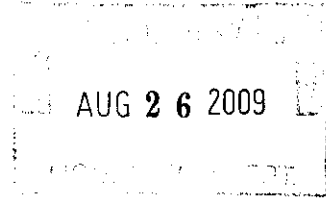


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August 24, 2009

Via: Hand Delivery

Clerk of the Court
Commonwealth Court of Pennsylvania
1339 Chestnut Street, Suite 990
Philadelphia, PA 19107

Re: Ario v. Reliance Insurance Company
(*in re: Republic Western Insurance Company*)
No. 269 M.D. 2001
Our file 7400-001/FPD

Dear Sir/Madam:

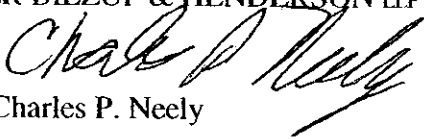
Pursuant to the Court's Order dated August 7, 2009, a copy of which is attached to this letter, enclosed please find an original and three copies of Republic Western Insurance Company's Petition of Republic Western Insurance Company to Declare Right of Setoff and For Injunctive Relief. We have also enclosed a copy of a CD onto which the filing has been copied, pursuant to this Court's Case Management Order dated December 12, 2008.

Please time stamp one copy of the documents and return same to our office.

Very truly yours,

PALMER BIEZUP & HENDERSON LLP

By:


Charles P. Neely

Enclosures

cc: Master Service List (attached)

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

RELIANCE INSURANCE COMPANY,

Defendant


No. 269 M.D. 2001

Re: Republic West Insurance Company

ORDER

And now, this 7th day of August, 2009, upon consideration of Republic West Insurance Company's Petition for Leave to Intervene and Relief from the Stay in order to file a declaratory judgment action asserting a right of setoff and upon consideration of the Liquidator's response thereto, the Petition is hereby GRANTED. Accordingly:

1. The Intervenor shall file the proposed Petition for Review for a declaratory Judgment and Relief from the Stay within 30 days;
2. The Liquidator shall file a responsive pleading within 20 days thereafter.


BONNIE BRIGANCE LEADBETTER,
President Judge

Certified from the Record

AUG 10 2009

and Order Exit

Master Service List

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania

v.

Reliance Insurance Company

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

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IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Joel S. Ario, :
Insurance Commissioner of the :
Commonwealth of Pennsylvania, :
Plaintiff :
v. :
Reliance Insurance Company, : No. 269 M.D. 2001
Defendant. :

RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHIL A)
2009 AUG 24 A 11:48

IN RE: Republic Western Insurance Company

**PETITION OF REPUBLIC WESTERN INSURANCE COMPANY
TO DECLARE RIGHT OF SETOFF AND FOR INJUNCTIVE RELIEF**

Petitioner, Republic Western Insurance Company (hereinafter “RepWest” or “Petitioner”), by its attorneys, **Palmer Biezup & Henderson, LLP**, petitions this Honorable Court to grant certain relief as set forth below:

INTRODUCTION

1. This petition seeks declaratory and injunctive relief with respect to an award (hereinafter the “Award”) obtained in confidential arbitration proceedings between the Liquidator of Reliance Insurance Company (hereinafter “Reliance”) and RepWest, including enforcement of RepWest’s statutory right of setoff pursuant to 40 P.S. § 221.32 – a right which was left “for determination in the Reliance liquidation proceeding” by the arbitration panel, and to stay any proceedings by the Liquidator to obtain a judgment based on the Award.

2. Petitioner does not seek a review of the Award issued in the above-referenced arbitration. Likewise, Petitioner is not seeking an affirmative award in the nature of payment from the Liquidator.

PARTIES

3. RepWest is an insurance company domiciled in Arizona.

4. Reliance is an insurance company that was formerly organized under the laws of Pennsylvania and is subject to an Order of Liquidation issued on October 3, 2001 (hereinafter, the "Liquidation Order"), by this Court in Case Number 269 M.D. 2001 (hereinafter "Liquidation Proceeding").

5. Pursuant to the Liquidation Order, the Insurance Commissioner of the Commonwealth of Pennsylvania was appointed as the liquidator (hereinafter "Liquidator") for Reliance.

STATEMENT OF JURISDICTION

6. The Court is vested with original jurisdiction over this matter pursuant to 42 Pa.C.S. §761(a)(1), (3), and paragraph 5 of the Liquidation Order.

STATEMENT OF FACTS

I. THE CONTRACTS AT ISSUE

A. Excess Workers Compensation Facultative Certificates:

7. From 1997 through 2000, Reliance reinsured RepWest pursuant to various Excess Workers Compensation and Employers Liability facultative certificates issued by Reliance (hereinafter the "Facultative Certificates"). Copies of the Facultative Certificates at issue (27 Certificates concerning 19 different insureds) are attached hereto as **Exhibit "A"**. The "General Conditions" applicable to each Facultative Certificate is attached hereto as **Exhibit "B"**.

8. The Facultative Certificates provide reinsurance for excess workers compensation policies issued by RepWest.

9. The Facultative Certificates have limits between \$50,000 to \$250,000, and attach above RepWest's retentions on the underlying excess workers compensation policies.

B. The RISE Treaty:

10. Reliance also reinsured RepWest under an Automobile Quota Share Reinsurance Treaty (hereinafter the "RISE Treaty"). The RISE Treaty was effective from August 1, 1995, to January 1, 1998.

11. Reliance's share of the RISE Treaty was 31% from August 1, 1995, to January 1, 1997, and 27.5% from January 1, 1997, to January 1, 1998. A copy of the RISE Treaty is attached hereto as **Exhibit "C"**.

12. The RISE Treaty reinsures supplemental liability insurance and personal effects coverage policies issued by RepWest.

C. The Non-Obligatory Excess Workers Compensation Treaties:

13. RepWest reinsured Reliance under two Non-Obligatory Excess Workers Compensation Treaties (hereinafter referred to collectively as "Excess Treaties") to Reliance.

14. Each of the Excess Treaties covers an annual term. The first Treaty was effective from December 1, 1997, through November 30, 1998. The second Treaty was effective from December 1, 1998, through November 30, 1999. Copies of the Excess Treaties are attached hereto as **Exhibits "D" and "E"**.

15. The Excess Treaties applied to qualifying large deductible and excess Workers Compensation policies issued by Reliance.

II. NOTICE OF CLAIMS AND REPWEST'S REQUEST FOR SETOFF

A. RepWest's Notices of Claim

16. RepWest began providing notice of potential claims under the Facultative Certificates in 2001.

17. In December 2003, RepWest timely filed Proofs of Claim in the Liquidation Proceeding with respect to the Facultative Certificates. Copies of the Proofs of Claim are attached hereto as **Exhibit "F"**. A chart of those claims, including the Proof of Claim number and the current amount due to RepWest by the Liquidator for each claim is attached hereto as **Exhibit "G"**.

18. RepWest provided additional information in support of its Proofs of Claim when requested by the Liquidator.

19. The Liquidator issued Notices of Determination regarding RepWest's Proofs of Claim. Copies of the relevant Notices of Determination are attached hereto as **Exhibit "H"**.

20. The Notices of Determination show that the Liquidator accepted all of these Proofs of Claim as Priority Level "e" claims.

21. Between September 2004 and February 2008, RepWest provided additional notices of claims and complied with requests for further information from the Liquidator as to all notified claims.

22. The Liquidator did not object to any claim noticed after December 31, 2003, on the basis that no Proof of Claim was filed.

23. RepWest's claims under the Facultative Certificates currently total \$2,687,264.77.

24. RepWest anticipates that it will make future payments on some or all of the claims at issue, and therefore the amounts it is claiming under the Proofs of Claim will increase in the future.

25. RepWest's claim under the RISE Treaty totals \$19,762.50.

26. The Liquidator has been aware of this claim since at least February 2008, and has never objected to this claim on any basis.

27. The Liquidator has not paid any of the amounts claimed by RepWest under the Facultative Certificates or the RISE Treaty.

B. The Liquidator Initially Pursued Setoff With RepWest

28. From mid-2004 until March 2006, the Liquidator communicated with RepWest on multiple occasions, requesting reconciliation and setoff of amounts due between the parties on various contracts, including the Facultative Certificates and the Excess Treaties.

29. RepWest reasonably relied upon representations by the Liquidator that it intended to setoff or commute claims between the parties.

30. In March 2006, the Liquidator abruptly asserted that it would not setoff any amounts between the Facultative Certificates and the Excess Treaties.

31. The Liquidator asserted that its new refusal to setoff claims due from RepWest was due to language in the contracts.

32. By requesting setoff from RepWest for a year and a half, the Liquidator has waived any right to deny that setoff is prohibited for the claims and contracts at issue. Likewise, the Liquidator is estopped from denying its obligation to setoff all proper claims between the parties.

33. Upon information and belief, the Liquidator has acknowledged rights of setoff under contracts with the same or substantially similar setoff provisions.

34. The Liquidator refused to grant setoff here because RepWest was challenging the amounts due Reliance above the amount of the setoff.

III. ARBITRATION AND AWARD

35. Beginning in 2000, Reliance made claims under the Excess Treaties.

36. In September 2007, the Liquidator initiated arbitration against RepWest with respect to its claims under the Excess Treaties.

37. An arbitration panel (hereinafter "Arbitration Panel") was constituted in early 2008 and the parties engaged in an arbitration.

38. The parties and the Arbitration Panel agreed that the arbitration proceedings and related materials would be subject to a Confidentiality Agreement.

39. The Arbitration Panel issued the confidential Award in March 2009. A copy of the Award has been submitted separately subject to a Petition for Leave to File Under Seal.

40. The Award, among other things, ordered RepWest to pay a certain confidential amount to the Liquidator within 30 days of the issuance of the Award.

41. The Award also expressly states that "the Panel makes no determination on the merits of claims asserted by Republic Western against Reliance and leaves those claims for determination in the Reliance liquidation proceeding."

42. RepWest has made a partial payment to the Liquidator pursuant to the Final Award. The partial payment is the amount that the Liquidator was awarded less \$2,707,027.27, the amount RepWest is currently owed by Reliance and for which RepWest now seeks to enforce its right of setoff.

FIRST APPLICATION FOR RELIEF – DECLARATORY JUDGMENT
CONCERNING RIGHT TO SET OFF

43. Petitioner realleges, and incorporates herein by reference, the allegations of the paragraphs set forth above.

44. A real controversy exists between the parties because RepWest seeks to enforce its right to setoff of amounts admittedly due to it by the Liquidator against an Award in favor of the Liquidator.

45. The Pennsylvania Insurance Liquidation Statute, 40 P.S. § 221.32, provides with respect to setoff:

- (a) Mutual debts or mutual credits between the insurer and another person in connection with any action or proceeding under this article shall be setoff and the balance only shall be allowed or paid, except as provided in subsection (b).
- (b) No setoff or counterclaim shall be allowed in favor of any person where:
 - (1) the obligation of the insurer to the person would not at the date of the filing of a petition for liquidation entitle the person to share as a claimant in the assets of the insurer;
 - (2) the obligation of the insurer to the person was purchased by or transferred to the person with a view to its being used as a setoff;
 - (3) the obligation of the person is to pay an assessment levied against the members or subscribers of the insurer, or is to pay a balance upon a subscription to the capital stock of the insurer, or is in any other way in the nature of a capital contribution; or

- (4) the obligation of the person is to pay premiums, whether earned or unearned, to the insurer.

46. Pursuant to 40 P.S. § 221.32, RepWest is entitled to setoff amounts due from Reliance against the amount owed by RepWest to Reliance under the Award.

47. For the purposes of this proceeding, RepWest is not seeking review of the Award. RepWest maintains only that there are mutual debts and credits between RepWest and Reliance that can be setoff.

48. The amount which Reliance owes to Petitioner under the Facultative Certificates and the RISE Treaty equals the remaining amount due to the Liquidator pursuant to the Award.

49. Pursuant to Pennsylvania and U.S. Supreme Court precedents, setoff is an equitable right which has been recognized and permitted at common law since the 1800's. *See, Transit Cas. Co. v. Selective Ins. Co. of the Southeast*, 137 F.3d 540, 543-544 (8th Cir. 1998), *citing Scott v. Armstrong*, 146 U.S. 499 (1892). *See also, Foster v. Mut. Fire, Marine and Inland Ins. Co.*, 531 Pa. 598, 616-617 (1992), *cert. den. by* 506 U.S. 1080 (1993).

50. Setoff is also routinely engaged in between insurance companies as a matter of commercial necessity and industry practice. *See, Koken v Legion Ins. Co.*, 865 A.2d 945, 953-954 (Pa. Commw. Ct. 2005).

51. The amount which Reliance owes to RepWest under the Facultative Certificates and the RISE Treaty equals the remaining amount due the Liquidator pursuant to the Arbitration Panel's Award.

WHEREFORE, RepWest seeks an Order of this Court declaring that it is entitled to setoff the amount which Reliance owes to it under the Facultative Certificates and the RISE Treaty against the amount due to the Liquidator pursuant to the Award.

SECOND APPLICATION FOR RELIEF – PERMANENT INJUNCTION

52. Petitioner realleges, and incorporates herein by reference, the allegations of the paragraphs set forth above.

53. RepWest has made partial payment to the Liquidator in compliance with the Arbitration Panel's Award.

54. RepWest's setoff claims equal the outstanding portion of the Award.

55. RepWest's right to setoff under 40 P.S. § 221.32 is clear and unequivocal and therefore RepWest is likely to succeed on the merits.

56. Because Petitioner's claims have been classified as Priority Level "e" by the Liquidator, it can anticipate only limited compensation for its claims at some unknown date in the future via the Liquidation Proceeding.

57. Since the possibility of RepWest securing complete or partial reimbursement for its Proofs of Claim in the future is remote, RepWest will suffer an irreparable injury if forced to pay the Award in full.

58. In contrast, RepWest can be fully compensated for its outstanding claims, and suffer no injury, if its right to setoff against the Award is enforced.

WHEREFORE, RepWest seeks an Order enjoining the Liquidator from enforcing the Award as to the amount not paid by RepWest. RepWest further seeks an order instructing the Liquidator to mark the Award satisfied by virtue of RepWest's setoff claims.

**THIRD APPLICATION FOR RELIEF – DECLARATORY JUDGMENT
CONCERNING FUTURE CLAIMS**

59. Petitioner realleges, and incorporates herein by reference, the allegations of the paragraphs set forth above.

60. Upon information and belief, RepWest will make further payments to its underlying insureds, and RepWest will make claims to the Liquidator under the Facultative Certificates for reimbursement and indemnity in respect of those further payments.

61. Upon information and belief, the Liquidator may make further payments to its underlying insureds, and the Liquidator will make claims to RepWest under the Excess Treaties for those further payments.

62. In addition to any other defenses RepWest may have to the Liquidator's future claims for payment under the Excess Treaties, RepWest is entitled, pursuant to 40 P.S. § 221.32, common law, and industry custom and practice, to setoff future amounts due it under the Facultative Certificates against any amounts due the Liquidator under the Excess Treaties.

WHEREFORE, RepWest seeks an order of this Court declaring that it is entitled to setoff any amounts which the Liquidator may, in the future, owe to RepWest under the Facultative Certificates against any amounts which may, in the future, be due to the Liquidator pursuant to the Excess Treaties.

STATEMENT OF RELIEF SOUGHT

63. Petitioner RepWest respectfully requests that this Court enter judgment in its favor and against the Liquidator and that it grant the following relief:

- A. A declaration that pursuant to 40 P.S. § 221.32, common law, and industry custom and practice, RepWest is entitled to setoff the amount which the Liquidator owes to RepWest, under the Facultative Certificates and the RISE Treaty against the amount due to the Liquidator as a result of the Award;
- B. A further declaration that Petitioner is entitled to setoff future amounts due between Petitioner and the Liquidator pursuant to the Excess Treaties and Facultative Certificates;
- C. An Order that the Award is satisfied by the application of the setoff; and
- D. For such other and further relief as this Court deems just and proper.

Dated: August 24, 2009

PALMER BIEZUP & HENDERSON LLP

By: 

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