

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO, INSURANCE
COMMISSIONER OF THE
COMMONWEALTH OF PENNSYLVANIA,

Plaintiff,

v.

RELIANCE INSURANCE COMPANY (IN
LIQUIDATION),

Defendant.

No. 269 M.D. 2001

2010 MAY 11 P 2:57

RECEIVED AND FILED
COMMONWEALTH COURT
OF PA (PHIL.A)

**IN RE: CONFIRMATION OF ARBITRATION AWARD ENTERED
AGAINST REPUBLIC WESTERN INSURANCE COMPANY**

**REPLY BRIEF IN SUPPORT OF APPLICATION FOR RELIEF IN
THE NATURE OF A MOTION TO CONFIRM ARBITRATION AWARD**

Republic Western opposes Reliance’s “Motion to Confirm Arbitration Award” on two grounds. First, Republic Western asserts that Reliance’s motion is untimely. Second, Republic Western contends that the Motion to Confirm may not be considered without first ruling upon Republic Western’s previously filed Petition seeking setoff against the arbitration award (“Arbitration Award”). The first argument is wrong as a matter of law; the second is legally and factually incorrect.

First, Republic Western contends that Reliance’s Motion to Confirm is out of time because the instant arbitration is governed by the Federal Arbitration Act (“FAA”), which contains a one-year time limit for such motions. Pennsylvania law does not impose any time

limit on motions to confirm arbitration awards;¹ thus, Republic Western asserts that “the FAA preempts the Pennsylvania law and controls.” *Id.* This is incorrect as a matter of law.

The Pennsylvania Supreme Court has explicitly stated that the FAA does not preempt state procedural time limits. *Moscatiello v. J.J.B. Hilliard, et al.*, 939 A.2d 325 (Pa. 2007). Quoting the United States Supreme Court decision in *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989), the *Moscatiello* Court stated, “The FAA contains no express pre-emptive provision nor does it reflect a congressional intent to occupy the entire field of arbitration.” Accordingly, the Pennsylvania Supreme Court held that

The FAA does not preempt the procedural rules governing arbitration in state courts, as that is beyond its reach. Thus, we hold there is no preemption.

Moscatiello, 939 A.2d at 329. *See also Joseph v. Advest*, 906 A.2d 1205, 1211 (Pa. Super. Ct. 2006) (“[t]hus, state courts employ their own procedural rules even when a state procedural rule is inconsistent with an FAA procedural rule if the state rule does not conflict with the FAA's purpose of expeditious resolution of legal matters through arbitration.”); *Holmes v. Mann Bracken, LLC*, 2009 U.S. Dist. LEXIS 119940, *13 (E.D. Pa. 2009) (quoting *Vaden v. Discover Bank*, 129 S. Ct. 1262 (2009), “state courts have a prominent role to play as enforcers of agreements to arbitrate.... [S]o long as state procedural rules do not substantially interfere with enforcement of an agreement to arbitrate, the FAA does not preempt.”).

There can be no plausible or credible argument that the absence of a time limit for confirming awards is antithetical to the public policy of enforcing agreements to arbitrate. To

¹ Republic Western acknowledges the lack of time constraints in motions to confirm under applicable Pennsylvania law. “Pennsylvania state law does not contain a statute of limitations for seeking confirmation of an arbitral award. *See* 42 Pa. C.S. §7313, 7342.(b).” “Memorandum of Law in Opposition to Motion to Confirm Arbitration Award,” hereinafter “RW Opp. Brf.” at 5, n. 1.

the contrary, the absence of a time limit for confirmation simply acknowledges Pennsylvania law, with respect to common law arbitrations,² that upon application by any party confirmation by the court is mandatory at any time after thirty days.

On application of a party made more than 30 days after an award is made by an arbitrator under section 7341 (relating to common law arbitration) the court shall enter an order confirming the award and shall enter a judgment or decree in conformity with the order.

42 Pa. C.S. § 7342 (b); *see also* 42 Pa. C.S. § 7313. *See also Sage v. Greenspan*, 765 A.2d 1139, 1143 (Pa. Super. Ct. 2000) (“Based on the language of this section, the trial court, after the passage of the 30 days’ time, is required to enter an order confirming the award and enter judgment in conformity with the order. The award of an arbitrator in a common law arbitration 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, or corruption or other irregularity caused the rendition of an unjust, inequitable or unconscionable award.”) (citation omitted).³ Plainly, Pennsylvania law is

² The present arbitration was a common law arbitration because the contract between the parties did not specify statutory arbitration. *See Jefferson Woodlands Partners, L.P. v. Jefferson Hills Borough*, 881 A.2d 44, 48 (Pa. Commw. Ct. 2005).

³ Because of this clear Pennsylvania precedent that Pennsylvania’s procedural rules apply, Republic Western’s arguments with respect to the clarifying email (“4/15/09 Email”) are irrelevant. However, it deserves mention that Republic Western misstates the law with respect to the doctrine of *functus officio*. A panel’s authority to clarify previously-issued awards is a well-recognized exception to that doctrine, “where the award, although seemingly complete, leaves doubt whether the submission has been fully executed, an ambiguity arises which the arbitrator is entitled to clarify.” *Stack v. Karavan Trailers, Inc.*, 864 A.2d 551, 556 (Pa. Super. Ct. 2004), *citing*, *Colonial Penn Ins. Co. v. Omaha Indemnity Co.*, 943 F.2d 327, 332 (3d Cir. 1991) (citations omitted). *See also Transtech Industries, Inc. v. A&Z Septic Clean*, 270 Fed. Appx. 200, 2008 U.S. App. LEXIS 6156, *11-*12 (3d Cir. 2008) (Court allows post award clarification to clarify an ambiguity raised by submissions submitted to the Panel after the Award was issued); *Teamsters Local 312 v. Matlack, Inc.*, 118 F.3d 985, 993 (3d Cir. 1997) (courts allow supplemental information from arbitrators to clarify awards) (citations omitted); *Scheidly v. Travelers Ins. Co.*, 33 Pa. D. & C. 4th 193, 198 (Pa. Comm. Pl. 1996) (court upholds clarification of an award even though no one filed a petition with the arbitrator nor asked the court for clarification; court found that a clarification upon inquiry of one of the parties was not in any way a change of the award).

entirely consistent with the public policy of requiring that arbitration awards should be confirmed as valid and enforceable, in the absence of *vacatur* or judicial modification.

Republic Western's second argument is equally unavailing, for multiple reasons.

First, in the absence of a motion to vacate or modify (which Republic Western admittedly has not filed), this Court is without authority to do anything other than enforce the Arbitration Award according to its terms. *Riley v. Farmers Fire Ins. Co.*, 735 A.2d 124, 130 (Pa. Super. Ct. 1999) ("Once thirty days has passed from the setting of the award, it [becomes] mandatory that the [] court confirm such award upon petition of either party."); *see also Sage v. Greenspan*, 765 A.2d at 1143 ("...the trial court, after the passage of the 30 days' time, is required to enter an order confirming the award and enter judgment in conformity with the order."). The Arbitration Award was very specific in ordering Republic Western to pay a sum certain by an established date:

[REDACTED]

[REDACTED]

[REDACTED]

See Final Award attached under seal as Exhibit A to the Liquidator's Application to Confirm.

Indeed, the Panel's 4/15/09 Email was to clarify the exact issue presently before this Court – whether or not the damages awarded in the Arbitration Award should or could be reduced because the Panel was not deciding Republic Western's set-off issue. In the 4/15/09 Email, the Panel removed any doubt as to the construction to be placed upon the Arbitration

Award and made clear that they intended to require Republic Western to make a full payment to Reliance, without regard or deduction for Republic Western's claim for set-off.



See 4/15/09 Email attached under seal as Exhibit A to the Liquidator's Application to Confirm; emphasis supplied.⁴

Second, Republic Western has no viable or demonstrable right of setoff as a matter of fact and law. Republic Western is seeking to setoff balances due to it arising under several reinsurance contracts⁵ *against* balances due and owing to Reliance (as a result of the Arbitration Award) under a separate reinsurance contract which does not permit cross-contract

⁴ To the extent that Republic Western asserts that the decision of the Panel may result in a hardship to it, because it "may" not be able to "fully recoup monies paid to a company in liquidation – as opposed to being required to accept a *pro-rata* share of such amounts as part of the creditor distribution process...." RW Opp. Brf. at 11 (emphasis in original), this simply is not true. If Republic Western makes a post liquidation payment and it turns out to be in error, that payment will be returned in full. If Republic Western is concerned about there being sufficient funds available to return the setoff amounts, it should review the last Quarterly Report of the Liquidator stating that the Estate's available short and intermediate duration investments were approximately \$2.2 billion, as of December 31, 2009 (See Quarterly Report of the Liquidator on the Status of the Liquidation of Reliance Insurance Company as of December 31, 2009 at 4 and Exhibit A to the Quarterly Report, available at <http://www.reliancedocuments.com/pdfs/2546.pdf>).

⁵ As illustrated below, Republic Western wishes to offset Reliance's assumed reinsurance treaties with the Reliance ceded treaty at issue in the arbitration even though the contracts do not allow offset against each other.

Name of Contract	Type of Contract	Offset Provision
Automobile Quota Share Reinsurance Treaty	Reliance <u>Assumed</u> Reinsurance Treaty	No Cross-Contract Offset
Excess Workers' Compensation Facultative Certificates	Reliance <u>Assumed</u> Reinsurance Treaty	Offset allowed only with contracts placed by same intermediary
Non-Obligatory Excess Workers' Compensation and Employers' Liability Variable Excess Loss Reinsurance Agreement	Reliance <u>Ceded</u> Reinsurance Treaty	No Cross-Contract Offset

offset. As set forth in Reliance's papers opposing Republic Western's offset request, no setoff is permissible under these circumstances -- the balances due to be offset must arise under contracts which both allow cross-contract offset, if not, the offset is not allowable. This "mutuality" requirement is expressly set forth in the setoff statute itself, Section 221.32 of the Pennsylvania Insurance Insolvency Act (requiring "[m]utual debts or mutual credits between the insurer and another person" for setoff), and was included for purposes of restricting the availability of setoffs, because they are in the nature of preferences. Again, the Pennsylvania Supreme Court has made this clear, stating that --

With respect to setoff, Section 532 of Article V [Section 221.32] is the operative statutory provision, and it does two things. First, it preserves the right of a creditor to assert setoff post-liquidation. Second, *it limits the circumstances under which setoff may be invoked.*

Koken v. Legion Ins. Co., 900 A.2d 418, 425 (Pa. Commw. Ct. 2006) ("*Bank of America*") (emphasis supplied). Consequently, the restrictive nature of the "mutuality" obligation for setoff was incorporated into Reliance's published Offset Guidelines issued to the insurance and reinsurance industry and the Guidelines likewise expressly require mutuality of offsetting provisions. (See Guidelines at Sections III(F) (attached as Exhibit G): "The reinsurance agreements must not contain a provision limiting offsets to within the same contract.")⁶ Simply stated, a claimant cannot offset reinsurance obligations in one contract against a contract that

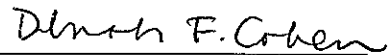
⁶ Reliance's adoption and publication of the Guidelines was to promote consistent application and enforcement of reinsurance setoff principle across the board in the Reliance estate. In *Ario v. Reliance Ins. Co.*, 980 A.2d 588 (Pa. 2009) ("*Farm Bureau*"), the Pennsylvania Supreme Court emphasized the importance of this uniformity. "In the context of a liquidation, where thousands of claims will be evaluated by various referees, there is value in an attempt to promote uniformity. Assuming for the sake of argument that multiple claims in the same litigation involve similar facts, the same outcome should be ordered in each claim." *Farm Bureau*, 980 A.2d at 597. Given that Reliance has consistently used these Guidelines to require other insurance companies to produce evidence of broad form contract clauses to obtain cross-contract setoff, Republic Western is not entitled to a different result.

limits offset. If pre-liquidation, for whatever reasons, the parties agreed to limit the scope of the offset rights to a contract or an intermediary,⁷ those contractual limitations are observed post-liquidation. “The setoff mutuality requirements are strictly construed because setoff is an exception to the orderly procedures for discharging claims against an insolvent debtor.” *Bank of America*, 900 A.2d at 423, *citing Newberry Corp. v. Fireman’s Fund Ins. Co.*, 95 F.3d 1392 (9th Cir. 1996).

⁷ Here, only one of the sets of contracts that Republic Western seeks to offset against, the Excess Workers Compensation Facultative Certificates, allows offset with other contracts placed by the same intermediary. This provision does not apply here because the Treaty at issue here does not allow cross contract offsets and are placed by a different intermediary.

Whether Republic Western's purported setoff rights are denied in this, or in the proceeding Republic Western itself instituted through intervention, is not significant. Republic Western has no legitimate basis to resist confirmation of the Arbitration Award and it is not entitled to any setoff because it cannot present to this Court contracts which mutually permit offset, as required by the Insurance Insolvency Act, the Guidelines or caselaw. Accordingly, Republic Western should be required by this Court to pay all amounts it was ordered to pay to Reliance, plus interest, as a result of its continuing failure to honor its obligations under the Treaty at issue in the arbitration, even when ordered to do so by an arbitration panel after a duly conducted arbitration.

Respectfully submitted,



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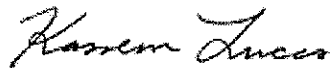
Attorneys for Joel S. Ario,
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in his official capacity as Statutory Liquidator
of Reliance Insurance Company (In
Liquidation)

CERTIFICATE OF SERVICE

I certify that, on this date, I caused a true and correct copy of the foregoing Liquidator's Reply Brief in Support of his Application for Relief in the Nature of a Motion to Confirm Under Seal and supporting papers to be served via email and U.S. First Class Mail upon the following:

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Dated: May 11, 2010