2004 DECISIONS OF INTEREST

PRESENTED TO THE

INTERNATIONAL ASSOCIATION OF INSURANCE RECEIVERS

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Introduction

Following is a discussion of cases decided during 2004, which relate to issues that arise in connection with delinquency proceedings. For the sake of simplicity, the summary generally does not contain citations to authority discussed or relied upon by the deciding court. The reader is referred to the text of the cases for that information. The cases are loosely organized based upon the principal issue raised by the parties; many cases, of course, discussed a number of the issues listed below.

The reader should note that since all of these decisions are recent, further appeals or rehearings may be granted which, as of this writing, are not reflected in WestLaw.

I. Stay of proceedings in other courts based upon provisions of Uniform Insurers Liquidation Act ("UILA")

A. ***Home Insurance Co. v. Montgomery County Comm'n***, 2004 WL 2829086, --- So.2d --- (Ala.2004) [NOT YET RELEASED FOR PUBLICATION], opinion issued Dec. 10, 2004.

Montgomery County moved, in Alabama Circuit Court, to enforce a settlement agreement between the County and the insolvent insurer undergoing rehabilitation in New Hampshire.

Holding: Under the UILA, the Alabama trial court was required to stay proceedings on the motion to enforce the settlement. Montgomery County was required to file its claim for the settlement amount with the insurer's liquidator in New Hampshire.

Background. In February 2003, Montgomery County and Home Insurance settled the County's case against the insurer. In March 2003, the New Hampshire Commissioner of Insurance filed a petition for rehabilitation of Home Insurance.

In May 2003, counsel for Home Insurance notified the County that he had received a check from Home Insurance payable to the County in the amount of the settlement but that he had been instructed not to deliver the check because Home Insurance had been placed into receivership in New Hampshire. The County moved the Alabama Circuit Court to enforce the settlement agreement.

In June 2003, the New Hampshire Superior Court entered an order of liquidation. In an order dated July 10, 2003, the Alabama Circuit Court then granted the County's motion to enforce the settlement and purported to enter a judgment against Home Insurance.

On appeal, the Alabama Supreme Court found that Alabama's version of the UILA required the County to seek enforcement of its settlement with Home Insurance's liquidator in New Hampshire, finding that New Hampshire is a reciprocal UILA state under the Alabama Code. The Alabama Circuit Court was thus without authority to enforce the settlement and enter judgment in favor of the County. The Court held that when an insurance company is undergoing rehabilitation or delinquency proceedings in another state that has adopted the UILA, Alabama courts should stay proceedings in Alabama, involving the insurance company.

B. ***SERIO, Superintendent of Insurance of the State of New York, as Rehabilitator of Frontier Insurance Company.* (*In re: Schillinger Place, L.L.C., et al. v. Cay-Chel, Inc., and Frontier Insurance Company*),** -- So.2d -- ; 2004 WL 1368204 (Ala. 2004) NOT YET RELEASED FOR PUBLICATION.

The New York Superintendent of Insurance, as rehabilitator of Frontier Insurance Company, petitioned for writ of mandamus to require the Circuit Court of Mobile County, Alabama ("the Alabama Circuit Court"), to enjoin an action against Frontier to recover on certain bonds, while permitting the Superintendent to pursue Frontier's counterclaims.

Holdings: (1) The New York rehabilitation order entitled the liquidator to a stay of the plaintiffs' Alabama action against Frontier; but (2) Although Frontier had shown that it has a right to maintain, in Alabama, its counterclaims against the Alabama plaintiffs, it had not shown a clear legal right to a particular timing of the disposition of its claims, thus the trial court had the option of deciding whether to leave Frontier's counterclaims on its administrative docket or restore them to its active docket.

Background: The plaintiffs in the underlying action entered into commercial development contracts with Cay-Chel, Inc., for each of which Cay-Chel executed with Frontier Insurance Company both a performance bond and a payment bond. After Cay-Chel defaulted on the contracts, the plaintiffs sued Cay-Chel and Frontier in the Alabama Circuit Court, and Frontier asserted counterclaims against the plaintiffs.

After the Alabama action had been pending for some time, Frontier became insolvent. The New York court (the "New York Court") issued its "Order of Rehabilitation. " The Order deferred until further order of the court, notice to all persons having claims against Frontier to file their claims, and enjoined such persons from prosecuting any actions or obtaining judgments against Frontier or the Rehabilitator.

The Alabama Circuit Court then placed the action between Cay-Chel and Frontier on its administrative docket pending a final order from the New York court regarding Frontier's status. Frontier moved the Alabama Circuit Court to reinstate Frontier's counterclaims to the court's active docket, and requested the court to continue to stay the plaintiffs' claims against Frontier. The circuit court instead reinstated the entire case to its active trial docket. Frontier then petitioned the Alabama Supreme Court for a writ of mandamus.

The Alabama Supreme Court found that Frontier had a clear legal right to have the plaintiffs' claims against it stayed, based on Alabama's version of the UILA. The Alabama Supreme Court found that New York is a reciprocal state under the Alabama UILA, thus the Alabama Circuit Court was bound to adhere to the New York Court's order.

As to Frontier's contention it was entitled to an order requiring that its counterclaims against the plaintiffs be placed on the active trial docket, the Alabama Supreme Court concluded that Frontier had not shown a clear legal right to that relief.

Frontier argued that under the Alabama UILA, the domiciliary receiver of an insurer in a reciprocal state may maintain an action in Alabama to recover assets to which he is entitled under Alabama law. The plaintiffs did not dispute this contention, but claimed they are entitled simultaneously to pursue their claims in the same action, should the receiver chose to maintain the action. They argued that not allowing them to assert their claims would result in a waste of judicial economy and undermine and seriously prejudice their rights and remedies.

The Court acknowledged that the same facts may be at issue in both the plaintiffs' claims and Frontier's counterclaims; however, it said, precluding the plaintiffs from asserting their claims against Frontier does not necessarily mean that those same facts will again be at issue in a later proceeding when the plaintiffs assert their claims. Citing other cases rejecting this contention, the court rejected the argument, as well.

Similarly, the Court rejected the plaintiffs' argument that they should be allowed to pursue their claims at the same time as Frontier because they have already invested several years in the litigation. Noting that courts rejecting that argument have been cognizant of the hardship suffered in such circumstances, the Court said that by enacting the UILA, the Legislature determined that such occasional instances of adversity are outweighed by the paramount interest of the various States in seeing that insurance companies domiciled within their respective boundaries are liquidated in a uniform, orderly and equitable manner without interference from external tribunals.

Interestingly, although the Alabama Court found that Frontier was entitled to maintain its counterclaims while plaintiffs' claims were stayed, it held that Frontier had no clear legal right, superior to the trial court's interests in avoiding piecemeal and possibly inconsistent dispositions of intertwined claims, to have those counterclaims moved off the administrative docket. The New York Order of Rehabilitation, the Court reasoned, states that notice to persons having claims against Frontier was deferred until further order of the New York Court, and that no information was provided by the parties concerning whether a process is in place pursuant to which the rehabilitator will receive claims such as the plaintiffs' in the Alabama action. Perhaps, the Court said, the plaintiffs' claims against Frontier will ultimately be allowed to proceed in Alabama, upon a lifting of the injunction.

The Court thus found that although Frontier had a right to maintain its claims even after entering into rehabilitation, it had not shown that it had a clear legal right to a particular timing of the disposition of its claims, and the trial court could exercise the option of leaving Frontier's claims on its administrative docket, or moving them to the active docket.

C. ***Olivine Corp. v. United Capitol Ins. Co.***, 92 P.3d 273 (Wash.Ct. App. Div. 1, 2004).

Lessor of property brought an action against United Capitol Ins. Co. ("United"), to recover pollution clean up costs. During the pendency of the initial appeal of the trial court decision[1], an Illinois court entered a liquidation order as to United, enjoining the parties from continuing to assert any claims against the insurer outside the Illinois liquidation proceeding. On remand from the initial appeal, the Washington trial court refused to dismiss the case.

Holdings: The Washington Court of Appeals found: (1) Illinois was a reciprocal state

[1] The trial court entered summary judgment in favor of the lessor and the Court of Appeals affirmed. The Washington Supreme Court affirmed in part and reversed in part and remanded. *Olivine Corp. v. United Capitol Ins. Co.*, 19 P.3d 1089 (Wash. Ct. App. 2001), reversed in part,

under the UILA, thus the Washington trial court was required to stay or dismiss the action. (2) Although the Washington Supreme Court's August 2002 opinion in the initial appeal was issued after the Illinois order to stay, the Court of Appeals would not vacate it, since (1) it has no power to vacate a Supreme Court opinion, and (2) the Illinois order was never brought to the Supreme Court's attention.

Background. The Washington State trial court granted summary judgment in Olivine's favor and against United, on coverage and damages issues. In March 2001, the Washington Court of Appeals affirmed. In November 2001, an Illinois circuit court issued an Order of Liquidation against United, which prohibited parties from prosecuting claims against it outside the liquidation proceedings. One month after this order was issued, the Washington Supreme Court agreed to review the Court of Appeals' March 2001 decision affirming coverage and damages. Neither Olivine nor the insurer notified the Supreme Court of the Illinois court's order. In August 2002, the Supreme Court affirmed in part and reversed in part, and remanded to the trial court to determine whether any issues of material fact on the coverage issue remained.

On remand, United moved to dismiss or stay the proceedings in light of the Illinois order. The trial court ultimately denied the motion and ordered discovery. United appealed.

Olivine argued on appeal that United's position as to the stay was contradictory. On the one hand, United sought to benefit from the Washington Supreme Court's decision remanding the case in part, yet now claims that the Illinois order that was issued *before* the Supreme Court's decision bars further proceedings on remand. Olivine thus asked that the Supreme Court's decision be vacated on the ground that the court lacked subject matter jurisdiction. Olivine contended that if the Illinois order divested Washington courts of jurisdiction, then the Supreme

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52 P.3d 494 (2002).

Court's August 2002 opinion, issued after the Illinois order, was void. By vacating the Supreme Court's opinion and reinstating the March 2001 opinion, Olivine would win against United.

The Court of Appeals found the Olivine argument "flawed." First, it noted, it cannot vacate a Supreme Court opinion. Second, a judgment entered by a court that lacks jurisdiction must be vacated once that lack of jurisdiction is brought to the court's attention. Even if the Court of Appeals could vacate the Supreme Court's opinion, it would be inappropriate to do so because the Illinois order was never brought to the Supreme Court's attention, but was not introduced until the case returned to the trial court. At that point, the Court of Appeals said, the trial court should have recognized that it lacked jurisdiction and dismissed the case, as it had no discretion when dealing with a void judgment, but must vacate it.

The issue, the Court of Appeals held, is not the validity of the Supreme Court's previous ruling but the effect of the Illinois court's order on the case in its present posture. Because the Court of Appeals was required by Washington law to respect the Illinois order, it must reverse the trial court's order denying United's motion to dismiss or stay the proceedings.

The Court of Appeals also addressed Olivine's contention that United waived its right to a stay or dismissal by failing promptly to alert the appropriate Washington court to the Illinois court's order. The Court stated that waiver applies in the insurance context if the insurer voluntarily and intentionally surrenders a known right or if its conduct may be interpreted as relinquishing this right. An insurer only waives a right if it made a conscious decision to do so, and the insurer must know that certain conduct has the effect of relinquishing a right. Here, the Court of Appeals held, United's behavior did not amount to a waiver, as it was unlikely United consciously intended to waive its right to a stay or dismissal. United should have notified the Court as soon as it became aware of the Illinois order, but its failure to do so does not confer jurisdiction on Washington courts when a statute deprives them of that jurisdiction.

Finally, Olivine argued that United lost its right to comity and full faith and credit by disregarding a trial court order. The trial court had ordered United to tender a cash deposit or post a supersedeas bond by November 12, 2001. United failed to comply. The Illinois court issued its liquidation order two days after the cash deposit/bond was due. Olivine claimed that because United and the State of Illinois failed to comply with the Washington order, Illinois failed to give full faith and credit and act with judicial comity; therefore, the Court of Appeals need not apply comity or full faith and credit to the Illinois order.

The Court of Appeals rejected that argument, stating that under the United States Constitution's Full Faith and Credit Clause, another state's judgment is valid in Washington unless the foreign state lacked jurisdiction or the judgment is constitutionally invalid. The Illinois court issued an Order of Conservation in September 2001, which enjoined United from paying any claims or contractual obligations without the court's approval. If this order is the reason United failed to comply with the trial court's order, the Court said, United should have called it to the attention of Olivine and the trial court. Nevertheless, failure to comply with the trial court's deposit/bond order is an insufficient reason to disregard Illinois' right to seek a stay of the proceedings. Notions of judicial comity and full faith and credit directed the court to respect the Illinois court's order by dismissing the case.

D. ***A.B. Medical Services PLLC, D.A., et al., v. Highlands Ins. Co.***, 4 Misc.3d 1020(A), 2004 WL 1977619 (N.Y.City Civ.Ct.), 2004 N.Y. Slip Op. 50978(U) (Unpublished Disposition) (Civil Court, City of New York, New York County).

Defendant insurer in New York proceedings moved without opposition for a stay based on an Agreed Permanent Injunction and Order Appointing Receiver issued by the District Court of Travis County, Texas.

Holding. While only Louisiana courts have specifically ruled on whether Texas is a reciprocal state under the UILA, holding that Texas does not qualify,[2] even if the New York court did not afford Texas reciprocal state status, the court may extend comity to Texas by enforcing the Texas Order's stay. Finding the UILA's purpose is to break down the differentiation among the states which prevented some of them from extending comity to other states in the liquidation of non-domiciliary insurers, the New York court recognized the Texas Order and granted defendant's motion for a stay.

E. ***All Star Advertising Agency, Inc., d/b/a/ All Star Automotive Group v. Reliance Ins. Co. in Liquidation,*** 871 So.2d 371 (La.App. 1 Cir. 2004); **Writ Granted at 2004 WL 2900580, 2004-1544 (La. 11/15/04) (La. Nov 15, 2004) (NO. 2004-C-1544), further appellate proceedings pending.**

Insured sought preliminary injunction preventing insurer placed into liquidation by order of the Commonwealth Court of Pennsylvania, from drawing on insured's standby letter of credit to satisfy retrospective premium adjustment. The District Court granted insurer's exception for lack of subject matter jurisdiction, and insured appealed.

Holding: Insurer was subject to suit in Louisiana because (1) Pennsylvania is not listed in the "Table of Jurisdictions Wherein [the UILA] Has Been Adopted," thus is not a reciprocal state, and (2) full faith and credit and comity do not require Louisiana to recognize the Pennsylvania Order if to do so it will violate the positive law or public policy of Louisiana, as is the case here, where the "unequivocal policy" of Louisiana is that no foreign insurer may do business in Louisiana without being prepared to answer any claims based on that business in the

[2] Citing *Bonura v. United Bankers Life Ins. Co.,* 552 So.2d 1248, 1251 (La.Ct.App.1989); and *Krueger v. Trabor*, 546 So.2d 1317, 1320 (La.Ct.App.1989).

Louisiana courts.

NOTE: **Writ to the Louisiana Supreme Court has been granting and as of this writing the appeal in that Court is pending.**

Background. Reliance Insurance Company ("Reliance") was placed into liquidation by the Commonwealth Court of Pennsylvania, on October 3, 2001. The Order of Liquidation provided that all assets of Reliance are found to be *in custodia legis* of the liquidation Court and that Court specifically asserted, to the fullest extent of its authority, *in rem* jurisdiction over all assets of Reliance wherever located, and exclusive jurisdiction over all determinations of the validity, amount, priority, and distribution as to all claims against Reliance. The Order provided that no action shall be brought against Reliance or the Liquidator, whether in the Commonwealth or elsewhere, nor shall any such existing action be maintained or further prosecuted, but all such actions are stayed, and shall be submitted and considered as claims in the liquidation proceeding.

Prior to the Liquidation Order, the plaintiff ("All Star"), purchased policies of automobile liability coverage and workers' compensation coverage from Reliance, and as part of the agreement, All Star and Reliance entered into a Retrospective Premium Endorsement. To secure its obligation to Reliance, All Star established an Irrevocable Standby Letter of Credit with Bank One.

When Reliance demanded payment of additional premiums due, All Star filed a Petition For Temporary Restraining Order and for Preliminary Injunction against Reliance in the Louisiana district court. Reliance objected based in part upon lack of subject matter jurisdiction. The district court found that pursuant to the Order of Liquidation in Pennsylvania, the Court lacked subject matter jurisdiction over the proceedings, and that the liquidation order must be given full faith and credit.

All Star appealed, contending that because it was not asserting any claim for monetary damages against Reliance or any relief that would affect the legitimate corpus of Reliance's assets, the Order of Liquidation did not grant exclusive jurisdiction to the Pennsylvania Court. The Louisiana Court of Appeals found that the trial court erred, but for reasons other than those argued by All Star.

Reliance contended that the Louisiana District Court lacked jurisdiction based on the provisions of the UILA as adopted in Louisiana; and that Pennsylvania is a reciprocal state as defined by Louisiana's UILA, thus, the Order of Liquidation is entitled to full faith and credit in Louisiana. Moreover, Reliance asserted that Louisiana law requires that where, as here, no ancillary receivership proceedings have been initiated in Louisiana, Louisiana residents must assert their claims in the proceedings of the domiciliary state of the foreign insurer--in this case, Pennsylvania.

The Louisiana Appellate Court, noting that Pennsylvania is not listed in the "Table of Jurisdictions Wherein [the UILA] Has Been Adopted," found without further analysis that Pennsylvania is not a reciprocal state. Accordingly, it held, the provisions of the UILA are not applicable to the case and cannot operate to confer exclusive jurisdiction over All Star's claims against Reliance in the Pennsylvania court.

Moreover, the Court said, although full faith and credit and the doctrine of comity might otherwise require Louisiana to recognize the Pennsylvania Order, the Louisiana Court is not required to do so if it will violate the positive law or public policy of Louisiana. The Court noted previous Louisiana case law indicating the "unequivocal policy" of Louisiana that no foreign insurer may enjoy the benefits of a source of business in this state without being prepared to answer any claims based on that business by a Louisiana resident in the Louisiana courts.

Based upon this policy, the Louisiana Court of Appeals found that the trial court erred in finding a lack of subject matter jurisdiction, based upon the Pennsylvania Court's order. Appeal to the Louisiana Supreme Court is pending.

II. Other decisions construing the UILA/NAIC Model Act.

A. Liquidation court's jurisdiction to determine right to remainder of special deposit.

In the Matter of Levin, Superintendent of Insurance of the State of New York v. National Colonial Ins. Co., and Chase Manhattan Bank, N.A., 806 N.E.2d 473 (N.Y. 2004).

New York conservator of trust fund created to allow now-insolvent Kansas insurer to sell excess line insurance in New York brought special proceeding seeking an order for distribution of the trust's remainder as between the New York trustee (Chase) and the Kansas liquidator. The Supreme Court, New York County, had ordered the funds distributed to the New York trustee. The Appellate Division, relying on full faith and credit, reversed and remanded[3], ruling that disposition was to be made by the Kansas liquidator as part of the Kansas liquidation proceeding because New York lacked jurisdiction to resolve Chase's claim. The New York Court of Appeals affirmed, but found full faith and credit inapplicable, and instead rested its holding that the Supreme Court lacked jurisdiction on the provisions of the Uniform Insurers Liquidation Act.

Holding: The New York conservator has authority under UILA special deposit claim provision to recover the special deposit and liquidate from it any claims made under covered policies, but the Kansas liquidation court was the proper forum for adjudicating competing claims for the remainder of the special deposit.

Background. In 1989, National Colonial Insurance Co. ("NCIC"), a Kansas insurer, sought to write excess and surplus line insurance policies in New York. New York required

NCIC to establish a trust fund exclusively for payment of claims under policies issued to a resident of or with respect to property situated in New York. NCIC funded the trust by depositing $750,000 with Chase as trustee.

The trust agreement with Chase specified that on its termination and payment of outstanding liabilities, the remainder would be distributed to NCIC. It provided that in the event NCIC was found insolvent pursuant to the laws of Kansas, the trustee was to disburse the trust fund at the direction of the New York Superintendent of Insurance in accordance with New York law.

After the Kansas Insurance Department notified NCIC that the trust agreement did not comply with Kansas law, Chase proposed alternative wording and advised that in the event this wording was unacceptable, NCIC will have to identify a new trustee and transfer the trust assets. NCIC advised Chase that the Kansas Insurance Department rejected its proposed wording and Chase notified NCIC that it could not accept the amendment to the trust agreement required by Kansas. At NCIC's direction, Chase electronically transferred the trust's assets (NCIC's original deposit of $750,000 plus interest, for a total of $917,846) to NCIC. In so doing, Chase violated several of the trust agreement's express terms, and New York regulations, including the requirement to notify the New York Superintendent upon the trust's termination.

In 1993, a Kansas District Court placed NCIC in liquidation. The liquidation order directed the Kansas liquidator to take possession of NCIC's property, business and affairs, and vested him with title to all NCIC's property. The order also enjoined all persons from bringing or further prosecuting any actions or claims against NCIC or its property or assets.

The New York Insurance Department then demanded a complete explanation from Chase

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[3] 745 N.Y.S.2d 28.

as to why the bank had released the trust funds to NCIC. Chase responded by replenishing the trust fund with $750,000 of its own.

In 1994, the New York Superintendent petitioned the New York Supreme Court for an order authorizing him to take possession of the trust as conservator under New York insurance law. Chase claimed entitlement to any funds remaining in the trust after valid policyholder and beneficiary claims had been satisfied, because the trust's funds were comprised solely of monies that it had contributed. Chase also filed a $750,000 proof of claim with the Kansas liquidator. NCIC argued that the trust remainder, if any, was part of the estate's general assets.

The New York Supreme Court granted the New York Superintendent possession of the trust as conservator, and enjoined all persons from bringing or further prosecuting in New York any action or claim against NCIC or the trust, and generally restrained all individuals from doing anything that might waste the trust while in the Superintendent's possession. The order directed the Superintendent to petition the Supreme Court, on notice to Chase and the Kansas liquidator, for further direction should trust funds remain upon the satisfaction of all outstanding claims by NCIC's insureds and beneficiaries.

In February 2000, the Kansas court approved the Kansas liquidator's recommended allowances for claims to NCIC's estate. The Kansas order included Chase, with a claim of $750,000, as a Class IV general unsecured creditor of the estate. Chase did not object to the Kansas order or take any further action in Kansas as to its claim to the trust remainder. The Kansas liquidator prepared an unaudited Statement of NCIC's Net Assets in Liquidation, which included as a potential recoverable, $987,229 in the New York Special Deposit. The Kansas liquidator noted that a dispute surrounding release of this deposit to the NCIC estate may arise.

In December 2000, the New York Superintendent brought the special proceeding in the

New York Supreme Court, advising that Chase and the Kansas liquidator both claimed entitlement to the trust remainder, and seeking an order directing its distribution. He relied on an affidavit in which the Kansas liquidator averred that there are and will be no claims upon the New York Trust Fund.

The Supreme Court determined that the funds deposited by Chase had not become a part of NCIC's estate, and entered an order directing that the trust remainder be distributed to Chase because otherwise NCIC would enjoy an "unjust windfall." The Appellate Division reversed, ordering distribution of the trust to the Kansas liquidator, reasoning that the Kansas court had jurisdiction over the disposition of the trust asset and the liquidator in that proceeding should determine distribution of the asset.

The New York Court of Appeals affirmed. The Court noted that New York adopted the UILA in 1940, with the purpose of providing a uniform system for the orderly and equitable administration of the assets and liabilities of defunct multistate insurers. Because of similarities between New York and Kansas law, the Court of Appeals found that Kansas qualified as a reciprocal state for purposes of the UILA, and that under the UILA, when assets of a nondomiciliary insolvent insurer are located both within and without New York, and when receivers have been appointed in both New York and the domiciliary state, the UILA recognizes the authority of the domiciliary state and its receiver over all of the insolvent insurer's assets, including those located in New York. Nonetheless, the Court said, when a New York receiver has been appointed, New York has the primary right to liquidate the special deposit claims.

The Court of Appeals found that the trust was a special deposit under New York law and that New York's policy regarding its authority over statutory special deposits, and its ability to conserve these assets for the beneficiaries of the trust, is consistent with the policy in Kansas.

Kansas, the Court found, recognizes the right of an ancillary receiver to liquidate special deposit claims and secured claims which are proved and allowed in the ancillary proceedings, when a domiciliary receiver also exists. Moreover, the Court found, nothing in the liquidation order contravenes New York's jurisdiction over the trust. Kansas exercises jurisdiction over NCIC's assets, but NCIC's interest in the trust fund was a contingent, remainder interest.

The New York conservator, the court held, had authority under the UILA to recover the trust fund and liquidate from it any claims made under covered policies. However, it said, since neither Chase nor NCIC was the holder or beneficiary of a policy protected under the trust, their claims to the remainder could not be adjudicated by the New York Court under the UILA's special deposit authority. The issue therefore became whether the New York Court properly exercised jurisdiction to resolve Chase's and NCIC's competing claims to the trust remainder.

The Court observed that the UILA is silent on some issues, because it was not intended as a comprehensive scheme displacing all state laws, substantive and procedural, relating to liquidation of insolvent insurance companies. However, as to its silence on the current issue, the Court said, the issue implicates one of the core "embarrassments" the UILA was designed to remedy -- "the ineffective administration of the liquidation process caused by differences in the laws of the various States regarding the title and right to possession of the property of a defunct nonresident insurer." The UILA's only statement bearing on the trust remainder, it said, is that after liquidating those special deposit claims and secured claims which are proved and allowed in the ancillary proceedings in New York, and paying the necessary expenses of the proceedings, the ancillary receiver shall promptly transfer the remainder to the domiciliary receiver.

The Court therefore concluded that in order to promote the UILA's goal of orderly and equitable liquidation proceedings, the domiciliary state is the proper forum in which to adjudicate competing claims to the trust remainder.

The Court noted that the Kansas liquidator included the trust remainder as an asset of NCIC's estate even though the remainder's value was contingent at the time. By entertaining Chase's claim of ownership, the New York trial court delayed the orderly administration of claims in Kansas. Once the conservator determined that there were no special deposit claims, the New York Court should have transferred the trust remainder to the Kansas liquidator. While the unusual facts of this case may complicate the UILA's plan for efficient administration, the Court said, they should not be allowed to override it.

This approach, the Court reasoned, is consistent with the modern trend in insurance liquidation as evidenced by the Model Act. In 1994, according to the Court, the Model Act was revised in a manner that substantially curtails the ancillary receiver's authority by requiring that upon entry of a final order of liquidation, all special deposits shall be delivered to the domiciliary liquidator and held as a general asset for the benefit of all creditors, and limiting the ancillary receiver's authority to proceedings that support the domiciliary proceeding. These changes, according to the Court, were intended to discourage retention of special or statutory deposits by nondomiciliary states in the event of a multistate insolvency. The basic principle behind the amendments is that insurers should be rehabilitated or liquidated in their state of domicile pursuant to the laws in that state, and that the domiciliary commissioner is in the best position to carry out that function.

The Appellate Division, the Court of Appeals noted, relied on full faith and credit to determine that New York lacked jurisdiction to resolve Chase's claim. The Court of Appeals, however, found full faith inapplicable, and instead rested its holding that the Supreme Court lacked jurisdiction on the provisions of the UILA. The decision, the Court noted, would not foreclose Chase from pressing a claim to the trust remainder in the Kansas proceeding.

B. Notice to policyholders and creditors.

Matter of Liquidation of American Mutual Liability Ins. Co., 802 N.E.2d 555 (Mass.2004).

Liggett Group Inc. (Liggett) purchased liability insurance policies from AMLICO from 1911 through 1979, but not thereafter. The policies issued during that time were occurrence policies, providing coverage for events taking place during the term of the policy regardless of the date the claim was filed. In 1989, AMLICO was declared insolvent. No notices were sent to Liggett regarding the insolvency.

Holdings: (1) The term "policyholders" in statute entitling policyholders to written notice of appointment of receiver for insurer is limited to parties with in-force policies at the time of the appointment. (2) The remedy for a receiver's failure to give proper written notice of appointment of receiver for insurer is not an extension of the deadline for filing a claim. (3) The holder of an insurance policy is not a "known creditor" within the meaning of the statute permitting liquidation of an insurance company after notice to all known creditors.

Background. In 1989, AMLICO was declared insolvent, and notice of the appointment of a receiver was given to all in-force policyholders.[4] Later, an order was entered establishing March 9, 1990, as the claim filing deadline, and notices were again mailed.[5]

Liggett was not mailed a copy of either notice. In 2000, Liggett submitted a claim to the

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[4] The notice was mailed to approximately 230,000 persons, including known creditors and in-force policyholders, and to all persons who purchased policies in the preceding five years. Notice was also published in the national edition of The Wall Street Journal and 16 other newspapers.

[5] This form, including the filing deadline, was sent to over 230,000 persons identified as "potential creditors," including in-force policyholders and those who had purchased policies during the previous eight years. Notice was also published in newspapers in the capital cities of all states, the District of Columbia, Puerto Rico, and Canada.

Massachusetts receiver for alleged losses. The Receiver determined that the claim was untimely.

Liggett contended its status in the liquidation was either that of a policyholder or of a known creditor, or both, and therefore it was entitled to receive notice of the proceedings. Because it received neither notice, Liggett contended that its claim, filed ten years after the claim filing deadline, should not be barred. A special master concluded Liggett qualified as a “policyholder” under the statute, and should have been sent notice of the receiver's appointment, but was not a known creditor entitled to notice of the receiver's application for liquidation, unless it could show that it had made a claim against AMLICO under its policy. The special master determined that the remedy for the receiver's failure to give notice of his appointment, absent possible estoppel or laches, was to treat Liggett's claim as timely.

The Massachusetts Supreme Court found that while Massachusetts law provides for notice of insolvency proceedings to “all policyholders of the company,” there is no statutory provision for notice of the claim filing deadline, although the liquidation court has historically ordered that such notice be given to potential claimants. The first issue was thus whether “policyholders” encompasses owners of “occurrence” policies whose policies are no longer in force at the time of the receiver's appointment. The Court held it does not.

The Court found that because the statutory language does not provide a definite answer to the question, it was appropriate to consult other sources, including relevant legislative history. The section in question was enacted in 1939, the Court said, as part of legislation based on the Uniform Insurers Liquidation Act (UILA). The notice requirement in the section, however, was not part of the UILA; rather, it was a reenactment of an essentially identical provision that predated the UILA, originally enacted in 1924, on the recommendation of the Commissioner.

The Commissioner's explanation of the reason for his recommendation[6], according to the Court, "supports the proposition that its purpose is to prevent parties from sustaining uninsured loss by giving them actual notice of the appointment of a receiver, thereby allowing them to secure an alternative source of insurance for future occurrences at the earliest possible moment." The fulfillment of this purpose does not require that the term "policyholders" include purchasers of occurrence policies whose policy periods have expired. In contrast to current holders of in-force policies, former purchasers are not, at the commencement of a receivership proceeding, covered for future occurrences; consequently, notice of the appointment of a receiver would not prevent those parties from sustaining future uninsured loss. Although owners of occurrence policies whose coverage periods have expired might seek to replace coverage by buying claims-made policies, the Court found, this kind of replacement is plainly not what the Legislature sought to facilitate by enacting the notice section. Moreover, the Court reasoned, it is unlikely that the Legislature, either in 1924, when it initially enacted former section, or in 1939, when it recodified it, would have looked beyond the predominate traditional "occurrence" model to anticipate the subsequent development of claims-made coverage.

In addition, the Court found, the Legislature could not have intended receivers to shoulder the unreasonable burden of providing notice to all former purchasers of occurrence policies. The notice section requires the receiver to mail notice to the last address of the insured appearing on the records of the company. In this case, AMLICO had address records relating to policies issued as far back as 1911, only the most recent years of which were accessible within

[6] The Commissioner explained: "A large number of cases have come to the attention of the Department in connection with these receiverships in which the insured had no actual knowledge that his policy had been terminated by the appointment of a receiver until long after the appointment and in several cases the insured sustained a fire loss after the receiver's appointment of which he had no knowledge."

AMLICO's computer system. If Liggett's reading were adopted, the receiver would have had twenty days to locate and mail notice to all of the addresses contained in seventy-eight years of archived records. This burden, which would accrue in any receivership involving an insurer that had been in business over an extended period of time, is unreasonable and could not have been intended by the Legislature. And, the Court noted, some, if not most, of the older addresses would have been hopelessly out of date.

While ensuring that parties are on notice to protect their contract rights may be a laudable goal, the Court said, it is not the purpose behind the notice provision. If notice of the appointment of a receiver to all parties to which the insurer owed contractual rights were the goal, the statute would be grossly underinclusive: it provides notice only for policyholders, excluding other parties--including creditors--who might also wish to take steps to better protect their contractual rights. Moreover, the appointment of a receiver by itself--the event that triggers the first notice-- has no effect on parties' contractual rights, as the notice is required regardless of whether the insurer might ultimately undergo rehabilitation or liquidation. The events of legal significance to a party with contractual rights are the actual liquidation of the insurer and the claim filing deadline. Notice of a receiver's application to liquidate is provided under another provision of the law, to "known creditors," and notice of a claim filing deadline will be broadly provided to potential claimants, consistent with the principles of due process.

The Court said that although the term "policyholders" is ambiguous, consistent with the legislative history, purpose, and the practical effect of the requirement set forth in the notice section, the Court construed the term to be limited to parties with in-force policies at the time of the appointment of a receiver.

The Court next addressed whether the remedy for a receiver's failure to give proper notice under is to permit the filing of a claim after the claim filing deadline[7]. The Court observed that the section makes no express provision for a remedy, but merely states that the receiver "shall" give notice of his appointment. Where the language of a statute provides no express remedy, the Court said, propriety of a proposed remedy is considered in light of the purposes of the statute.

Having found that the primary purpose of notice of the receivership is to prevent insured parties from sustaining future uninsured loss by allowing them to secure an alternative source of insurance, the extension of the claim filing deadline for losses that have already occurred is unrelated to this purpose. Moreover, the underlying event for which this notice is provided has nothing to do with filing claims or the claim filing deadline because at the time a receiver is appointed the need for liquidation and a claims filing period will be undetermined. If this becomes necessary, other notice provisions apply. Consequently, the extension of the claim filing deadline, the Court held, is not consistent with the purposes of notice of the receivership.

Additionally, the Court reasoned, permitting the extension of the claim filing deadline when a receiver fails to give adequate notice would undermine one of the chief purposes of the Insurance Liquidation Act--to ensure the prompt, fair, and orderly processing of claims against insolvent insurers. The extension of the claim filing deadline would only be an appropriate remedy where the specific failure bears directly on the fairness of the liquidation or the claim filing process. Violation of the notice requirement for initiation of the receivership does not rise to that level.

Finally, the Court addressed whether the holder of an insurance policy is a "known creditor" for purposes of the notice to creditors at the time a receiver seeks an order of

[7] The Court noted that its answer to the notice issue question technically rendered this issue moot; however, it made an exception to the general rule against hearing moot claims because of the public interest involved and the uncertainty and confusion that exists.

insolvency, and a claims deadline is imposed. The text of the statute, denominated § 180C, provides, "The court, after notice to all known creditors and stockholders of the company and a full hearing, may order [the insurer's] liquidation and appoint the commissioner as permanent receiver thereof....The rights and liabilities of the company and of its creditors, except those holding contingent claims, and of its policyholders, stockholders or members, and of all other persons interested in its assets, shall, unless otherwise ordered by the court, be fixed as of the date of the decree ordering liquidation."

The Court noted that the Legislature's use of the term "creditor," and its juxtaposition with the term "policyholder" in the statute, strongly suggests that it did not intend the status of mere "policyholder" to be the equivalent of "creditor." If all "policyholders" were "creditors," there would have been no need to list them as a separate category of interested persons in a liquidation.

A creditor, the Court said, is one to whom a debt is owed. While the relationship between insurer and policyholder is contractual, policies almost universally require an insured to give notice to an insurer (typically by filing a claim) before the insurer owes anything to the policyholder under the policy. The contractual relationship between a policyholder and an insurer is not converted to one of creditor and debtor until at least that step is taken. Because this principle holds for almost all insurance policies, and because requiring a receiver to search the text of each policy for exceptions would undermine the Legislature's clear preference in favor of expedient and final resolution of liquidation proceedings, the Court held that a policyholder does not become a "creditor" for the purpose of § 180C notice until that policyholder files a claim with the insurer.

The Court also held, for the same reasons, that an insurer's awareness from any source that a claim will likely be made in the future does not transform the insured into a "known creditor." Identification of known creditors to whom notice must be given cannot depend on subjective predictions of the insurer's employees, but rather on the insurer's records of claims actually made.

C. Ancillary vs. Domiciliary Receivers.

In re Lifeco Investment Group, Inc., Debtor, 173 B.R. 478 (U.S.B.C., D. Del.).

Florida Department of Insurance, as ancillary receiver for insolvent insurance company not domiciled in Florida, moved for Rule 2004 examination and for change of venue in Chapter 11 case of insurance holding company that owned the insolvent insurer.

Holding. The Florida Department lacked standing to bring either motion because it was not the real party in interest.

Background. In June 1994, Lifeco Investment Group, Inc. ("Lifeco"), a holding company incorporated in Florida, filed for relief in Delaware, under Chapter 11 of the U.S. Bankruptcy Code. Lifeco's primary asset was National Heritage Life Insurance Company ("National"), a life insurance company incorporated in Delaware. Lifeco's selection of Delaware venue rested on the facts that National was a Delaware corporation subject to regulation by the Delaware Department of Insurance (the "Delaware Department") and National was currently in a rehabilitation proceeding in the Delaware Court of Chancery.

Both Lifeco and National had their principal places of business in Orlando, Florida. Most of Lifeco's 20 largest creditors were located in Florida, and its largest creditor was National, with a claim of approximately $8,000,000. While National sold insurance in many states, its income from Florida residents was larger than that of any other state, representing 35% of its annual premium income. Its annual premium income from Delaware residents was only .5% of the total. According to the Florida Department of Insurance (the “Florida Department”), National was insolvent by $161,000,000 and the Florida Life and Health Insurance Guarantee Association would have to contribute an estimated $160,000,000 to meet the shortfall to pay Florida policyholders. The Florida Department, the Court found, therefore had an interest in the affairs of National.

National’s principal assets were mortgages and mortgage backed bonds secured by properties located throughout the U.S. Few of the mortgages were with respect to Florida properties. The mortgages were being serviced by several different companies located in states other than Delaware and Florida.

The day after entry of the Rehabilitation Order in May 1994, the Circuit Court of Leon County, Florida, appointed the Florida Department as ancillary receiver of National (the “First Ancillary Order”). Lifeco then filed its Chapter 11 petition in Delaware on June 6, 1994, then on June 22, 1994, the Florida Department obtained an order from the Leon County Circuit Court directing it, as ancillary receiver, to pursue causes of action and take all necessary action in the bankruptcy case as a creditor of Lifeco, to protect the interest of Florida policyholders and claimants (the “Second Ancillary Order”).

The Florida Department asserted it had standing to argue its motions before the bankruptcy court because (a) it is a creditor of Lifeco by virtue of being the ancillary receiver of National, and (b) it has a significant economic and regulatory stake in the Chapter 11 case. Lifeco and the Delaware Department argued that (a) pursuant to the Delaware Rehabilitation Order, the Delaware Department, as domiciliary receiver, held title to National's claim against Lifeco, and (b) the Florida Department's regulatory interest in National's rehabilitation is too remote to give it standing in Lifeco's bankruptcy case.

The Court noted that a Rule 2004 examination can be ordered “on motion of any party in interest.” Similarly, a properly filed case can be dismissed or transferred to another district “on timely motion of a party in interest.”

The Court found that both the Delaware receiver and the Florida receiver are involved in the affairs of National pursuant to the UILA adopted by each state. The Court reasoned that there are two important features of the UILA: (1) where an insurer is in a rehabilitation or liquidation proceeding the department of insurance of the state in which the insurer is domiciled has paramount authority and control, and (2) the concept of comity is accorded to reciprocal states -- states which have adopted the UILA. Delaware and Florida, the Court found, are reciprocal states with respect to each other.

The Bankruptcy Court was less than enamoured with the UILA, stating that it “is not a model of clarity.” Indeed, the Court said, “except for those who may be steeped in its genesis and application, I suspect that others share my view that many of its provisions are obtuse and confusing.” Nevertheless, the bankruptcy judge “attempt[ed] to articulate my discernment of the provisions applicable to the issue before me.”

The Court noted, first, that the Delaware Department commenced a delinquency proceeding with respect to National, for the purpose of rehabilitation. The Court examined the powers and duties of the Delaware domiciliary receiver under the Delaware UILA, as well as pursuant to the Rehabilitation Order. By reason of the Rehabilitation Order, the Court found, the Delaware Department, as domiciliary receiver, had the exclusive right to deal with National's assets, including its $8,000,000 claim against Lifeco, for the benefit of National's policyholders, stockholders and creditors.

However, the Court said, Section 5913(b) of the Delaware Act carves out an exception to the domiciliary receiver's powers for ancillary receivers, providing that ancillary receivers "in reciprocal states shall have, as to assets located in their respective states, the rights and powers which are herein prescribed for ancillary receivers appointed in this State as to assets located in this State." The Florida Act, the Court noted, contained a similar provision in its version of the Uniform Act. After examining various provisions of each act, however, the Court ultimately agreed with Florida that its ancillary receivership was pursuant to a conservation concept governed by § 631.131(1) of the Florida Act. The Court found, however, that "Unfortunately, the Uniform Act provides little guidance on what is intended by authorizing the ancillary receiver "to conserve" property.

The Court then turned to UILA case law, pursuant to which the Court found that an ancillary receiver's role is subordinate to that of the domiciliary receiver.

The Court then went on to discuss the specific wording of the Delaware Rehabilitation Order and the Florida First and Second Ancillary Orders. It found that the Second Ancillary Order conflicted with the Rehabilitation Order, which authorized the Delaware Department to operate National's business, whereas the Second Ancillary Order authorized the Florida Department to liquidate National's business in Florida. Additionally, the Rehabilitation Order gave the Delaware Department exclusive authority to pursue claims, including the $8,000,000 claim against Lifeco, whereas the Second Ancillary Order purported to grant that authority to the Florida Department.

Equally important, the Court found, was the fact that the Second Ancillary Order was defective as to its statutory basis. Neither of the sections of the Florida Act it relied upon was authority for a receiver in conservation to obtain the type of order that was granted. Section

631.091 of the Florida Act provided the Florida department may apply to the circuit court for an order appointing it as ancillary receiver of, and directing it to liquidate the business and assets of, a foreign insurer which has assets, business, or claims in Florida, upon the appointment in the domiciliary state of such insurer of a receiver, liquidator, conservator, rehabilitator, or other officer, for the purpose of liquidating the business of such insurer. The Delaware Department, as domiciliary receiver, was engaged in rehabilitation, not liquidation, the Court found; consequently, there was no basis for the Florida Department to invoke § 631.091.

Section 631.152 of the Florida Act, the Court noted, grants an ancillary receiver authority over three types of assets: statutory deposits, special statutory deposits and property subject to a security interest. The claim against Lifeco, the Court found, did not fall within any of the three categories.

While the Court noted that it obviously had no authority to declare the Second Ancillary Order void or otherwise to modify it, for purposes of deciding whether the Florida Department, as ancillary receiver, is a party in interest in the bankruptcy, the Court declined to be bound by an order which it found (a) patently conflicts with a prior rehabilitation order and (b) the court found was incorrectly granted. The Court concluded the Florida Department was not a party in interest based on its purported position as the representative of National's claim against Lifeco and had no standing as a creditor of Lifeco.

The Court next turned to the Florida Department's argument that it had standing because it has a significant economic and regulatory stake in the case. The Court rejected the proposition that anyone with an economic stake in the outcome of a bankruptcy case has standing to participate in that case, finding that pursuant to the purposes of the UILA, the Delaware Department, as domiciliary receiver, was charged with pursuing the interests of all the constituents of National in its parent's bankruptcy case. Following the reasoning of the Florida Department, insurance commissioners in any state in which National sold policies or had assets would also have standing. Allowing such participation, the Court said, would not only burden the case administration but could create confusion and conflict. By reason of the Rehabilitation Order the Delaware Department, as domiciliary receiver, would speak for National with respect to all its interests. To allow others to participate in that role runs counter to the purpose and intent of the UILA. The Court noted that it appeared that the two Departments had ended up in just the type of conflict the UILA was designed to avoid. To give the Florida Department standing in this case would produce a situation in conflict with the fundamental purpose for which the UILA was adopted.

D. *Koken, Insurance Commissioner, Commonwealth of Pennsylvania v. Legion Ins. Co.*, 2004 WL 1987368 (Pa.Cmwlth.)

Bank of America, N.A., as successor to NationsBank, N.A. ("Bank"), applied for relief from the stay of litigation against Legion Insurance Company In Liquidation ("Legion"). The Bank sought relief from the statutory stay to pursue a counterclaim against Legion in an action pending in Florida. Prior to being placed in receivership, Legion had initiated the Florida lawsuit against the Bank, and the Bank had filed a counter-claim against Legion.

Holding. The Pennsylvania statute based upon the National Association of Insurance Commissioner's Model Supervision, Rehabilitation and Liquidation Act, is interpreted to mean that a defendant may not pursue a counterclaim outside the proof of claim process because it would create a preference over similarly situated creditors standing in line in the liquidation proceeding. While addressing all issues at one time and in another state's proceeding may be the most efficient disposition of the dispute, judicial economy is not a basis stated in the

Pennsylvania statute for allowing the Bank's counterclaim to go forward in the Florida court.

Background. In 1998, Wetzel Services ("Wetzel") filed for bankruptcy. Legion filed a proof of claim in the bankruptcy, then in 1999, initiated its lawsuit to recover funds retained by the Bank to cover Wetzel overdrafts and other debts. In October 2000, the Trustee for the Debtor in Bankruptcy (Trustee) filed an adversary proceeding against Legion in the Bankruptcy Court. The Bank asserted that the overdrafts were a debt created by Wetzel as agent for Legion, for which Legion is responsible.

In March 2002, Legion was placed into rehabilitation by order of the Pennsylvania Court, which stayed litigation against Legion. The Trustee's adversary proceeding was stayed pursuant to the Bankruptcy Court in May 2003, which gave full faith and credit to the Pennsylvania Court's order. In July 2003, the Pennsylvania Court ordered Legion liquidated, which triggered the statutory stay of all litigation by or against Legion.

When the Legion Liquidator decided to continue to prosecute its Florida claim against the Bank, the Bank petitioned the Pennsylvania Court to grant relief from the stay so that it may pursue its counterclaim against Legion in Florida. The Liquidator asserted that the Bank's counterclaim must be adjudicated in the liquidation proceeding in Pennsylvania, contending that the state statutes provide one means for establishing the liabilities of an insurer in liquidation: the proof of claims process, and that a defendant may not pursue a counterclaim against an insurer in liquidation even though the statutory liquidator may litigate against that defendant.

The Bank contended that if it prevailed in its counterclaim, it would file a proof of claim with the Legion estate, and that it would be more efficient to determine Legion's liability by way of a counterclaim in the Florida proceeding. The Bank noted that it is routine for bankruptcy courts to grant relief from the automatic stay of the Bankruptcy Code, for this purpose.

The Court, after reviewing the relevant Pennsylvania statutes, observed that assuming the Liquidator's action against the Bank is "incident" to an agency arrangement between Wetzel and Legion, the Liquidator could have brought suit in any Pennsylvania court with jurisdiction. However, the Liquidator chose to continue the action in Florida, where it was instituted by Legion before it was placed into rehabilitation. This choice of the Liquidator was expressly authorized by Pennsylvania law.

The Court further noted that it was mindful of the stark difference between the stay of litigation against Legion established in the Pennsylvania statutes, and the stay of litigation against debtors found in the Bankruptcy Code. In addition to enumerating specific exceptions to the automatic stay, the Bankruptcy Code gives the court authority to grant relief from the stay by "terminating, annulling, modifying, or conditioning such stay" for cause. One recognized cause, the Court said, is to permit an action to proceed to completion in another tribunal. The Pennsylvania statute, however, does not confer comparable express authority upon the Pennsylvania Court to modify a stay to allow a counterclaim against an insurer in liquidation.[8]

According to the Court, the Pennsylvania statute in question was based upon the National Association of Insurance Commissioner's Model Supervision, Rehabilitation and Liquidation Act, and that the Model Act's stay has been interpreted to mean that a defendant may not pursue a counterclaim outside the proof of claim process because it would create a preference over similarly situated creditors standing in line in the liquidation proceeding.

The Court said that while addressing all issues at one time in the Florida proceeding may be the most efficient disposition of the dispute between Legion and the Bank, judicial economy

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[8] The court noted that such authority may exist by implication; however, whether relief from the stay can be granted in the appropriate rare circumstance need not be decided in this case because

is not a basis stated in the Pennsylvania statute for allowing the Bank's counterclaim to go forward in the Florida court. The statute prohibits assertion of any counterclaims in actions brought or continued by the Liquidator, thus, the Court held, the Bank may not litigate, in Florida, in part or in whole, any of the counterclaims included in its pleading, but may, of course, assert any available defenses to show that it was legally entitled to the funds in dispute.

III. Cases construing application of the McCarran-Ferguson Act

A. New York Receivership Court need not give Full Faith and Credit to decision of Fifth Circuit Court of Appeals

Matter of the REHABILITATION OF FRONTIER INSURANCE CO., 2004 WL 2671945 (N.Y.Supp.), decided Nov. 22, 2004.

The New York Superintendent of Insurance brought delinquency proceedings against an insurer that was a surety on a performance bond ("the New York Court" proceeding). The obligee (Callon) asked the New York Court to fix its claim as liquidated, based upon a decision by a Louisiana federal district court (the "Louisiana Court") liquidating the claim, which was rendered after the delinquency proceeding was commenced and a restraining order had been issued. In an earlier decision, the New York Court denied the motion. The instant decision was rendered in response to Callon's motion for renewal and reargument, based upon the Fifth Circuit's subsequent decision affirming the Louisiana Court's jurisdiction over the claim.

The decision provides a useful summary of cases deciding whether federal courts lose jurisdiction and/or whether they should decline to hear claims based upon Burford abstention principles, after a state receivership court has issued a restraining order or injunction.

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the Bank asserts a reason for a counterclaim that cannot be distinguished from that of any defendant in a suit brought by a liquidator.

Holding: Based upon the McCarran-Ferguson Act, the New York State Court, in a delinquency proceeding, was not required to give full faith and credit to a Fifth Circuit Court of Appeals' decision affirming a Louisiana federal district court order liquidating a claim in a diversity action. However, the Court held, its holding "is not to say that the Fifth Circuit determination would not be binding on Frontier should it be successfully rehabilitated."

Background.

Callon obtains judgment in Louisiana after Liquidation order entered. In May 2001, Callon instigated judicial proceedings against Frontier in federal district court for the Eastern District of Louisiana (the "Louisiana Court"), alleging that Frontier, as surety, was liable for the payment of $2,700,000 on a bond it had issued to Callon. On August 17, 2001, Callon filed a motion for summary judgment with the Louisiana Court. On August 27, 2001, the delinquency proceeding against Frontier was commenced in New York, and Show Cause and Restraining Orders were issued. The Louisiana Court nevertheless rendered a decision on September 6, 2001, directing entry of judgment in the amount of $2,700,000 in favor of Callon and against Frontier.

Callon seeks acceptance of judgment in the New York Court. Approximately a year later, Callon sought an order from the New York Court directing the Superintendent to show cause why Callon's claim in the delinquency proceeding should not be fixed as liquidated.

The Superintendent is denied relief in Louisiana. Subsequently, but prior to argument on Callon's New York motion, the Superintendent moved in the Louisiana Court to vacate the judgment, claiming the Louisiana Court had no jurisdiction[9]. On December 11, 2002, the Louisiana Court denied the motion, holding that prosecution of the Louisiana action was not barred by the New York delinquency Order as it "did not constitute the transaction of Frontier's

[9] The challenge was based upon FRCP § 60(b).

business as contemplated by the Order." The Louisiana Court also found that although the Superintendent contended the delinquency Order forbid counsel for the Superintendent from appearing in the Louisiana proceeding, under the language of the Order, the Superintendent could have authorized opposition to the motion be filed in Louisiana on Frontier's behalf.

New York Court denies relief to Callon. The New York Court found that the initial delinquency Order stayed attorneys for Frontier from being present in the Louisiana Court to oppose Callon's summary judgment motion, but by its terms it did not stay Callon from proceeding on its motion against Frontier. The New York court denied Callon's motion to accept its claim as liquidated, concluding that the entry of judgment at a time when Frontier's attorneys were barred from being present to oppose the motion was not consistent with due process, and that being placed in a position of having to vacate a judgment is vastly different from that of having to initially defend a summary judgment motion.

Fifth Circuit affirms Louisiana order. The Superintendent appealed the Louisiana Court's order denying vacation of the judgment in Louisiana. The Fifth Circuit affirmed[10], holding that the judgment was not void.

New York Court denies full faith and credit to Fifth Circuit opinion. After the Fifth Circuit decision, Callon sought rehearing before the New York Court, seeking acceptance of its claim as liquidated. The issue before the New York Court on rehearing, which is the subject of the instant opinion, was thus the effect of the Fifth Circuit's decision on the New York court.

The New York Court noted first that a state court is not obligated under the United States Constitution to give full faith and credit to decisions of a federal court. However, the Court noted

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[10] *Callon Petroleum Co. v. Frontier Ins. Co.*, 351 F.3d 204 (5th Cir. 2003).

that 28 U.S.C. § 1738[11], has been interpreted to require state courts to give such recognition to decisions of federal courts.

The Court, however, declined to do so. The New York Court found that "the crux" of the Fifth Circuit's reasoning was simply that the Superintendent offered no plausible excuse for ignoring the judgment for fourteen months. In response to the Superintendent's contention that jurisdiction over Callon's claim vested exclusively in the New York Court, the Fifth Circuit had held that because federal courts regulate the scope of their own jurisdiction, the challenge to jurisdiction should be sustained only where there is a clear usurpation of power, or the jurisdictional error is egregious, and that in this case, the jurisdictional error, if any, in entering judgment after the New York Order did not appear to be egregious.

Regarding the McCarran-Ferguson Act, the New York Court said that the Fifth Circuit had noted that federal courts normally avoid interfering with state rehabilitation proceedings, exercising abstention in the manner commonly referred to as the Burford doctrine.[12] However, for purposes of the Superintendent's Louisiana motion to vacate, the Fifth Circuit had stated that had the Superintendent "timely moved" the district court to dismiss or stay the action on Burford grounds, it would have been proper, if not obligatory, for the Louisiana Court to have done so. The Fifth Circuit concluded, however, that because the Louisiana Court had diversity jurisdiction, it was not automatically stripped of subject matter jurisdiction over claims asserted against an insurer undergoing state insolvency or rehabilitation proceedings.

The New York Court, however, reasoned, first, that the UILA has been enacted in both New York and Louisiana. Citing the purposes of the UILA, the New York Court noted that

[11] The statute provides that "judicial proceedings…shall have the same full faith and credit in every court within the United States…as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."

claimants residing in states that have adopted the UILA are required to file claims in the New York proceeding unless an ancillary receiver has been appointed in the state of the claimant's residence, and no ancillary proceeding had been commenced in Louisiana.

The Court then discussed the New York cases requiring that the New York Court, in a liquidation proceeding, must take cognizance of the interests of the policyholders, creditors, stockholders, and the public. These cases also hold, the Court said, that the delinquency court is intended to have exclusive jurisdiction of claims both for and against an insurance company in liquidation, and other courts, except when called upon by the court of primary jurisdiction for assistance, are excluded from participation.

The New York Court than discussed the provisions of the McCarran-Ferguson Act which provide for preemption of Acts of Congress by state statutes regulating the business of insurance, unless the Act specifically relates to the business of insurance. The Act, the Court said, was designed to restore the supremacy of the states in the realm of insurance regulation.[13]

Noting that there is a conflict in the case law as to the theory under which a claim against an insurer involved in a delinquency proceeding is to be referred to a state court, the New York Court found that it is clear under the McCarran-Ferguson Act and the UILA that once such a proceeding is commenced in a state that has adopted the UILA, such a claim is to be referred to the court supervising the proceeding. The “difficult roadblock” presented by Callon’s motion is the Fifth Circuit holding, the “crux” of which is the 14 month delay of the Superintendent in moving to vacate the District Court judgment.

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[12] *Burford v. Sun Oil Co.,* 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943).
[13] Citing *United States Department of Treasury v. Fabe*, 508 U.S. 491, 500, 113 S.Ct. 2202, 124 L.Ed.2d 449 (1993).

The Court reasoned that if Callon's motion to accept the claim as liquidated is granted, a claim of $2,700,000, that has never been adjudicated on the merits, must be honored by the Superintendent. If the Superintendent succeeds in rehabilitating Frontier, no other party would appear to be adversely affected and Callon may well have a liquidated claim against Frontier. However, if it is necessary to liquidate Frontier, then creditors, policyholders and other interested parties could be adversely affected by such a ruling. Since the public policy behind the enactment of UILA mandates that claims against the insurer be handled in a uniform and consistent manner, the Court reasoned, directing that the Callon claim be allowed without consideration of the merits would not be in accord with such policy.

The New York Court thus found that solely for purposes of the New York proceeding, it need not grant full faith and credit to the Fifth Circuit holding as the requirement for full faith and credit emanates from an Act of Congress (28 U.S.C. § 1738), which Act does not specifically relate "to the business of insurance." The theory behind this conclusion, the Court said, is consistent with that employed by courts that have found they lacked jurisdiction over litigation involving an insolvent insurer when the sole basis thereof was the federal diversity statute, which statute also did not "specifically relate to the business of insurance." However, the Court held, its holding is not to say that the Fifth Circuit determination would not be binding on Frontier should it be successfully rehabilitated.

B. McCarran-Ferguson Act does not reverse-preempt Declaratory Judgment Act, and Burford abstention not warranted

AmSouth Bank and First Tennessee Bank v. Dale et al., 386 F.3d 763 6th Cir. 2004).

Two banks (the "Banks") brought declaratory judgment actions against receivers for insolvent insurance companies, seeking determination that banks were not liable to receivers in connection with money-laundering scheme, and seeking injunction barring receivers from bringing future lawsuits against them. The United States District Court for the Middle District of Tennessee denied the Receivers' motions to dismiss the declaratory actions, and barred them from pursuing related litigation against banks in different state.

Holding. The Sixth Circuit reversed and ordered the declaratory judgment action dismissed based upon a finding the district court abused its discretion in assuming jurisdiction over the banks' declaratory judgment actions. However, in doing so, the Sixth Circuit rejected the Receivers' contentions that the McCarran-Ferguson Act reverse-preempted the federal Declaratory Judgment Act[14], or that the district court should have abstained under the Burford abstention doctrine.

Background. As the Sixth Circuit put it, "[t]his case concerns the latest effort of the Receivers [of seven insolvent insurance companies] to recover some of the funds embezzled from the companies by the infamous Martin Frankel." Bank accounts used in Frankel's money-laundering scheme were held by the insurance companies at AmSouth and First Tennessee Banks. While the Receivers and the Banks were in settlement discussion, the Banks filed a declaratory judgment action in the Middle District of Tennessee, asking for declaratory relief that they are not liable to the Receivers. The Receivers' motions to dismiss were denied.

On appeal, the Receivers argued that the district court improperly entertained the declaratory action because it lacked jurisdiction or because it should have declined jurisdiction in its discretion. Finding the district court abused its discretion in entertaining the declaratory actions, the Sixth circuit reversed the district court and remanded the case with instructions to dismiss the actions.

[14] 28 U.S.C.A. §2201.

The Sixth Circuit's reversal was based upon its conclusion "that the practical effect of [the Banks'] participation in settlement negotiations and affirmative representations of that participation was to lull the Receivers into believing that amicable negotiation was still possible, and that the filing of these declaratory actions was an effort to engage in procedural fencing to secure the Banks' choice of forum." While the facts leading to this result are interesting, they are not relevant to the two issues relating to receivership law which are the subject of this paper -- the Court's refusal to apply the McCarran-Ferguson Act to reverse preempt the Declaratory Judgment Act, and Burford abstention.

The Receivers argued that McCarran-Ferguson Act reverse preemption and Burford abstention formed independent grounds for the district court to have found it lacked jurisdiction. The Sixth Circuit commented that reviewing the cases cited by the parties, it becomes clear that often when faced with suit in federal court, a state commissioner of insurance as receiver or liquidator of an insurance company will rely on one or both of these doctrines to attempt to defeat federal court jurisdiction. Because state liquidation proceedings of insolvent insurers are exactly the sort of intricate state regulation on behalf of state-resident policyholders that these doctrines are intended to protect, these arguments, the Court said, have some force when angry creditors attempt to sue insolvent insurance companies in federal court to jump ahead in the queue of claims. However, the Court continued, these doctrines have less force where the insurance companies are themselves the natural plaintiffs. Here, the Court said, the dispute involves the Receivers' attempt to recover money in an ordinary common-law-damages suit; the Banks do not attempt to disrupt a coherent state scheme in favor of enriching their own pockets.

The Receivers contended that the McCarran-Ferguson Act reverse-preempts the Declaratory Judgment Act, since, if the Declaratory Judgment Act allows this action against them, it impairs the operation of state laws providing for the liquidation of insurance companies, including those providing for antisuit injunctions such as those issued in the liquidation proceedings for each of the insolvent insurance companies. Those injunctions barred suits against the insurance companies in any court. Both parties agreed on appeal that the injunctions of their own force cannot limit federal judicial power, but the Receivers argued that McCarran-Ferguson gives them that power.

The Court reasoned that McCarran-Ferguson reverse preemption depends upon the policies that undergird state law. Where a state law protects state insurance-policyholders, it is a "law enacted…for the purpose of regulating the business of insurance"; when it protects other interests, for instance, those of stockholders in those insurance companies, it is not such a law within the meaning of the Act. Noting that every preference accorded to creditors of an insolvent insurer ultimately may redound to the benefit of policyholders by enhancing the reliability of the insurance company, the Court said this argument, however, goes too far. Such indirect effects are insufficient for a state law to avoid pre-emption.

Finally, the Circuit Court examined whether the state statute increased the substantive rights of policyholders, was limited to policyholders, or was confined to policy disputes. Where the statute is enacted not so much for the purpose of regulating the business of insurance as for the purpose of regulating a foreign insurer's choice of forum, the Sixth Circuit stated the statute was not within McCarran-Ferguson's sweep.

The Court observed that where the insolvent insurer is a plaintiff in an ordinary contract or tort action, courts tend to look unfavorably on claims of McCarran-Ferguson preemption of the Federal Arbitration Act or the removal statutes, so as to insulate that action from the federal courts. That seems to be motivated, the Court said, as much by frustration over the attempts by parties to evade federal jurisdiction as by reasoned doctrinal analysis, but one way to cast it in a favorable doctrinal light is to extend the rule that impairment must be defined with respect to the particular cause of action -- to the question of purpose. An ordinary suit against a tortfeasor by an insolvent insurance company implicates a "regulation of the business of insurance" only in the attenuated fashion rejected in *Fabe*[15]; an antisuit injunction would only be a regulation of the business of insurance to the extent it protected the assets of the insurance company from suit. Here, the Court said, the Banks seek only declaratory judgment based on a threatened ordinary common-law action against them, and the assets of the insurance companies are up for grabs only in that attenuated fashion.

A second wrinkle, the Court said, is the narrow or broad definition of "impair." Here, the Court concluded, it would be an overly expansive reading of the case law and the purposes of the doctrine to find McCarran-Ferguson reverse preemption. The declaratory judgment actions against insolvent insurance companies for the purpose of evading liability in a threatened common-law coercive action by the insurance companies have only an attenuated connection to regulating the business of insurance.

The Court found Burford abstention similarly inapplicable. Burford, the Court said, does not require abstention whenever there exists a complex state administrative process, or even in all cases where there is a potential for conflict with state regulatory law or policy. Instead, this balance only rarely favors abstention, and the power to dismiss recognized in Burford represents an extraordinary and narrow exception to the duty of the District Court to adjudicate a controversy properly before it. State liquidation proceedings seem like an excellent candidate for Burford abstention, the Court said, but it is difficult to see how a federal court's pronouncement

[15] *United States Department of Treasury v. Fabe*, 508 U.S. 491, 500, 113 S.Ct. 2202, 124

on issues of common-law liability having nothing to do with insurance could be disruptive of those proceedings. As with the McCarran-Ferguson analysis, that Receivers are covered by the antisuit provisions of the various liquidation laws seems mere coincidence, and abstention seems inappropriate. Because Burford abstention is concerned with potential disruption of a state administrative scheme, rather than the mere existence of such a scheme, looking behind the action to determine whether it implicates the concerns of Burford is necessary, and the issues in this litigation, the Court found, concerning liability of the Banks for non-insurance-related activities, federal law defenses, and state tort law, do not warrant Burford abstention.

C. Arizona priority statute reverse preempts federal super-priority of IRS, with respect to guaranty association claim.

Greene, as Receiver for Great Global Assurance Co., in Liquidation v. United States, 62 Fed.Cl. 418 (2004)

Receiver for insolvent life insurance company brought suit against the United States alleging that the IRS erroneously withheld a tax refund due to the company.

Holdings: Pursuant to the McCarran-Ferguson Act, the Arizona priorities statute reverse pre-empted the federal priorities statute, thus the Guaranty Fund was entitled to priority claims ahead of the federal government's tax claim and the insolvent insurer was entitled to a complete refund of the subject tax, plus interest.

D. Nebraska forum statute cannot be invalidated by permitting litigation in federal court on basis of diversity.

In re Amwest Surety Ins. Co., Debtor
State ex rel Wagner, Director of Insurance for the State of Nebraska v. Swiss Reinsurance America Corp., 2004 WL 628217 (D.Neb.)

L.Ed.2d 449 (1993).

Reinsurer of insolvent insurer removed to federal court litigation filed by liquidator in state court proceeding. Federal subject matter jurisdiction was premised on diversity of citizenship.

Holding. The statute in the Nebraska Liquidation Act which designates the forum for adjudication of claims, regulates the business of insurance and under the McCarran-Ferguson Act, cannot lawfully be invalidated, impaired, or superceded by permitting additional litigation in federal court on the basis of diversity.

Background: Amwest Surety Insurance Company ("Amwest") was declared insolvent by the District Court of Lancaster County, Nebraska. The Liquidator brought several claims pursuant to the Nebraska Insurers Supervision, Rehabilitation, and Liquidation Act ("NISRLA," or the "Act"), against Swiss America Reinsurance Corp., in the state District Court. Swiss Re removed the action to federal court, premised upon diversity of citizenship. The Liquidator moved to remand the case and Swiss Re objected, contending the preference provision of the Nebraska Liquidation Act does not reverse-preempt federal jurisdiction under the McCarran-Ferguson Act because the preference statute does not regulate the business of insurance.

The Court noted that the liquidator's action involves the interpretation of several contracts of reinsurance between the parties, and the application of Nebraska's scheme for liquidation of insolvent insurers to those contracts. Because the federal diversity statute does not relate specifically to the business of insurance and because Nebraska has enacted a comprehensive statutory scheme to regulate the business of insurance, the question, the Court said, is whether application of diversity jurisdiction in the present circumstance would invalidate, impair, or supersede Nebraska's insurance laws pursuant to the McCarran-Ferguson Act.

After discussing the legislative intent reflected in the Nebraska Act, the Court found that proceedings in cases of insurer insolvency and delinquency are an integral aspect of the business of insurance and are of vital public interest and concern. The Nebraska Act provides that all actions brought under the Act shall be brought in the district court of Lancaster County, Nebraska. Therefore, application of diversity jurisdiction would frustrate state policy and interfere with Nebraska's administrative regime in connection with liquidation of insurers.

The Court found that the Nebraska Act specifically anticipates claims against reinsurers. Additionally, resolution of the dispute between the parties involves issues of preference and setoff, also specifically covered under the Act. The Liquidator's lawsuit requests relief unique to NISRLA and will involve a statutory priority determination under NISRLA. Accordingly, the Court found the Nebraska statute designating the state forum for adjudication of the Swiss Re claims regulates the business of insurance and under the McCarran-Ferguson Act, cannot lawfully be invalidated, impaired, or superceded by litigation in federal court on the basis of diversity.

IV. Cases construing Burford abstention doctrine or other federal doctrines.

A. ***AmSouth Bank and First Tennessee Bank v. Dale et al.***, 386 F.3d 763, 2004 Fed.App. 0321P (6th Cir. 2004) (See discussion at IV, *supra*)

B. ***Matter of the REHABILITATION OF FRONTIER INSURANCE CO.***, 2004 WL 2671945 (N.Y.Supp.), decided Nov. 22, 2004. (See discussion at IV, *supra*)

C. ***Koken, Insurance Commissioner of Pennsylvania v. Viad Corp.,*** 307 F.Supp.2d 650 (E.D. Pa. 2004).

Pennsylvania Insurance Commissioner, as liquidator of insolvent insurer, brought state court suit against insured to recover alleged preferential payment from insurer, under policy. Insured removed action to federal district court.

Holdings: On Commissioner's motion to remand, the federal District Court found that

Burford abstention over the action was not appropriate, and notwithstanding the fact that the Pennsylvania Court had in rem jurisdiction over the insurer's assets as result of the liquidation order, the federal court was not precluded from exercising jurisdiction over Commissioner's suit by the *Princess Lida* doctrine, which provides that a federal court generally may not exercise its jurisdiction to disturb or affect possession of property in custody of state court.

Background. In October 2003, the Insurance Commissioner of the Commonwealth of Pennsylvania (“the Commissioner”), as Liquidator of Reliance Insurance Company (“Reliance”), filed a complaint in the Commonwealth Court of Pennsylvania to recover money that Viad Corp. (“Viad”) received from Reliance. Based on diversity of citizenship, Viad removed the action to federal court and the Commissioner moved for remand to the Commonwealth Court.

In 2000, Viad had reported a claim for losses, and Viad, Reliance, and other policy participants executed an Interim Payment and Assignment Agreement (“the Agreement”). Reliance's portion of the interim payment owed to Viad was $1,974,979.69.

On January 29, 2001, for reasons unrelated to this case, the Pennsylvania Insurance Department put Reliance under regulatory supervision. On February 5, 2001, Reliance paid Viad its portion of the interim payment.

In early May 2001, Reliance was placed in rehabilitation and the Commissioner was appointed the Rehabilitator.

On October 2, 2003, the Commissioner, as Liquidator, brought suit in the Commonwealth Court of Pennsylvania to recover the payment of $1,974,979.68 from Reliance to Viad, claiming that under Pennsylvania insurance laws, the payment was a preferential payment that the Liquidator can void. Viad removed the case to federal court based on diversity of citizenship, and the Commissioner filed a motion to remand, but did not request a stay.

The Commissioner contended the case should be remanded to the Commonwealth Court of Pennsylvania on grounds of abstention, and because the Commonwealth Court has exclusive jurisdiction over all of Reliance's assets, the case was improperly removed.

As to abstention, the court observed that under *Quackenbush v. Allstate Ins. Co*.[16], federal courts have a strict duty to exercise the jurisdiction that Congress has conferred upon them, except under some “extraordinary and narrow exception[s] to the duty of the District Court to adjudicate a controversy properly before it.” *Colorado River Water Conservation Dist. v. United States*.[17] The abstention doctrines, the Court said, evolved from these exceptions.

Finding that the facts in *Quackenbush* were closely analogous to the instant case, the Court found *Quackenbush* was controlling. In *Quackenbush*, the Court said, the Supreme Court upheld the Ninth Circuit's ruling that abstention principles limit a federal court's possible course of action. When the remedy sought is legal rather than equitable, the court said, a district court may not abstain under Burford and remand the complaint to state court. When the relief sought is equitable in nature, however, abstention principles allow a federal court to stay the action, dismiss the suit, or remand it to state court.

The court then turned to a determination of the issue of whether an action commenced by Pennsylvania's statutory liquidator to recover an alleged preferential payment constitutes an action at law or in equity. Finding no Pennsylvania state cases addressed the issue, the court examined federal and state cases from other jurisdictions, and determined that uniformly these cases found that the action is at law.

Because this is an action at law, the Court held, remand is unavailable, therefore, the Commissioner's claim that Burford provides a basis for remand of the instant action fails.

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[16] 517 U.S. 706, 716, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996).

As to the Commissioner's contention the action was improperly removed to federal court because the Commonwealth Court has exclusive jurisdiction over the liquidation proceedings, the Court noted that while state and federal courts generally must not interfere with or try to restrain each other's proceedings, an exception has been made in cases where a court has custody of property. In such instances, the Supreme Court has held that the state or federal court once having custody of such property has exclusive jurisdiction to proceed thereafter, citing *Princess Lida v. Thompson*[18]. The *Princess Lida* doctrine applies, the Court said, when: (1) the nature of the litigation in both fora is *in rem* or *quasi in rem*, and (2) the relief sought requires that the second court exercise control over the property in dispute and such property is already under the control of the first court.

The Court found that neither requirement was met in this case, thus the *Princess Lida* doctrine is not applicable. Where the relief sought is a money judgment only, the action is *in personam*; that is, an action that enforces a personal liability, or establishes a debt or a right to share in property. In this case, the Court held, the Commissioner seeks monies owed to Reliance by Viad. Viad seeks a ruling that it is entitled to keep the payment it received from Reliance. The instant action is therefore similar to those actions characterized by the Supreme Court as *in personam*. While there is no dispute that the Commonwealth Court has *in rem* jurisdiction over Reliance's assets as a result of the liquidation order, the dispute is not for the recovery of a specific piece of Reliance's property. If the Commissioner is victorious in the underlying action, Viad will not return the same check or dollar bills it received from Reliance, as the payment received by Viad from Reliance is not a sequestered nor distinguishable piece of property, but is fungible.

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[17] 424 U.S. 800, 813, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).

As to the second prong of the *Princess Lida* standard, the Court held, the relief sought in the second court must necessitate that the second court exercise control over the property in dispute, but such property is already under the control of the first court. However, the doctrine provides that a federal court may exercise its jurisdiction to adjudicate rights in such property if the final judgment does not interfere with the state court's possession, except to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court.

Although it was clear, the Court noted, that Reliance's assets are in the custody of the state court, the federal court need not exercise control over Reliance's assets to effectuate judgment in the instant case. All that must be determined is whether the payment made to Viad is a voidable preferential payment entitling the Commissioner to a money judgment. A federal court judgment would thus not interfere with the state court's possession of Reliance assets, but would merely bind the state court to the determination of whether Reliance's payment to Viad was a voidable preference. Therefore, the second prong of *Princess Lida* was also not met. Because the *Princess Lida* doctrine did not apply, the Commissioner's claim that the Commonwealth Court has exclusive jurisdiction over Reliance's preference claims failed.

C. Burford and Colorado River abstention.

Sevigny, Insurance Commissioner of New Hampshire, as Liquidator of Home Insurance Co., v. Employers Ins. Of Wausau, 2004 WL 1969871 (D.N.H.).

After the Home Insurance Co. ("Home") liquidator filed an action for declaratory judgment in the state court, Wausau removed the action to federal court, asserting that the federal court had jurisdiction over it under 28 U.S.C. § 1441.

Holding. The Court found that it should abstain from hearing the matter based upon the

[18] 305 U.S. 456, 466, 59 S.Ct. 275, 83 L.Ed. 285 (1939).

Burford and Colorado River abstention doctrines.

Background. The action was commenced by the liquidator/Commissioner in the state liquidation court, by filing a complaint requesting a declaratory judgment. The issues related to whether certain offsets should be allowed based on various reinsurance agreements. After the action was removed to federal, the Commissioner did not contend that the federal court lacked subject matter jurisdiction or that there had been a defect in the removal procedure, but urged the court to decline to exercise its jurisdiction under the abstention doctrines discussed in *Burford v. Sun Oil Co*.[19], and its progeny, and *Colorado River Water Conservation Dist. v. United States.*[20] The Commissioner contended the action arises as an integral part of the state's liquidation proceedings against an insolvent insurance company, and that since Wausau seeks to make a setoff that is not founded on mutuality, Wausau is subject to the stay imposed by the Superior Court's liquidation order and must go to that court for relief.

Wausau responded that a threshold issue is whether the Commissioner is precluded from relitigating the setoff issue, which had previously been determined through arbitration, arguing that such issues are commonly decided by federal courts, implicate the Federal Arbitration Act, and present no occasion for the federal Court to apply the Burford or Colorado River abstention doctrines. The Commissioner responded that Wausau's objection inappropriately focuses on the parties' pre-insolvency relations, and that the commencement of the liquidation proceeding against Home invokes application of New Hampshire statutory law and the state court's equitable power to limit setoff rights in order to protect the rights of creditors. Therefore, the Commissioner argued, the doctrine of *res judicata* does not apply.

[19] 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943).
[20] 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).

The court found that it had the authority to abstain, relying upon *Quackenbush*[21], wherein the Supreme Court recognized that in cases where the relief being sought is equitable in nature or otherwise discretionary, federal courts not only have the power to stay the action based on abstention principles, but can, in otherwise appropriate circumstances, decline to exercise jurisdiction altogether by dismissing the suit or remanding it to state court. Since the Commissioner seeks declaratory relief, the Court said, the relief sought is discretionary. Accordingly, the court held, federal court has the power to dismiss or remand this case if a recognized abstention doctrine applies.

The federal court, in considering the circumstances in which it would be appropriate to abstain, noted that under *Quackenbush v. Allstate Ins. Co*.[22], federal courts may decline to exercise jurisdiction in exceptional circumstances where denying a federal forum would clearly serve an important countervailing interest. The court's authority to abstain, it said, extends to all cases in which the court has discretion to grant or deny relief.

The Court said that the Burford and Colorado River abstention doctrines asserted by the Commissioner have different rationales. The Burford doctrine provides that where timely and adequate state-court review is available, a federal court sitting in equity must decline to interfere with the proceedings or orders of state administrative agencies: (1) when there are difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar; or where the exercise of federal review of the question in the case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern. There is no formulaic test, the Court said, for determining when dismissal under the Burford doctrine is appropriate. The

[21] 517 U.S. 706, 716, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996).

decision is based on a balancing of the strong federal interest in having certain classes of cases, and certain federal rights, adjudicated in federal court, against the State's interests in maintaining uniformity in the treatment of an essentially local problem. The Supreme Court has found that this balance only rarely favors abstention.

Distinct from the principles of the Burford doctrine, the Court noted, the Supreme Court found in *Colorado River* that a federal court may abstain from hearing a matter when there is a concurrent state proceeding, based on considerations of wise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation. Though not an exhaustive list, six factors have been identified that ought to be considered in determining whether Colorado River abstention applies: (1) whether either court has assumed jurisdiction over a *res*; (2) the inconvenience of the federal forum; (3) the desirability of avoiding piecemeal litigation; (4) the order in which the forums obtained jurisdiction; (5) whether federal law or state law controls; and (6) whether the state forum will adequately protect the interests of the parties.

The Liquidation Order, the Court noted, included language that to the full extent of the jurisdiction of the state court and the comity to which orders of the court are entitled, all persons were permanently enjoined and restrained from maintaining various actions, including an action for setoff not founded on mutuality.

The court found that Wausau has an opportunity for timely and adequate review of its preclusion defense in the state court, and that this action raises difficult questions of substantial public import pertaining to the extent of setoff rights in a liquidation proceeding, thus it would be appropriate for the federal court to abstain in order for the state court to determine in the first instance how state law and the Superior Court's Order of Liquidation applies to these facts.

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[22] 517 U.S. 706, 716, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996)

As to abstention under the Colorado River test, the court said that Colorado River abstention may apply when there is concurrent state and federal litigation involving essentially the same issues. Although a pending liquidation proceeding in the state court pertaining to Home existed, which the liquidator argued was “an integral part” of the liquidation proceedings, the Court held that as a technical matter the dispute was not currently being actively litigated in the state court since it has been removed to the federal court. The Commissioner’s actions under the liquidation act to collect all debts and moneys due and claims belonging to the insurer, and to institute actions in New Hampshire or elsewhere in order to effect the purpose of the Act, were incidental to the liquidation proceeding. Moreover, the Superior Court obtained jurisdiction over liquidation of Home months before the instant action was commenced, and the Superior Court has jurisdiction over the instant dispute. Finally, Wausau's interests can be adequately protected in the state forum. All of these factors support the application of Colorado River abstention.

Most significantly, the court found, state law controls the outcome of this dispute. The New Hampshire insolvency statute, and the state court's equitable powers in a liquidation proceeding, limit Wausau's setoff rights. While Wausau contended that federal law applies because the prior arbitration awards in its favor are governed by the Federal Arbitration Act (“FAA”), the Court noted that federal courts have held that a party's rights under the FAA are preempted by state laws regulating the business of insurance pursuant to the McCarran-Ferguson Act. Because the Commissioner's claim is based on the interpretation of state laws regulating the business of insurance that are not preempted by the FAA, the Court found that state law issues predominate in the instant action. The Court therefore found that weighing the relevant considerations, Colorado River abstention applies to this action.

D. Burford abstention not warranted in action under the Miller Act.

United States, for the benefit of ACCA Const. Services, L.L.C. v. F.A.S. Development CO., Inc., a Commercial Casualty Ins. Co. of Ga., 304 F.Supp.2d 1359 (N.D. Ga. 2004)

Construction company brought action seeking to recover on payment bond issued by surety for its principal, a development company. After suit was filed, surety became subject to rehabilitation proceedings in North Carolina, and the state court issued a preliminary injunction, enjoining all pending actions against surety.

Holdings. Burford abstention over the Miller Act suit was not warranted, and principals of comity did not dictate stay of the suit; rather, wise judicial administration required that suit be allowed to proceed.

Background. The United States, as plaintiff, filed the action in June 2002, seeking to recover on a payment bond issued by Commercial Casualty Insurance Company of Georgia ("Commercial Casualty"), for principal F.A.S. Development Company, Inc. The action was brought pursuant to the Miller Act, which vests exclusive jurisdiction in the United States district courts.

In November 2003, the North Carolina Insurance Commissioner (the "Commissioner") took control of Commercial Casualty pursuant to a statutory rehabilitation process, which prohibited further prosecution of actions against Commercial Casualty. The North Carolina, court issued an order of rehabilitation and preliminary injunction (the "North Carolina Order") which stayed all pending actions.

The Commissioner then filed a motion to stay the proceedings in the federal court, pursuant to the North Carolina Order, contending the order is entitled to full faith and credit. Alternatively, the Commissioner contended that the Court should stay the case either as a matter of comity or pursuant to the abstention doctrine announced in *Burford v. Sun Oil Co*.[23] The issue presented is whether the stay should be honored in a Miller Act action, since the Miller Act specifically provides for exclusive jurisdiction of such actions in federal district courts.

The Court noted that only a few cases addressed the issue presented, where the action pending in federal court is a claim pursuant to the Miller Act. Examining other case law, the Court found that this case does not fit the strictures of the *Burford* abstention doctrine. Burford, the Court said, allows a federal court to dismiss a case only if it presents difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar, or if its adjudication in a federal forum would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern. A decision to abstain under Burford must be based on a careful consideration of the federal interests in retaining jurisdiction over the dispute, and ultimately represents a determination that a dispute would best be adjudicated in a state forum. The court said that this is a Miller Act suit which presents no difficult questions of state law, and may be adjudicated only in a federal forum. Moreover, Burford abstention is permissible only when the district court has discretion to grant or deny relief. The relief sought here is not committed to the Court's discretion. Thus, for all of these reasons, abstention is not a viable option.

The Court held that wise judicial administration requires that the case be permitted to proceed, stating, "Allowing the case to proceed permits Plaintiff to have its Miller Act claim adjudicated in the only forum authorized to do so. Establishment of Plaintiff's claim should facilitate the liquidation process. The rehabilitator will have the benefit of Plaintiff's claim being an established amount rather than a contested amount which the liquidator is not empowered to

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[23] 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed.2d 1424 (1943).

resolve. This approach does not violate notions of comity because this Court is deciding only the issue that must be decided by this Court, the amount of Plaintiff's claim. This decision does not invade the province of the rehabilitator who must decide on the proper distribution of the assets of Commercial Casualty. If the Court stayed this action until the liquidation ended, the parties would still have to litigate these issues before this Court…Thus, no significant saving is realized by delay."

V. Other matters.

A. Discovery disputes.

Benjamin, as liquidator of American Chambers Life Ins. Co. v Sawicz, 2004 WL 2635601 (Ohio App. 10 Dist.)

Discovery dispute between the superintendent of insurance, as liquidator, and defendants in an action filed by the liquidator against officers of the failed insurer. After the trial court held that the "Director of the Ohio Department of Insurance, or as Liquidator of American Chambers Life Insurance Company…shall answer the various discovery demands and requests propounded by the defendants," the Liquidator appealed.

Holding. Where claims raised by the Superintendent of Insurance, as liquidator, implicated matters within the knowledge of the department of insurance, presumably acquired both prior to and after the Superintendent's appointment as liquidator, the appeals court was unable to conclude that the trial court erred in rejecting appellant's capacities argument, and found no abuse of discretion by the trial court in rendering a discovery order requiring the Superintendent to respond to the discovery as to the insurance department.

Background. American Chambers Life Ins. Co. ("ACLIC") was a life, accident and health insurance company that transacted business in Ohio. The Liquidator filed a complaint against the defendants, who were officers and directors of ACLIC, alleging that ACLIC's financial condition had deteriorated rapidly in 1998 and 1999, resulting in ACLIC's insolvency, and that the existence and extent of ACLIC's financial condition, as well as its insolvency, was concealed and/or negligently not disclosed by the defendants to the Ohio Department of Insurance ("ODI"), ACLIC's policyholders, creditors and/or the public. The liquidator contended that the conduct of the defendant officers and directors of ACLIC constituted a breach of fiduciary duties, causing harm to its policyholders, creditors and the public.

After discovery issues arose, the trial court held in part that the liquidator, "whether acting as Director of the Ohio Department of Insurance, or as Liquidator of American Chambers Life Insurance Company…shall answer the various discovery demands and requests propounded by the defendants." The liquidator appealed, contending that the statutory role of the superintendent as liquidator is separate and distinct from the role the superintendent assumes as director of ODI, thus the trial court erred in requiring her to provide discovery in her capacity as director of ODI when she brought the instant action solely in her separate capacity as liquidator.

The Court noted that Ohio has a liberal discovery policy which, subject to privilege, enables opposing parties to obtain from each other all evidence that is material, relevant and competent, notwithstanding its admissibility at trial. In addressing the liquidator's "capacities" argument, the court acknowledged the general statutory framework under which the superintendent of insurance operates, and her general powers and duties as superintendent of insurance. Pursuant to those provisions, the superintendent of insurance "is granted wide latitude and authority in overseeing insurance companies. It is his [or her] mandatory duty to execute and enforce the laws relating to insurance."

The liquidator contended that the superintendent's role as liquidator is separate and legally distinct from that of regulator, citing cases from other jurisdictions in which courts have recognized, under similar statutory frameworks, the distinct roles performed by the superintendent/commissioner as regulator of insurance, and as liquidator or rehabilitator. The court, however, distinguished those cases as dealing primarily with whether various claims or affirmative defenses could be raised against a plaintiff in a capacity different from that in which the plaintiff appeared in the action. The liquidator's argument advancing the legal distinction between the superintendent as regulator and as liquidator, the Court said, would be more significant if the issue on appeal involved whether affirmative defenses could be asserted against the superintendent based upon her regulatory conduct. Even accepting, however, that the superintendent, in her capacity as liquidator, acts separately and distinctly from the role occupied as regulator, the Court held it did not find that distinction to be dispositive of the trial court's discovery order in this case.

Rather, the Court relied upon case law finding that examination of a party in a different capacity may be had when its conduct in that other capacity has been placed in issue. Here, the conduct of the Superintendent prior to the time of liquidation has been placed squarely in issue. The plaintiff had under his control, in the Insurance Department, special and direct knowledge vital to the action and must disclose all information material and relevant to this action whether in his capacity as Regulator or Liquidator.

The court also addressed the contention that because the Superintendent, as Regulator, is a separate and distinct third party, any deposition of her employees should be treated as depositions of “non party witnesses.” As such, the Superintendent contended, the witnesses should be available to the defendants only by means of subpoena, and any documents in the Superintendent's possession should be discoverable only by means of court order. The Court said that the reason for the limitations regarding discovery of non-party witnesses is to ensure that a non-party has notice and an opportunity to contest the discovery. By this very proceeding, the Court said, the liquidator has had the opportunity to contest the discovery sought. Reversal, now, would not serve to further either the statutory purposes or any salutary purpose other than delay.

In the present case, the Court held, the claims asserted in the complaint placed in issue alleged conduct by appellees affecting ODI that occurred prior to the time the superintendent was appointed as liquidator, including the time during which the superintendent was acting as regulator. The Court thus held that where the superintendent has initiated an action against officers of a failed corporation and raised claims implicating matters within the knowledge of the department of insurance, presumably acquired both prior to and after the superintendent's appointment as liquidator, the court was unable to conclude that the trial court erred in rejecting appellant's capacities argument, and found no abuse of discretion by the trial court in rendering its discovery order.

B. No coverage for directors and officers under D & O policy, for action filed by liquidator.

TIG Specialty Ins. Co. v. Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, Liquidator of HRM Health Plans (PA), Inc., et al., 855 A.2d 900 (Pa.Cmwlth. 2004)

After the liquidator brought an action against the directors and officers of the insolvent insurer, the Directors' and Officers' liability insurer brought an action for declaratory judgment that the policy excluded coverage for alleged liability to the liquidator.

Holding: The policy did not provide coverage, since the liquidator was HMO's "successor" within the meaning of a policy exclusion making the policy inapplicable to any claim made against any insured "arising out of any claim brought by, on behalf of, or at the behest of the company or its successor," and an exception to the exclusion did not apply since any action by the liquidator was, in effect, brought with the assistance and participation of the company.

Background. After a statutory liquidation proceeding was initiated involving an insolvent insurer/medical benefits coordinator named Health Resources Management Health Plans (PA), Inc. (HRMPA), the Liquidator filed a separate action against the directors and officers of HRMPA ("D & O Action"), alleging various breaches of their fiduciary duties and seeking to recover damages. Health Resources Management, Inc. (HRM), the parent company of HRMPA, had purchased a Directors' & Officers' Liability Insurance Policy from TIG Specialty Insurance Company (TIG) to protect the Directors and Officers of both companies. In the instant action, TIG and the Directors and Officers sought a declaratory judgment as to whether the D & O Policy provided insurance coverage for the claims in the D & O Action.

In 2001, the Insurance Commissioner asserted control over HRMPA under rehabilitation proceedings, and within a few weeks, HRMPA was placed into liquidation. The Liquidator filed a complaint with the Commonwealth Court, seeking to recover from HRMPA's Directors and Officers, the lost value of HRMPA's assets which allegedly resulted from breaches of their fiduciary duties in their management of HRMPA (D & O Action).

TIG sought a declaratory judgment that the D & O Policy it issued to HRM, which also covered the Directors and Officers of HRMPA, did not require it to provide coverage to the Directors and Officers of HRMPA in the D & O Action filed by the Liquidator. TIG argued that the Liquidator is a "successor" to HRMPA, and, therefore, coverage is precluded by the plain language of the policy. The defendant Directors and Officers argued that the plain language of the exclusion clearly allows for insurance coverage in the D & O Action because the exclusion does not specifically include the term “liquidator.” Alternatively, they argued that the exclusion is ambiguous as to whether the Liquidator is a “successor,” and that under rules of insurance contract interpretation, ambiguities are interpreted against the drafter and in favor of coverage.

The Liquidator argued that the term “successor” in the insurance contract requires the successor to be of like character. The Liquidator contended that she is of a different character because she does not act in the sole interest of the company as would a true successor to a corporation, but rather acts to protect the interest of creditors and the Commonwealth as a whole. Additionally, the Liquidator noted that the transfer of authority is not self-executing because the Insurance Act requires her to obtain permission from the Commonwealth Court before dissolving a corporation, whereas a Board of Directors could do so under its own authority.

The Court, noting that the D & O Policy does not define the term “successor,” held that when words are undefined within an insurance policy, words of common usage are to be construed in their natural, plain, and ordinary sense, and a reviewing court may inform its understanding of these terms by considering their dictionary definitions. Since “successor” is a word of common usage, the Court relied upon definitions of the term each of which encompassed the concept that successor means that by assuming the interests of another, one takes the other's place.

Under the statutory language of the Insurance Act, the Court found, the Insurance Act strips the insolvent insurer of any power to bring suit, instead granting that power to the Liquidator. Under the Act, the Liquidator takes the place of the insurer because the statute transfers all property, contracts and rights of action from the insurer to her, and requires the Court to direct the liquidator forthwith to take possession of the assets of the insurer ordered liquidated and to administer them under the orders of the court, vesting the Liquidator with title to all property of the insolvent insurer. These provisions from the Insurance Act, the Court said, are consistent with the dictionary definitions of the term “successor.” Accordingly, the Liquidator can be considered, for the purposes of the D&O policy, to come within the meaning of the term “successor.”

The Court rejected the Liquidator’s contention that successor necessarily refers only to a “corporate” successor, noting that while the definition from the 6th Edition of Blacks Law Dictionary contains the phrase “like character,” the 7th edition of Black's has deleted the phrase from its definition, providing it is “[a] person who succeeds to the office, rights, responsibilities, or place of another; one who replaces or follows another.” Given removal of the phrase from the later definition, and given that neither the general dictionaries nor the Civil Rules contains language requiring a successor to maintain identical structure, identity and form to the entity to which it succeeds, the Court refused to read this requirement into the definition.

The Court further rejected the contention that public policy considerations militate in favor of finding coverage. While it is the liquidator’s responsibility to recover assets and a finding that there is insurance coverage furthers that goal, in an instance such as this one, the Court said, involving a form of insurance coverage not required by Pennsylvania law, public policy cannot be a means to find coverage that is not there. The potential difficulty in recovering assets directly from the purported perpetrators cannot, in the name of public policy, be used to eviscerate an otherwise valid exclusion.

The Court also rejected the contention that the policy’s exception to the exclusion applied. The exception allowed coverage for derivative suits brought or maintained on behalf of the Company by one or more persons who are not insured and who bring and maintain the claim without solicitation, assistance or active participation of the company or any insured. The

Directors and Officers argued that the D & O Action was akin to a derivative suit because it was being brought by the Liquidator who is not insured, and because the Liquidator acts without assistance or involvement of the Company or any Insured.

In order to come within the exception, the Court said, the action must have been brought without the assistance or involvement of the company. The Court held that by law and court order, the Liquidator has been vested with all of the company's property rights, including contract rights, as well as the company's power to sue and be sued. The Liquidator stands in the shoes of the company, and is the management successor to the former directors and officers of the company. A company acts through its management, the Court said, and, since the Liquidator takes the place of the management, any action she brings is in effect brought with the assistance and participation of the company. Thus, the D & O Action did not come within the exception.

C. Arbitration clause not enforceable against liquidator; separate treaties may not be used for offset.

Koken v. Reliance Ins. Co, 846 A.2d 778 (Pa. 2004)
In re New Mexico Mutual Casualty Company and Southwest Casualty Company's Petition for Injunctive Relief and for Relief from Stay to Compel Arbitration.

Parent insurer and its subsidiary petitioned for injunctive relief and relief from stay, to compel liquidator to submit to arbitration as set forth in insurance contract, as to setoff claim involving insurers and insolvent insurer under reinsurance treaties.

Holdings: Liquidator could not be compelled to arbitrate offset claim, and parent insurer was not entitled to offset.

Background. Southwest Casualty Company (SWCC) was a wholly owned subsidiary of New Mexico Mutual Casualty Company (NMMCC). NMMCC and SWCC were parties to a treaty ("Treaty") and a reinsurance agreement ("Agreement"). NMMCC secured its obligation under the Agreement by providing Reliance with a Letter of Credit (LOC) from Wells Fargo Bank, on which Reliance was entitled to draw to reimburse Reliance for certain reinsured losses. Under the Treaty, NMMCC could exercise the right to offset any balance or balances due from one party to the other party. The agreement memorializing the transaction contained an arbitration clause wherein the parties agreed that all disputes were to be submitted to arbitration.

Reliance and NMMCC and SWCC were also parties to a second reinsurance agreement (the "2nd Treaty"). Under the 2^{nd} Treaty there was also a right to off-set balances due from one party to the other. This treaty also contained an arbitration clause.

Reliance sought to draw down on the LOC and NMMCC alleged that it was entitled to offset any sums due Reliance under the Treaty, against those sums due under the 2nd Treaty. NMMCC sought an order compelling the Liquidator to submit the matter to arbitration.

The Liquidator objected, contending that the liquidation court has exclusive jurisdiction to resolve issues related to the liquidation, and that pursuant to the order of the Court, no entity may sue Reliance without the Liquidator's consent.

The court noted a number of factors as relevant to its decision denying the motion. First, Insurance Commissioner is acting as Liquidator, not as Rehabilitator; second, the Court has entered an order declaring that no action may be brought against the Liquidator, including actions for arbitration, and that all actions shall be brought in the liquidation court; and third, the Liquidator was not the initiator of the suit. The liquidation order, the court held, clearly advises that disputes will not be submitted to arbitration unless the Liquidator so agrees, and "that is the critical point. The Liquidator has not agreed to suit; the Liquidator has not initiated suit."

The court said that the clarifying point here, as distinguished from other cases in which arbitration was allowed, is that consideration must be given to the party that initiates the lawsuit.

When initiating the lawsuit, one submits to the jurisdiction of the Court in which the action is filed, and the mere filing of a suit automatically implicates any contractual agreement to pursue arbitration. Where such an agreement exists, the agreement will be given primary consideration to determine the forum for continuation of the litigation. In initiating the lawsuit, the plaintiff must be bound by agreements to arbitrate unless grounds exist for revocation of that agreement.

Where, as here, a party to an agreement initiates an action against the Liquidator, and seeks to force the Liquidator to honor the contractual arbitration clause, the Liquidator may decline to do so, asserting a compelling reason to revoke that contractual provision. The mere presence of an arbitration clause does not divest a court of jurisdiction, but the court should not extinguish the freely negotiated right of a party to arbitrate absent a compelling reason.

The court said it gave primary consideration to the fact that the Liquidator is asking not to be required to arbitrate a matter in a forum other than Pennsylvania, and that the matter would at most result in a judgment that must then be submitted to the proof of claim process in the liquidation proceeding. The Liquidator contends that this is a time-consuming and inefficient way to handle the affairs of the estate. That point, the court said, was “most cogent.” The Court reasoned that it has put into place a mechanism that recommends that certain matters be submitted to Referees for resolution and that process has proven most effective. To remove this issue from the Court's jurisdiction for the net result of having a proof of claim submitted to the estate, which conceivably could be subjected to further litigation, lays waste to the assets of the Estate.

The Court also rejected NMMCC's assertion that NMMCC and SWCC are essentially the same entity thereby creating a mutual debt or credit that implicates the set-off provisions of the Insurance Act. The two treaties are not to be read together and treated as one, it held, with each used to offset the debts and obligations owed under the other. To constitute a mutual debt, the debt must be solely between the same parties and the contracts under the debt arise must be between the same parties. Reliance, the creditor, chose not to seek to pierce the corporate veil of the two entities, and the Court will not compel it do to do so. There are separate agreements that involve separate legal entities. Set-off is not available as there are not mutual demands, i.e., reciprocal demands. Instead, through a circuitous route, NMMCC would have its obligation to Reliance reduced by the obligation owed by Reliance to SWCC.

D. Missouri receivership court may apply law of another forum in determining validity of claims.

Viacom, Inc. v. Transit Casualty Co. in Receivership, 138 S.W.3d 723 (Mo. 2004)

Insured manufacturer of asbestos products sought to apply Pennsylvania law to claims filed in Missouri receivership proceeding.

Holding. Although conflict-of-laws analysis is governed by the common law, since the choice-of-law question is not addressed by the insolvency code, the common law and general statutes will be applied. Therefore, under general conflict-of-laws principles, Pennsylvania law would be applied to the Westinghouse, now Viacom, claim asserted in the Missouri insolvency proceeding. Moreover, applying Pennsylvania law does not impair uniformity and fairness in Missouri proceeding.

Background. Westinghouse Electric Corporation, now Viacom, Inc., purchased excess-insurance policies from Transit Casualty Company. Transit was later placed in receivership. Westinghouse sought to apply Pennsylvania law, because under Missouri law, Westinghouse would collect nothing on its policies.

The policies provided that in the event Transit failed to pay the claims, Transit would submit to the jurisdiction of any court of competent jurisdiction within the United States and would comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such court.

Based upon general conflicts of laws principles, the Missouri court held that ordinarily, Pennsylvania law would control the validity of the claims. Having resolved that issue, the Court found it was still necessary to determine if Transit's receivership status changed that result.

Transit argued that Missouri law applied to the claims in the receivership, among other reasons, because conflict-of-laws analysis is common law, over which the insolvency statute prevails. However, the Court found that the choice-of-law question is not addressed by the insolvency code. Where the insolvency code is silent, courts apply the common law and general statutes.

Transit also contended that applying Missouri law to all claims is the only way to achieve uniformity and fairness. It contended that in order for an insolvent company to focus on ratably distributing its assets to all its creditors, only one law -- Missouri’s -- can be applied to all the claims. The Court, however, held that the argument ignores that when parties initially contract for insurance, they know they are subject to the law of the state they choose or the state with the most significant relationship. If a claim is made, that state's law determines coverage.

The most ratable distribution of Transit's assets, the Court reasoned, requires that the receivership only pay claims that would be valid if the company had remained solvent. Engaging in a conflict-of-laws analysis to determine which state's law applies is a reasonable request of the receivership court. If that analysis determines that a law other than Missouri's controls, applying foreign law should not burden the receivership court more than analyzing a claim under Missouri law.