Assurances

Assurances

What are your legal remedies? Collecting on Claims against Insolvent Insurers

John N. Gavin

Volume 57, Number 2, 1989

URI: https://id.erudit.org/iderudit/1104695ar
DOI: https://doi.org/10.7202/1104695ar

See table of contents

Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)
2817-3465 (digital)

Explore this journal

Cite this document

Gavin, J. (1989). What are your legal remedies? Collecting on Claims against Insolvent Insurers. *Assurances*, *57*(2), 156–172. https://doi.org/10.7202/1104695ar

Article abstract

La perspective de subir une perte majeure et non recouvrable suffit pour convaincre la plupart des gestionnaires de risques de l'importance d'analyser la stabilité financière de leurs assureurs. Malgré tous vos efforts pour placer une couverture avec des sociétés financièrement stables, vous risquez néanmoins de devenir un réclamateur contre une compagnie d'assurances en faillite. Dans un tel cas, avez-vous un recours contre le réassureur de votre assureur ? Voilà une des questions abordées par l'auteur dans son analyse des moyens légaux auxquels les réclamateurs peuvent recourir dans de telles situations.

What are your legal remedies ? Collecting on Claims against Insolvent Insurers[1]

by

John N. Gavin[2]

La perspective de subir une perte majeure et non recouvrable suffit pour convaincre la plupart des gestionnaires de risques de l'importance d'analyser la stabilité financière de leurs assureurs. Malgré tous vos efforts pour placer une couverture avec des sociétés financièrement stables, vous risquez néanmoins de devenir un réclamateur contre une compagnie d'assurances en faillite. Dans un tel cas, avez-vous un recours contre le réassureur de votre assureur ? Voilà une des questions abordées par l'auteur dans son analyse des moyens légaux auxquels les réclamateurs peuvent recourir dans de telles situations.

~

The subject of this article encompasses a myriad of separate legal issues involving claims against insolvent insurance companies. Those issues may be conveniently categorized into three general areas, however : (a) seeking recovery by means other than a claim against the general assets of the insolvent insurer ; (b) pursuing claims against the general assets of the insolvent insurer ; and (c) issues regarding particular claims. Since the alternative of pursuing assets other than general assets provides the best opportunity for the claimant to recover, that will be discussed first.

---

[1] Reprinted from *The John Liner Review*, Volume 2, Number 3, Fall 1988, with permission of the publisher, Shelby Publishing Corporation, 210 Lincoln Street, Suite 700, Boston, MA 02111-2491. Subscription information : (800) 682-5759.

[2] Mr. John N. Gavin is a partner in the law firm of Hopkins & Sutter in Chicago.

Pursuing Assets Other Than General Assets

In most insurance insolvencies, there may be a number of possible alternatives to recover on a claim other than by filing a claim against the general assets of the insolvent insurer. These include :

- claims against the guaranty associations (a subject in itself that is beyond the scope of this article),
- claims against statutory deposits,
- claims against other local assets of the insurer in foreign states,
- secured claims,
- attachment and garnishment,
- trust claims,
- set-offs,
- reinsurance,
- excess insurance,
- actions against insureds.

The availability and practicality of each of these approaches depends on a number of factors – *e.g.*, the law of the domicile of the insolvent insurer, the law of the state of the claimant and of the state where the asset is located, the agreements executed by the insolvent insurer, and the actions taken by the claimant prior to the liquidation. The issues raised in the general discussion which follows may vary because of these and other factors in any particular instance.

Statutory deposits : Many states require foreign insurers to deposit assets with state officials as a condition of doing business there. The deposit may be made for the benefit of all policyholders of the company, *see, e.g.*, Ill. Rev. Stat., Ch. 73, § 638, or for the benefit of the creditors in that state alone. If the latter is the case, a creditor may be able to seek and obtain a recovery on its claim out of the deposit made in that state. *See, e.g., Andrews v. Cahoon*, 86 S.E. 2d 173 (Va. 1955), *State ex rel. Driscoll v. Early American Insurance Company*, 733 P. 2d 919 (Oregon Ct. App. 1987).

In addition, even though a state statute may provide that the deposit is for the benefit of all the company's policyholders and creditors, a deposit may, by virtue of the retaliatory laws of such

state, be held to be a special deposit for the benefit of that one state's policyholders and creditors. *See, e.g., Commissioner of Insurance v. Equity General Insurance Company*, 363 Mass. 233 (1963).

This preference accorded to local creditors is valid under both the Constitution and the Uniform Insurers Liquidation Act. Even though a liquidator has title to all assets of an insolvent insurer, each state has jurisdiction to determine for itself the liability of property within such state to the claims of creditors within such state. *See, e.g., Clark v. Willard*, 294 U.S. 211 (1935) ; *Clark v. Preferred Accident Insurance Company of New York*, 97 S.E. 2d 498. 502 (S. Car. Sup. Ct. 1957).

Although one of the purposes of the Uniform Insurers Liquidation Act is to ensure equality of treatment among creditors, the Uniform Insurers Liquidation Act still allows for preferences to be given local creditors out of statutory deposits. However, the Uniform Insurers Liquidation Act provides that claimants receiving a recovery on their claims out of such deposits may not recover any amount of the general assets of the estate until all policyholders have received an equivalent recovery.

The parties entitled to make a claim against such a deposit, the priority of such claimants, and the manner of making such a claim, are governed entirely by the laws of the local state. In most cases, the claim must be proved to the satisfaction of the local insurance commissioner and perhaps approved by the court. *See, e.g., Underdahl v. Holman*, 60 P. 2d 968, 971 (Or. Sup. Ct. 1936).

If both the domiciliary state and the state where the deposit is made are reciprocal states within the meaning of the Uniform Insurers Liquidation Act, even special deposit claims may have to be presented and ruled upon by the domiciliary liquidator and court (if no ancillary receiver has been appointed in the state where the deposit is made). *See, e.g., Hill v. Superintendent*, 678 S.W. 2d 434, 438-39 (Mo. Ct. App. 1984).

Other Local Assets : The same principal relating to statutory deposits may in some cases be applied to other assets of the insurer located in an ancillary state. A few states may still provide that such local assets are subject to the claims of creditors of that state. If so, creditors may be able to secure payment of their claims out of such

assets. *See In re National Surety Co.*, 36 N.E. 2d 119, 122 (N.Y. Ct. App. 1941) ; *Couch on Insurance* § 22:92.

However, most states explicitly afford priority to local claimants only with respect to statutory deposits made in that state. Moreover, the Uniform Insurers Liquidation Act will preclude any effort by local creditors to secure payment of claims out of the general assets in the state (assuming that both the domiciliary state of the insurer and the creditors' state are reciprocal states).

Secured claims : The Uniform Insurers Liquidation Act provides that the owner of a secured claim may : (1) surrender the security and file a claim as a general creditor ; or (2) such secured claim may be discharged by resort to the security. The value of the security is generally determined by agreement between the liquidator and the claimant or the liquidation court. The deficiency, if any, is treated as a claim against the general assets of the insurer on the same basis as claims of unsecured creditors.

At least one court has held that, in cases involving reciprocal states, a claimant must present his claim to the domiciliary receiver (or an ancillary receiver, if any) in order to have the validity and amount of the claim determined. *See G.C. Murphy Company v. Reserve Insurance Company*, 429 N.E. 2d 111 (N.Y. Ct. App. 1981). *See also Hill v. Superintendent*, 678 S.W. 2d 434 (Mo. App. Ct. 1984).

In addition, creditors that have security for their claims are at times afforded a priority over policyholders and other general creditors. *See, e.g.*, Ill. Rev. Stat. Ch. 73 § 817.

Trust claims : The circumstances surrounding a claim may be such so as to allow the claimant to argue that certain assets are held in trust for his benefit. The best example of a situation in which such a claim may be asserted is where the assets are identifiable and segregated from other assets and the applicable documentation makes it clear that such assets are held in trust. Even in such cases, however, the courts can be expected to apply general trust principles including the requirement that the trust funds at one time must have been in the possession of the insolvent insurer and that the property remaining in the possession of the insolvent insurer includes trust funds.

See, e.g., In re New York Title and Mortgage Company, 297 N.Y.S. 524 (N.Y. Sup. Ct. 1937).

In addition, there have been situations where a claimant's claim regarding a trust were upheld on theories relating to a "resulting trust," or constructive trust or similar arguments. *See, e.g., In re Imperial Insurance Company*, 203 Cal. Rptr. 664 (Cal. Ct. App. 1984). However, the courts are generally not receptive to arguments in cases where the funds are not segregated and explicit documentation does not provide for trust. *See, e.g., State ex rel. Hunt v. Community*
160 *National Life Insurance Company*, 560 P. 2d 560 (Ok. Sup. Ct. 1977) ; *Liquidation of Union Indemnity Insurance Company of New York*, 502 N.Y.S. 2d 907 (N.Y. Sup. Ct. 1986).

Attachment and garnishment : The Uniform Insurers Liquidation Act provides that : (1) during delinquency proceedings, no action in the nature of an attachment, garnishment or execution may be commenced or maintained in a state's courts ; and (2) a lien obtained by any such attachment or garnishment proceeding within four months prior to the commencement of insolvency proceedings is void. In addition, even apart from the Uniform Insurers Liquidation Act, a state's law may well preclude attachments by creditors of insolvent insurers. *See, e.g., Arroyo v. Chesapeake Insurance Company*, 224 A. 2d 101 (Pa. Super. Ct. 1966).

Nonetheless, possibilities for attachment or garnishment still exist. If attachments or garnishments are effective in sufficient time ahead of the initiation of insolvency proceedings, the creditor may obtain the value of such attachment or garnishment. *See, e.g., Williams v. Gottlieb*, 249 So. 2d 425 (Fla. Sup. Ct. 1971) ; *Lewycka v. Springfield Mutual Insurance Company*, 191 A. 2d 925 (Pa. Super. Ct. 1963).

In addition, if the domiciliary state of the insurer and the state where garnishment or attachment proceedings are pending are not both reciprocal states, the prohibitions of the Uniform Insurers Liquidation Act will not apply. *See, e.g., Alabama National Life Insurance Company v. Gammill*, 504 P. 2d 516 (Ariz. Ct. App. 1972).

Offsets : Most states' statutes allow offsets in the cases of "mutual debts or mutual credits" between the insolvent insurer and the creditor. A creditor meeting the requirements of the applicable

statutory provisions may therefore be entitled to recover on a claim against an insolvent insurer by simply offsetting the amount due the claimant against any amounts due from the creditor to the insolvent insurer.

Generally, in order to meet the requirement of "mutual debts or mutual credits," the claims must be due to and from the same persons in the same capacity. As a result, if one claim is in the nature of a trust, and the other claim is a contractual obligation of a debtor or creditor, this requirement may not be satisfied. *See, e.g., Superintendent of Insurance of the State of New York v. Baker & Hostetler,* 668 F. Supp. 1057 (N.D. Ohio 1986). In addition, the obligations to and from the creditor must both have existed at the time of insolvency. *See Melco System v. Receivers of Trans-America, Inc. Co.*, 105 So. 2d 43 (Ala. Sup. Ct. 1958).

While in a number of instances offsets have been thought to be self-executing, at least one decision holds that an offset may be taken only upon presentation to the receivership court of a claim for the offset. *See Sunset Commercial Bank v. Florida Department of Insurance,* 509 So. 2d. 366 (Fla. Dist. Ct. App. 1987).

Reinsurance : Generally speaking, a policyholder is not entitled to the proceeds of any payments due pursuant to reinsurance agreements between the insolvent insurer and the reinsurer. Numerous court decisions have held that the policyholder has no right of action against the reinsurer and has no right to the payments due from the reinsurer. *See, e.g., Arrow Truck Co. v. Continental Insurance Company,* 465 So. 2d 691 (La. Sup. Ct. 1985).

However, two possible approaches might be available to policyholders in seeking an exception to the above general rules. First, the terms of the reinsurance agreement might be construed to allow a policyholder to sue the reinsurer directly and to seek and obtain amounts due from the reinsurer. *See, e.g., Ott v. All-star Insurance Co.*, 299 N.W. 2d 839 (Wisc. Sup. Ct. 1981). Such situations are rare. Generally, the reinsurance agreement will be construed to preclude payment directly to the insured (especially if the standard insolvency clause is present in the agreement).

Second, the insured may have been successful, when its policy with the insolvent insurer was issued, in seeking and obtaining a

"cut-through" endorsement specifically providing that reinsurance on such policy is to be payable directly to the insured claimant. In such cases, the insured obviously has a much stronger argument that it is entitled to the reinsurance proceeds. However, at least one court decision has ruled that a cut-through endorsement in an insolvency situation confers a preference on the policyholder benefiting from the cut-through endorsement and is therefore invalid. *See Warranty Ass'n v. Commonwealth Insurance Company*, No. R-80334 (Puerto Rico Sup. Ct. April 13, 1983). As a result, several commentators have questioned whether cut-through endorsements are enforceable
162 if the insurer issuing the policy is insolvent.

Excess insurance : A policyholder may also be able to look to its excess insurance policy as a source of recovery if the primary insurer is insolvent. In such situations, the insured may be able to argue that the excess coverage "drops down" to provide coverage for the portion of the claim within the primary policy's coverage. Such arguments have been successful in at least several cases. *See, e.g., Reserve Insurance Company v. Pisciotta*, 180 Cal. Rptr. 628, 640 P. 2d 764 (Cal. Sup. Ct. 1982) ; *Donald B. MacNeal, Inc. v. Interstate Fire and Casualty Co.*, 477 N.E. 2d 1322 (Ill. App. Ct. 1985).

However, excess carriers can be expected to argue strongly that their coverage applies only if the primary policy's limits have been reached (regardless of whether any amounts have been paid pursuant to the primary policy). The courts have sustained such arguments when the language in the excess policy made clear that the excess policy provided coverage only over specified limits.

Actions against insureds : Of course, third parties injured by insureds of an insolvent insurer can still pursue and prosecute claims against such insureds, notwithstanding the insolvency of the insurer. *See, e.g., Larey v. Morris*, 432 S.W. 2d 861, 864 (Ark. Sup. Ct. 1968). Obviously, such an approach is not particularly useful if the insured has no property. Even in such cases, however, any judgments against the insurer might be used as evidence in the liquidation proceeding of the amount and validity of the injured party's claim.

Claims against General Assets of Insurer's Estate.

In many cases, none of the foregoing alternatives will be available to the creditor, and its sole recourse will be to file a claim against

the general assets of the insolvent insurer's estate. A number of separate matters may arise in connection with any such claim.

Filing the claim : A creditor must typically initiate its recovery against the estate by filing a claim with the liquidator. In some cases, however, local statutes (or procedures adopted by the liquidator) will not require claimants to file claims ; the liquidator will determine claims by review of information in the company's files. In addition, claimants might not be required to file claims if they are assignees of parties that have already filed claims. *See, e.g., Maryland Insurance Guarantee Association v. Muhl*, 504 A. 2d 637, 646 (Md. Ct. App. 1986).

Form of claim : Typically, liquidators will prepare and send to all claimants a printed form of claim setting forth the information that the liquidator requires in order to process the claim. However, in most cases, liquidators will accept for filing any document signed by a claimant that satisfies the basic elements for a proof of claim – *i.e.*, the name of the policyholder, the amount of the claim, and the circumstances of the claim.

Timely filing of claims : It is important for claimants to insure that claims are filed within the time fixed by statute or by court order, because otherwise they may be barred from recovery. *See, e.g., Great American Investment Company v. McFarling*, 416 S.W. 2d 479 (Tex. Ct. Civ. App. 1967). This applies even if the claimant did not know of the third party claim against him at the time of the deadline for filing claims against the estate. *See, e.g., Jason v. Superintendent of Insurance*, 413 N.Y.S. 2d 17, aff'd 406 N.E. 2d 143 ; *Ohio Insurance Guaranty Association v. Berea Roll & Bowl, Inc.*, 482 N.E. 2d 995 (Ohio Ct. C.P. 1984).

To protect themselves in such situations, claimants have been advised to file a protective claim even though they know of no specific incident which could give rise to a claim. *Cf. Middleton v. Imperial Insurance Company*, 666 P. 2d1, 4n.5 (Cal. Sup. Ct. 1983). It is not clear whether such a measure will really protect a claimant's interest, but it is the best that can be done under the circumstance.

Several states' statutes allow a late claim to share in the distribution of assets if the claimant meets the requirements of such statutes, and the allowance of such claim will not prejudice the orderly

administration of the estate. In addition, several decisions have upheld a claimant's untimely claim if the claimant can establish that he was among the class of persons that the liquidator should have notified of the liquidation proceedings, but failed to do so. *See, e.g., Middleton v. Imperial Insurance Company*, 666 P. 2d 1 (Cal. Sup. Ct. 1983) ; *Georgia Insurers Insolvency Pool v. Moore*, 357 S.E. 2d 823 (Ga. Ct. App. 1987).

One court has extended this concept to an untimely claim filed by a claimant to whom notice had been mailed at his last known address. The claimant never actually received the notice due to the liquidator's failure to ascertain the claimant's new address. *Bunner v. Imperial Insurance Company*, 225 Cal. Rptr. 912 (Calif. Ct. App. 1986).

Amendment of claim : Circumstances may arise where a claimant may wish to amend a claim it filed in the liquidation proceedings. There is very little case law on this question. A claimant's ability to amend its claim may depend on the scope of its original claim and the subsequent circumstances giving rise to the amendment. At least one court has held that an amendment to a claim may be made but that the amendment, in effect, is considered a new claim to be treated in the same manner as all late claims – *i.e.*, no payment was to be made on such claim until all allowed timely claims were paid in full with interest. *See Professional Construction Consultants Inc. v. State ex rel. Grimes*, 646 P. 2d 1262, 1267-68 (Ok. Sup. Ct. 1982). *See also Muir v. Transportation Mutual Insurance Company*, 523 A. 2d 1190, 1192 (Pa. Common. Ct. 1987).

Evidence in support of a claim : Obviously, a claimant should present evidence in support of the claim – either at the time the claim is filed or at a different time if permitted by the liquidator or the court. Included among such evidence should be a copy of the policy and sufficient documents to indicate that the loss is within the scope of the policy and to establish the amount of the loss.

The decisions of the courts indicate that the claimant must prove both the terms of the policy and that the loss is covered by the terms of the policy. *See, e.g., In re International Reinsurance Corporation*, 48 A.2d, 529 (Del. Ct. Chanc. 1946). A failure to present evidence in support of the claim can be grounds for a liquidator to bar any recovery on the claim. *See Appleman* § 10725 at page 228. The

claimant has the burden of proof to support a claim and the mere filing of a proof of claim does not cast that burden upon the liquidator. *See Couch on Insurance* § 22:82.

Processing of claim : Typically, the liquidator's staffs work very slowly in reviewing and processing claims. As a result, claimants can expect to wait a lengthy period of time pending the resolution of their claims. It would probably be wise on the part of the claimants, in order to insure that the claim is not "lost in the shuffle," to check periodically with the liquidator's staff in order to determine the status of the claim.

If a claimant is particularly concerned about the resolution of the claim, the claimant could attempt to seek a resolution by the liquidation court of its claim by filing a petition with the court regarding its claim. While the liquidator may object to such an approach by claiming that it unduly disrupts the review process, at least the claimant will have brought the claim to the attention of the court, which can then detemine how the claim should be resolved.

Determination of claim : The liquidator's staff is generally charged in the first instance with reviewing the claim and determining the validity, amount and priority of the claim. The NAIC Model Act requires the liquidator to notify a claimant of his initial decision and allows a claimant to file objections with the liquidator within 60 days ; if the claimant fails to do so, he waives the right to contest the liquidator's recommendation in court. The liquidator may consider his decision upon receipt of such objections.

Any determination by the liquidator must then typically be reviewed by a court. The vast majority of claims are approved by the court without objection by the claimant. In such cases, the liquidator's initial determination has satisfied the claimant, or the liquidator's staff and the claimant have reached an agreement after negotiation upon the validity, amount and prioritry of the claim.

In the relatively few cases where the liquidator's staff and the claimant may not have agreed on the resolution of the claim, the claimant must object in court to the liquidator's determination with respect to the claim. The procedure by which the claimant can do so may differ in the various states.

In many instances, the liquidator's staff will initiate the process by presenting its recommendation to the court, and the claimant will be advised as to the date of the hearing on the claim and the manner in which he can present his objections to the court. However, in other states, the burden may be on the claimant to initiate the process before the court. Claimants must insure that they carefully review the procedures established by each state's statutes or court orders in order to determine the manner in which they must timely object to any proposed determination by the liquidator's staff with respect to their claim.

How the liquidation court hears and determines questions relating to the claim is again guided by local state statute and that court's procedures. Those procedures will address such issues as the order and manner in which the parties may present their contentions to the court, whether a jury trial is available, and the manner for appealing determinations reached by the liquidation court.

Alternative methods for determining claims : In the alternative, a claimant may prefer that his claim be resolved in a forum other than the liquidation court. Although generally claims must be heard and resolved by the liquidation court, the claimant may have some other alternatives available to it :

(a) Ancillary proceedings. If the domicile of the insurer and the claimant's state are both reciprocal states, and if the commissioner of insurance in the claimant's state establishes an ancillary proceeding, the claimant will be entitled to present its claim in the ancillary proceeding. *See State v. Preferred Accident Insurance Company of New York*, 149 So. 2d 632 (La. Ct. App. 1963). Under the Uniform Insurers Liquidation Act, the ancillary court would have jurisdiction to hear and determine the claim. The allowance of the claim by the courts of the ancillary state is to be final and conclusive both as to its amount and also as to its priority, if any, against special deposits or other security located within the ancillary state.

(b) Independent actions in other forums. Generally speaking, either the statutes of the insurer's domicile, or orders entered by the liquidation court, will seek to enjoin the prosecution of actions against the insolvent insurer in forums other than the liquidation court. Although the weight of authority is against the claimant seeking to litigate a claim outside of the liquidation proceedings, there

may be several ways to approach this alternative. First, if the claim is a federal claim, a claimant may well be able to litigate the claim in the federal courts, particularly if a state's courts do not have jurisdiction over such claim or doubt exists whether they can afford the relief requested. *See, e.g., Central States v. Old Security Life Insurance Company*, 600 F. 2d 671 (7th Cir. 1979); *Universal Marine Insurance Company, Ltd. v. Beacon Insurance Company*, 592 F. Supp. 948 (W. Dist. N.C. 1984). Second, although some state and federal courts have accorded a binding effect to an injunction issued by another state's court, other courts have refused to do so. *See, e.g., Slotkin v. Brookdale Hospital Center*, 357 F. Supp. 705 (S.D. N.Y. 1972); *Furham v. United American Insurers*, 269 N.W. 2d 842 (Minn. Sup. Ct. 1978).

(c) Arbitration. Although there are decisions which indicate that arbitration provisions in contracts with an insurer are not enforceable once insolvency proceedings begin, *see, e.g., Knickerbocker Agency, Inc. v. Holz*, 149 N.E. 2d 885 (N.Y. Ct. App. 1958), several recent federal court decisions indicate that the provisions of the Federal Arbitration Act allow a claimant to seek and obtain arbitration if the claimant's contract with the insolvent insurer provides for arbitration. *See, e.g., Universal Marine Insurance Company v. Beacon Insurance Company*, 592 F. Supp. 948 (W.D. N.C. 1984). At least one federal court, however, has refused to allow arbitration under such circumstances. *See Washburn v. Corcoran*, 643 F. Supp. 554 (S. Dist. N.Y. 1986).

(d) Actions against the insured. Typically, neither the liquidation statutes nor the orders of a liquidation court preclude parties from pursuing actions against an insured of an insolvent insurer. Accordingly, parties obtaining judgments against such insureds may present those judgments in liquidation proceedings. In such cases, at least one court has held that the liquidator is bound by such judgments and could not require third parties to prove their claims anew in the liquidation proceedings. *See, e.g., Commonwealth ex rel. Woodside v. Seabord Mutual Casualty Company*, 202 A. 2d42 (Pa. Sup. Ct. 1964). *See also In re International Reinsurance Corporation*, 48 A. 2d 529 (Del. Ct. Chanc. 1946).

However, many states' liquidation statutes contain provisions stating that no judgment against an insured after the date of the

commencement of the insolvency proceedings shall be considered in the liquidation proceedings as evidence of liability or damages. Although such provisions may raise questions under the Full Faith and Credit Clause, *see Morris v. Jones*, 329 U.S., 545 (1947), *Couch on Insurance* § 22:83, at least one court has given effect to such provision. *Ratner v. Wheeler*, 301 S.W. 2d 268 (Tex. Ct. Civ. App. 1957).

Particular Issues Regarding Claims

A myriad of issues can arise in a liquidation proceeding regarding the various types of claims presented. While it is not possible to

discuss each issue that may arise, the following discussion relates to the types of issues that arise most frequently :

Cancellation of policies : Typically, a liquidation court will order that all policies be cancelled as of the date of liquidation (or shortly thereafter). Claimants must act immediately to replace such coverage, since any loss occurring after the date of cancellation cannot be asserted as a claim against the insolvent insurer. *See Appleman*, § 10724 at p. 216.

Defense of claims : The other most immediate problem a claimant may face is the question whether the insolvent insurer will continue to defend actions against such claimant pursuant to the terms of the insurance policy. In general, most states' statutes provide that the obligation of the insurer to defend an action against an insured ceases upon the initiation of liquidation proceedings. *See Prince Carpentry, Inc. v. Cosmopolitan Mutual Insurance Company*, 479 N.Y.S. 2d 284, 291 (N.Y. Sup. Ct. 1984). In such situations, however, a claimant may well be able to secure a defense from the local guaranty association. Most states' statutes generally provide that the cost of defending the litigation may be added to the claimant's claim against the estate.

Rights fixed as of a certain date : Most states' statutes or court orders regarding liquidation will establish a date as of which the rights of the insurer and all persons claiming against the insurer become fixed. This date is important for several reasons, including the date as of which the claim must be valued, interest on the claim and possible offset rights.

Priority of claims : As a general rule, in the absence of a contrary statutory provision, the general assets of an insurance com-

pany are distributed ratably among the policyholders and general creditors of the company. *See Appleman* § 10721 at p. 200 ; *Couch on Insurance* § 22:84 ; *Matter of Dome Insurance Company*, 592 F. Supp. 1219 (D.V.I. 1984). However, almost all state statutes now prescribe the priority to be accorded to different types of claims.

One issue which has been litigated in several courts recently is the question of whether reinsured insurance companies are entitled to the same priority as the policyholders. Recent decisions of the courts indicate that, where a state liquidation code affords priority to policyholders ahead of general creditors, reinsured insurance companies are not to be regarded as policyholders ; rather, they fall within the category of general creditors. *See, e.g., Foremost Life Insurance Company v. Department of Insurance*, 409 N.E. 2d 1092 (Ind. Sup. Ct. 1980).

Contingent claims : Under many states' insurance liquidation codes, parties holding contingent claims must file on the last claim date fixed by the liquidation court ; however, they are afforded a certain amount of time thereafter in order to liquidate the contingent claim. While this approach affords those parties holding a contingent claim the luxury of additional time in order to establish the validity and the amount of such claim, the decisions interpreting such provisions reach differing views as to what is a "contingent claim." For example :

- At least one court has taken the view that, if an event giving rise to liability has already occurred, a cause of action has already accrued and a claim thus grounded cannot be said to be contingent. *See Pierce v. Johnson*, 23 N.E. 2d 993, 995 (Ohio Sup. Ct. 1939). Under this approach, very few, if any, claims would be contingent claims ; so, the provisions regarding contingent claims would have little, if any, effect.
- A number of decisions take the view that "in insolvency cases, a contingent claim is one as to which it remains uncertain whether the insolvent party will ever become liable to pay. If the liability is certain, then the claim is not contingent but merely unliquidated." *Hilgeman v. State ex rel. Payne*, 374 So. 2d 1327, 1329 (Ala. Sup. Ct. 1979). *See also Matter of Empire State Surety Company*, 108 N.E. 825 (N.Y. Ct. App. 1915). Under this approach, if liability is fixed, but the

amount of liability is undetermined, the claim would not be a contingent claim.

- Several decisions have taken the approach that the term contingent claim covers claims that "either as to their existence or as to the amount, depend upon some future event uncertain either as to its occurrence altogether, or as to the time of its occurrence." *See Collier on Bankruptcy*, II 63.30 (14th ed. 1975) ; *In re Gladding Corp.*, 20 B.R. 566, 567 (1982). This approach appears to be supported by less judicial authority relating to insolvent insurers than the one discussed in the preceding paragraph.

- At least one court has stated that the truly contingent claim is one "where the event on which liability would arise has not yet occurred. An illustration is a possible future claim on a fire policy on which there has not yet been a fire." *See Matter of Wisconsin Surety Corporation*, 332 N.W. 2d 860, 863 (Wis. Ct. App. 1983).
- Finally, another court has described a contingent claim as one where the event giving rise to the loss occurred but the claimant does not yet know about it. *See Middleton v. Imperial Insurance Company*, 666 P. 2d 1, 3-4 (Cal. Sup. Ct. 1983).

One question which frequently arises in this area is whether claimants may recover for unmatured installments. Several courts have determined that a claim for unmatured installments may be upheld. *See Pate v. Security Union Insurance Company*, 54 S.W. 2d 355, 357 (Tex. Civ. App. 1932) ; *Pennsylvania Steel Co. v. New York City Railway Co.*, 198 F. 721, 738-39 (2d Cir. 1912). Other courts have extended this principle to uphold claims even where the duration of the installments is dependent upon the life of a person, for the reason that resort may be made to "certain tables used in the business of life insurance showing the expectancy of life for persons of all ages." *See Caminetti v. Manierre*, 142 P. 2d 741, 749 (Calif. Sup. Ct. 1943).

Third party claims : In most cases, it is pointless for a third party to seek recovery from an insured, for the reason that such insured would not be able to pay much, if any, of the judgment awarded. Consequently, most state insurance codes afford a third

party who has a claim against an insured to file a claim in the liquidation proceeding. Typically, such claim may be allowed if (1) satisfactory proof is presented that the third party would be able to obtain a judgment against the insured, and (2) the total liability of the insurer to all claimants arising out of the same act of the insured would be no greater than its total liability if it were not in liquidation.

One note of caution : Several states provide that, by filing a claim in the liquidation proceedings, a third party releases the insured to the extent of applicable policy limits. *See Wis. Stat.* § 645.64.

Attorneys' fees : Claims by attorneys for fees for services rendered on behalf of the insolvent insurer prior to insolvency proceedings are generally regarded as general creditor claims and entitled to priority only as general creditors. *See Kelly, Walker & Liles v. McFarling*, 509 S.W. 2d 659 (Tex. Ct. Civ. App. 1974) ; *Greenfield v. Pennsylvania Guaranty Association*, 389 A. 2d 638, 640 (Pa. Super. Ct. 1978). However, attorneys' fees for services rendered in resisting liquidation proceedings may be paid as a preferred claim as part of the expenses of the administration. *People ex rel. Schacht v. Main Insurance Company*, 448 N.E. 2d 950 (Ill. App. Ct. 1983). Insureds that retain attorneys in defense of claims against such insureds may generally add the cost of such attorneys' fees to a claim against the insolvent insurer.

Claims by assignees : Typically, the courts have allowed assignees to stand in the shoes of their assignors with respect to the assignor's claim against the insolvent insurer. *See, e.g., Maryland Insurance Guaranty Association v. Muhl*, 504 A. 2d 637 (Md. 1986). However, many states' statutes or court decisions preclude an assignee from taking an offset against an insolvent insurer where the claim was purchased by such assignee with a view of its being used as a set-off or counterclaim. *See, e.g., Gamrbell v. Cox*, 157 S.E. 2d 233 (S. Car. Sup. Ct. 1967).

Interest : The general rule regarding interest on claims is that a creditor is entitled to interest on its claim only to the date of the liquidation order and not thereafter. *See Joplin Corporation v. State ex rel. Grimes*, 570 P. 2d 1161 (Ok. Sup. Ct. 1977). At least one court, however, has held that where sufficient funds existed to pay all claims with interest, allowance of interest on allowed claims was

proper. *See Matter of United States Branch of Sumitomo Marine and Fire Insurance Company*, 133 N.Y.S. 2d 342 (N.Y. Sup. Ct. 1954).

Class action claims : At least one court has held that a claim may be pursued as a class action. *See Matter of Consolidated Mutual Insurance Company*, 488 N.Y.S. 2d 19 (N.Y. Sup. Ct. 1985). *But see Mendel v. Garner*, 678 S.W. 2d 759 (Ark. Sup. Ct. 1984).

Assumptions of liabilities by new insurer : In some cases, a solvent insurer will assume the liabilities of the insolvent insurer pursuant to an agreement with the liquidator and approved by the court. If
172 the insured accepts this arrangement, the rights of the insured may well be governed not only by the terms of its policy with the insolvent insurer and the circumstances surrounding its claim, but also by the terms of the contract by which the solvent insurer has assumed the liabilities of the insolvent insurer. *See, e.g., Casteel v. Kentucky Home Life Ins. Co.*, 79 S.W. 2d 941, 943 (Ky. 1935). However, an insured need not accept such an arrangement, in which case the insured still is entitled to its pro rata share of the assets of the insolvent insurer. *Id.* at 944.

United States' claims : The United States has become much more aggressive in prosecuting its claims against insolvent insurers. The United States prosecutes its claims under Section 3713 of Title 31 of the United States Code, which establishes as absolute priority for government claims. Thus far, the decisions are conflicting with respect to such priority, with one decision stating that the federal government's priority is to be determined by the state liquidation code because of the McCarran-Ferguson Act, *see State of Idaho v. United States*, 662 F. Supp. 60 (D. Id. 1987) ; and one decision upholding the federal government's priority claim. *See Gordon v. United States Department of Treasury*, 668 F. Supp. 483 (D. Md. 1987).

A Concluding Note

As noted at the outset, this article attempts only to describe generally the law applicable to claims against insolvent insurance companies. The foregoing discussion may not apply to any particular instance because of differences in the laws of the domiciliary state of the residence of the claimant, the type of claim involved, the agreements involved, or other factors.