

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO, INSURANCE :
COMMISSIONER OF THE :
COMMONWEALTH OF :
PENNSYLVANIA, :
Petitioner, :
and : No. 269 M.D. 2001
RELIANCE INSURANCE COMPANY, :
Defendant. :

RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHILA)
2009 SEP 14 P 2:25

IN RE: REPUBLIC WESTERN INSURANCE COMPANY

**THE LIQUIDATOR’S PRELIMINARY OBJECTIONS TO
TO PETITION OF REPUBLIC WESTERN INSURANCE COMPANY**

Pursuant to Pennsylvania Rule of Appellate Procedure 1028 and Pennsylvania Rule of Appellate Procedure 106, the Liquidator submits his Preliminary Objections to Republic Western Insurance Company’s Petition to Declare Right of Setoff and for Injunctive Relief (“Petition”). As set forth more fully below and in the accompanying Memorandum of Law, the Liquidator preliminarily objects because Republic Western’s Petition fails to state a cause of action for which relief can be granted.

Background

The Reinsurance Agreements

1. Prior to Reliance’s liquidation, Republic Western and Reliance were reinsurance partners under several agreements: (1) the Non-Obligatory Excess Workers’ Compensation and Employers’ Liability Variable Excess of Loss Reinsurance Agreement (“Excess Treaty”); (2) various Certificates of Facultative Reinsurance (“Facultative Certificates”); and (3) the Automobile Quota Share Reinsurance Treaty (“RISE Treaty”).

2. On the Excess Treaty, Reliance was the ceding company and Republic Western the reinsurer. As to the Facultative Certificates and the RISE Treaty (collectively referred to as the “Assumed Contracts”), Republic Western was the ceding company and Reliance was the reinsurer.

3. In its Petition, Republic Western seeks to offset amounts that it owes Reliance under the Excess Treaty with balances purportedly owed by Reliance to Republic Western under the Assumed Contracts.

4. None of the reinsurance agreements permit setoff with each other.

5. The Excess Treaty provides that offsets may only be allowed with respect to balances due between Reliance and Republic Western under the Excess Treaty itself -- “Offset this Contract only.” 1997 and 1998 Excess Treaty Slips at “CLAUSES”, attached as Exhibits “D” and “E” to the Petition.¹

6. According to the Petition at ¶ 7, the various Facultative Certificates each contain the same “General Conditions.” The General Conditions provide that the parties may offset balances “due from one party to the other under this CERTIFICATE, or any other agreement on business produced by the same intermediary named herein.” *See* General Conditions of the Facultative Certificates at Art. 13, attached to the Petition as Exhibit “B.”

7. Offset was limited to balances within the Facultative Certificates because the intermediaries are not the same among the reinsurance contracts.

¹ Exhibits “D” and “E” to the Petition are placement slips which were signed and fully executed by both parties. Only Reliance signed the full reinsurance contract wording of the Excess Treaty, attached as Exhibit “2.” Like the placement slips, the full wording also prohibits cross-contract offsets. *See* Exhibit “2” at Art. XXVII (“[Reliance] and the Reinsurer shall have the right to offset any balance or amounts due from one party to the other under the terms of this Contract.”).

8. Under the RISE Treaty, the parties “may offset any balance or balances ... due from one part to the other under this Treaty ...” RISE Treaty at Art. 24, attached to the Petition as Exhibit “C” (emphasis added).

The Liquidation of Reliance and the Offset Guidelines

9. Courts do not disturb the Insurance Commissioner’s administrative discretion in interpreting legislation within its own sphere of expertise absent fraud, bad faith, abuse of discretion or clearly arbitrary action.

10. Reliance entered liquidation on October 3, 2001 under the Commonwealth Court’s Order of Liquidation, which named the Insurance Commissioner as Statutory Liquidator of the Estate of Reliance.

11. The Liquidator promulgated Offset Guidelines on July 3, 2002 to establish an equitable and orderly process to determine offset rights of Reliance’s creditors and members of the reinsurance industry. *See* “Offset Guidelines” attached as Exhibit “1”.

12. The Liquidator’s Offset Guidelines provide that offsets may be applied against Reliance “if the debts and credits are mutual, and only where allowed under (1) Pennsylvania statute, (2) the terms of the specific reinsurance contracts involved provided the contract is not inconsistent with the statute, and (3) the parameters outlined in any applicable scenario below. All these conditions must be satisfied.” *See id.* at p. 3.

13. In every single “scenario” involving cross-contract offsetting, the Offset Guidelines state that to permit cross-contract offset, “[t]he reinsurance agreements must not contain a provision limiting offsets to within same contract.” *Id.* at pp.3-4, II.D, III.F, IV.H.

The Panel Issues the Arbitration Award in the Liquidator's Favor

14. As a result of Republic Western's failure to make any payments under the Excess Treaty, in September 2007 Reliance commenced arbitration against Republic Western. Petition at ¶¶ 35-36.

15. During the arbitration process, the parties accepted a panel of impartial and experienced arbitrators, exchanged extensive discovery, briefed their positions, and conducted a nine-day hearing in January and February, 2009.

16. On March 8, 2009, the arbitration panel ("Panel") issued an award ordering Republic Western to pay a confidential amount within thirty days representing losses due to Reliance under the Excess Treaty ("Award"). Award at ¶ 1, Exhibit "D" to Republic Western's June 5, 2009 Petition For Leave to File Confidential Arbitration Materials Under Seal; Petition at ¶¶ 39 and 40.

17. The Panel elected not to make a determination with regards to the offsets of counter-claims. Petition at ¶ 41.

18. However, the Panel clarified that Republic Western was obligated to pay the full amount of the Award: "the use of an offset to reduce the award is not permitted." See sealed April 15, 2009 email from Umpire Elizabeth Thompson, Esq. to the parties attached as Exhibit "M" to Republic Western's June 5, 2009 Petition For Leave to File Confidential Arbitration Materials Under Seal.

19. Republic Western has nevertheless done precisely this directly violating the Award and in an attempt to undermine the liquidation process. Republic Western made a partial payment to Reliance withholding over two million dollars from the Award. Petition at ¶ 42.

Preliminary Objection

A. Preliminary Objection In The Nature Of A Demurrer

20. The allegations in paragraphs 1 to 19 above are incorporated herein as though set forth in full.

21. Rule 1028(a)(4) of the Pennsylvania Rules of Civil Procedure provides that parties may preliminarily object to pleadings for legal insufficiency of a pleading in the nature of a demurrer.

22. Where the complaint fails to set forth a valid cause of action, a preliminary objection in the nature of a demurrer is properly sustained.

23. The administration of an insolvent estate must be performed equitably and uniformly; creditor preferences must be avoided. Accordingly, setoff is not regularly allowed as a general commercial remedy, nor is it broadly applied.

24. Section 221.32 of the Pennsylvania Insurance Insolvency Statute is the operative provision for determining setoffs in liquidations, and places strict limits on the use of setoff.

25. Section 221.32 requires “mutuality” between the debts at issue to allow an offset.

26. Mutual debts and credits arise from contractual relationships.

27. To be mutual, the preliquidation debts or credits must be in the same right and between the same parties, standing in the same capacity.

28. While the parties are titularly the same on the multiple contracts, the contracts do not create common rights among them; as such, there are no “mutual debts or mutual credits” between Reliance and Republic Western.

29. Mutuality was incorporated into and formed the basis for Reliance's Offset Guidelines. "The underlying principle of these guidelines is that the statute requires mutuality of debts for an offset to be allowed." Offset Guidelines, Exhibit "1" at p. 2.

30. However Republic Western attempts to characterize the relief it seeks in its Petition, it is absolutely clear that this Court may not modify, correct or vacate (in whole or in part) a valid arbitration award except upon a timely petition to vacate.

31. The arbitration panel's award is binding and may not be vacated or modified unless it is clearly shown that a party was denied a hearing or that fraud, misconduct, corruption or other irregularity caused the rendition of an unjust, inequitable or unconscionable.

32. As Republic Western did not petition to vacate the award (and has no legal basis to do so), this Court has no authority to overturn the Award as a matter of law.

33. 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.

WHEREFORE, the Liquidator respectfully requests that the Petition be stricken with prejudice pursuant to Pennsylvania Rule of Civil Procedure 1028(a) for the reasons stated above.

Respectfully submitted,

Deborah F. Cohen

Deborah F. Cohen (Pa. Id. 21538)
Kassem Lucas (Pa. Id. No. 85851)
Ken Massey (Pa. Id. No. 93377)
PEPPER HAMILTON LLP
3000 Two Logan Square
Eighteenth & Arch Streets
Philadelphia, PA 19103-2799
(215) 981-4000

Attorneys for Joel S. Ario,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in his official capacity as Statutory Liquidator
of Reliance Insurance Company (In
Liquidation)

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