the implied covenant of good faith and fair dealing; it is not a separate claim for breach of the duty of good faith and fair dealing. *See Counterclaim*, ¶¶ 80-90 at 20-22. *Mercy Health* similarly held only that separate causes of action for breach of contract and breach of the implied covenant of good faith and fair dealing cannot be brought against the same defendant, *see Mercy Health*, 2003 WL 21904583, at *2, which is plainly not the case here.

Even assuming that Pennsylvania law applies, the Pennsylvania Supreme Court has yet to decide whether a cause of action for breach of the implied covenant of good faith and fair dealing exists separate and apart from a breach of contract claim against the same defendant. *See Ash v. Continental Insurance Company*, 593 Pa. 523, 533 n.2 (Pa. 2007) (the Court recognized that there was “considerable disagreement over the applicability of the implied duty of good faith” but declined to decide it because it was not presently before the Court). However, like the Pennsylvania Supreme Court, this Court need not address how this issue would be resolved under Pennsylvania law because Reliance has not asserted an independent cause of action for breach of the duty of good faith and fair dealing. Rather, Count II is a breach of contract claim that includes breach of the implied duty of good faith and fair dealing. Reliance asserted that breach of contract claim against some (but not all) of the Counterclaim Defendants, i.e., Underwriters of Syndicates 79, 456, 435, 623, 839, 1007, 1212, 1096, 205, 250 and St. Paul Reinsurance Company Limited (n/k/a Unionamerica Insurance Company Limited). *See*

Reliance's Counterclaim, ¶¶ 80-90 at 20-22. Counterclaim Defendants concede as much. See Counterclaim Defendants' Memorandum of Law at 5. With respect to the other Counterclaim Defendants, Reliance asserted a simple claim for breach of contract in Count I. Therefore, Counts I and II are two breach of contract claims asserted against different groups of Counterclaim Defendant that do not duplicate each other.

As for the legal sufficiency of Count II, New York, not Pennsylvania law, applies to the breach of contract claim asserted in Count II.⁴ As Reliance alleged in Paragraph 52 of its Counterclaim, Reliance's New York office negotiated these Reinsurance Agreements and administered them, including policies issued by several Reliance companies. Therefore, New York, not Pennsylvania law, applies to this claim. As the New York Court of Appeals recently held, under New York law, a party is permitted to plead a breach of contract claim that includes breach of the implied covenant of good faith and fair dealing. If a party prevails on that claim, the party may recover not only compensatory, but also consequential damages. *Bi-Economy Market, Inc. v. Harleysville Insurance Company of New York*, 886 N.E.2d 127, 132 (N.Y. 2008). In *Bi-Economy Market*, the New York Court of Appeals recently reversed a lower court's ruling dismissing plaintiff's breach of contract claim seeking to recover consequential damages. As the Court explained, under New York law, implicit in all contracts of insurance is a covenant of good faith and fair dealing which, if breached, may support an award for not only compensatory, but also consequential damages. *Bi-Economy Market, Inc.*, 886 N.E.2d at 131-32; see also *Panasia Estates, Inc. v. Hudson Insurance Company*, 886 N.E.2d 135 (N.Y. 2008) (allowing consequential damages due to the breach of the implied covenant of good faith and fair dealing).

⁴ With respect to the rest of Reliance's claims, there is no difference between Pennsylvania and New York law. Therefore, the Court need not consider the choice of law issue.

The only difference between Counts I and II of Reliance's Counterclaim is the damages that Reliance can recover if it prevails, i.e., under Count I, if Reliance prevails, it is entitled to recover compensatory damages. *See* Counterclaim, ¶ 79 at 19-20. Whereas, under Count II, if Reliance prevails, it is entitled to recover compensatory and consequential damages, and such other and further relief as the Court may deem just, equitable and proper. *See* Counterclaim, ¶ 90 at 22. In other words, Reliance chose to seek only compensatory damages against the Counterclaim Defendants named in Count I, but to seek compensatory and consequential damages against the Counterclaim Defendants named in Count II.

Reliance certainly is not required to seek the same damages from every party to this action nor does its decision to differentiate among the various Counterclaim Defendants impair its right to recover consequential and other damages from some (but not all) of the Counterclaim Defendants. Counterclaim Defendants do not suggest otherwise, nor do they cite any case law that would support such a result. Instead, they argue somewhat incongruously that the Plaintiffs and the Counterclaim Defendants that are not named as defendants in Count II somehow will be prejudiced by evidence that will be submitted if Count II is not stricken. *See* Counterclaim Defendants' Br. at 7. Because Reliance has not and does not intend later to file any claim against those parties for breach of contract, including breach of the implied covenant of good faith and fair dealing, they cannot be prejudiced by any evidence that is submitted with respect to those parties already named as defendants in Count II.

Because Count II of the Counterclaim sufficiently alleges a cause of action for breach of contract, including breach of the implied covenant of good faith and fair dealing, for which consequential damages may be awarded, Counterclaim Defendants' preliminary objections should be overruled. While Counterclaim Defendants only challenge Count II based

on Reliance's averments for breach of the implied duty of good faith and fair dealing and its request for an award of consequential damages, they request that, if the Court grants the Preliminary Objection to Count II, that the Court strike Count II in its entirety with prejudice. While Reliance contends that Count II is a viable breach of contract claim that is properly pleaded, if the Court grants Counterclaim Defendants' Preliminary Objection to Count II, it should not strike Count II, but rather should permit Reliance to replead Count II as a simple breach of contract claim.

As for the sufficiency of the factual averments, the Pennsylvania Rules of Civil Procedure require only that a complaint "contain averments of all of the facts the plaintiff will eventually have to prove in order to recover" and be "sufficiently specific so as to enable defendant to prepare his defense." *Smith v. Wagner*, 588 A.2d 1308, 403 Pa. Super. 316, 319 (1991) (citations omitted). One need only read the Statement of Facts in Counterclaim Defendants' own Brief in Support of its Preliminary Objections to confirm that Reliance has far exceeded these requirements by pleading detailed and specific facts supporting this (and its other) claims. *See* Counterclaim Defendants' Br. at 2-4. A simple reading of the Counterclaims also confirms that Reliance has alleged highly specific, detailed factual averments supporting both Counts I and II. *See* Counterclaim, ¶ 49-70 at 11-18. These factual averments are incorporated by references into Count I and Count II. *See* Counterclaims, ¶ 71 at 18 and ¶ 80 at 20. Consequently, the Counterclaim Defendants are on notice and plainly have more than sufficient information to prepare their defenses.

2. Count III

Reliance also properly pleaded Count III, its claim for breach of this Court's Order of Liquidation. Counterclaim Defendants contend otherwise, insisting that Count III is

legally deficient because the Order itself “makes no provision for the award of damages if the Order is violated.” Counterclaim Defendants’ Preliminary Objections, ¶ 31 at 7. However, Counterclaim Defendants not surprisingly cite no cases to support that proposition. Moreover, the law is clear that this Court has the inherent power to enforce its own Order and to impose sanctions as a result of Counterclaim Defendants’ breach of that Order. *See Lindsey v. Lindsey*, 492 A.2d 396, 398 (Pa. Super. Ct. 1985) (“It is axiomatic that a court must have the power to enforce its own orders.”); *see also Brocker v. Brocker*, 241 A.2d 336, 339 (Pa. 1968) (when a party breaches a court order the purpose of sanctions is to “coerce the defendant into compliance with the court’s order, and to compensate the complainant for losses sustained.”).

Nor can Count III be stricken as “duplicative” of Counts I and II because “it is well-settled that Pa. R.C.P. 1020 (c) permits a party to plead alternative causes of action, even if the claims advanced in the complaint are inconsistent or conflicting.” *DTK Ventures, L.P. v. Russo*, No. 05 EQ 4059, 2006 WL 2988463 at * 5 (Pa. Com. Pl., August 21, 2006). Here, of course, the breach of contract claims set out in Counts I and II are entirely compatible and consistent with the claim in Count III for breach of the Liquidation Order. Count III is an alternative legal theory that, if successful, simply affords Reliance the right to recover not only its unpaid balances, but also its attorneys’ fees and costs and such other relief as the Court may deem appropriate. *Goodman v. Goodman*, 556 A.2d 1379, 1392 n. 8 (Pa. Super. Ct. 1989); *Rhoades v. Pryce*, 874 A.2d 148, 152 (Pa. Super. Ct. 2005).

Counterclaim Defendants’ challenge to the sufficiency of the factual averments supporting Count III for breach of the Liquidation Order also should be overruled because Reliance’s factual averments far exceed what is required. With respect to the assets that

Counterclaim Defendants failed to turn over, Reliance alleged in Paragraph 57 of its

Counterclaim that:

Before Reliance was placed in liquidation, Counterclaim Defendants, through their designated representative listed in the Reinsurance Agreements, or their agent AUSCO, controlled how claims were handled, including making coverage determinations, setting reserves and approving payments in all cases before Reliance had paid the claim. Underwriters and/or AUSCO had already made coverage determinations and set reserves for claims that were pending when Reliance was placed in liquidation. After Reliance was placed in liquidation by this Court's October 3, 2001 Liquidation Order, AUSCO transferred the claim files to state guaranty associations which, by operation of law, are now responsible for handling and settling claims. Counterclaim Defendants have refused to reimburse Reliance for over \$7 million in claims that Reliance paid on Counterclaim Defendants' behalf before Reliance was placed in liquidation, and for almost \$7 million in claims paid since Reliance was placed in liquidation.

Counterclaim, ¶ 57 at 13. The "assets" are the funds that should be paid to the Reliance Estate for the "over \$7 million in claims that Reliance paid on Counterclaim Defendants' behalf before Reliance was placed in liquidation, and for almost \$7 million in claims paid since Reliance was placed in liquidation." *Id.* For the avoidance of doubt, Reliance referred to Paragraph 57 in Paragraphs 94 and 95 of Count III. The charts in Paragraphs 63-68 of the Counterclaim set out the amounts owed by each of the Counterclaim Defendants. Based on these detailed factual averments, there can be no uncertainty about the factual basis of Count III.

3. Reliance's Claim for Attorneys' Fees

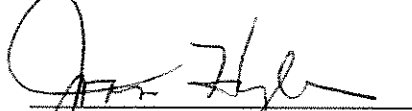
Finally, Counterclaim Defendants' Preliminary Objection to Reliance's demand for attorneys' fees also should be overruled because Count III entitles Reliance to special damages, including attorneys' fees. Attorneys' fees and other disbursements may be recovered for noncompliance with a court order. *Rhoades*, 874 A.2d at 152. Because an award of counsel fees is intended to reimburse an innocent litigant for expenses it incurred made necessary by the

conduct of an opponent, it is coercive and compensatory, and not punitive. *Goodman*, 556 A.2d at 1392 n.8; *Rhoades*, 874 A.2d at 152. Therefore, Counterclaim Defendants' preliminary objections to Reliance's demand for attorneys' fees should be overruled.

V. Conclusion

For the foregoing reasons, all of Counterclaim Defendants' Preliminary Objections should be overruled. However, even if the Court sustains Counterclaim Defendants' Preliminary Objection to the legal sufficiency of Reliance's Count II for breach of contract, including breach of the implied covenant of good faith and fair dealing, the proper remedy is not to strike Count II with prejudice, but rather to permit Reliance to replead Count II as a simple breach of contract claim.

Respectfully submitted,



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Dated: December 15, 2008

CERTIFICATE OF SERVICE

I hereby certify that, on December 15, 2008, I served a true and correct copy of the foregoing Response And Memorandum Of Law In Opposition To Counterclaim Defendants' Preliminary Objections upon the following:

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