

IN THE SUPREME COURT OF OHIO

J. LEE COVINGTON, III,
Superintendent of Insurance,
State of Ohio,

Appellant,

v.

THE OHIO GENERAL INSURANCE
COMPANY (U.M.C.-U.M.C. Limited),

Appellee.

On Appeal from the
Franklin County Court of Appeals,
Tenth Appellate District

Case No. 01-1874

FILED

APR 10 2002

MARCIA J. MENGEL, CLERK
SUPREME COURT OF OHIO

**BRIEF OF NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS
AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT J. LEE COVINGTON, III,
SUPERINTENDENT OF INSURANCE, STATE OF OHIO**

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AMICUS CURIAE STATEMENT OF INTEREST

The National Association of Insurance Commissioners (NAIC) is a non-profit corporation whose membership consists of the principal insurance regulatory officials of the fifty States, the District of Columbia, the territories and insular possessions of the United States. Started in 1871, it is the nation's oldest association of state government officials. The members of the NAIC completely control the same.

In submitting this brief, the NAIC seeks to demonstrate its interest in this proceeding and to fulfill the mission of the NAIC, as set out in its Annual Report, to:

... assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost-effective manner, consistent with the wishes of its members:

1. Protect the public interest, promote competitive markets and facilitate the fair and equitable treatment of insurance consumers;
2. Promote the reliability, solvency, and financial solidity of insurance institutions; and
3. Support and improve state regulation of insurance.

The members of the NAIC believe that the decision of the Ohio Court of Appeals harms the consumers of insurance whom the members of the NAIC are charged to protect. If upheld it can result in substantially reduced payments of claims to ordinary policyholders and place greater demands on the state guaranty fund system. Furthermore, it results in a lessening of the motivation of insurers to only cede their insurance business to strong, sufficiently funded reinsurers. Insurers have the sophistication and resources to determine which reinsurers are sufficiently funded to handle their ceded business. Ordinary policyholders are not so equipped. Insurers have much less reason to exercise due diligence in selecting their reinsurers if they are given the same claim priority as ordinary policyholders.

The members of the NAIC ask this Honorable Court to rule in favor of Appellant in this cause. The members believe the Ohio legislature intended that ordinary policyholders be given Class 2 priority in claims, not insurers pursuing sophisticated reinsurance claims at the expense of ordinary policyholders. The members of the NAIC believe that such a result is in the best interest of insurance consumers, to whom all insurance commissioners, superintendents and directors (all of whom are members of and control the NAIC) are charged by both state and federal law to protect.

STATEMENT OF THE CASE AND FACTS

Amicus curiae adopts the Statement of the Case and Facts of Appellant J. Lee Covington, III, Superintendent of Insurance, State of Ohio.

ARGUMENT

Proposition of Law No. 1: R.C. 3903.42(B) is written and structured differently from Sec. 46 of the NAIC Rehabilitation and Liquidation Model Act such that a comparison of their differences does not create a presumption that reinsurance treaties are entitled to the same priority as policies of insurance.

The Tenth Appellate District of the Ohio Court of Appeals has ruled that the Ohio legislature intended that an insurance company pursuing a claim filed with the estate of a liquidated insurance company is entitled to the same Class 2 priority as that of an ordinary insurance consumer pursuing a claim based on an insurance policy issued to the consumer by the liquidated company. The Court of Appeals apparently based this ruling on its belief that the Ohio legislature adopted Paragraph C. of Sec. 46 of the NAIC *Rehabilitation and Liquidation Model Act* and specifically struck out the provision excluding “obligations of the insolvent insurer arising out of reinsurance contracts.” The resulting statute was codified as R.C. 3903.42(B).

However, *amicus curiae* believes that this is an incorrect assumption. While the Ohio legislature appears to have adopted the great majority of this very lengthy model as Chapter 3903 of the Ohio Revised Code, it did not adopt Paragraph C. of Section 46 of the Model, instead adopting language that does not follow Section 46. Thus, it does not follow that there is a presumption that reinsurance treaties (i.e., contracts of reinsurance) are entitled to Class 2 priority since the legislature did not in fact specifically strike that provision addressing reinsurance contracts from the language it adopted.

Paragraph C. of Section 46 follows:

Section 46. Priority of Distribution

The priority of distribution of claims from the insurer’s estate shall be in accordance

with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. Once such funds are retained by the liquidator and approved by the Court, the insurer's estate shall have no further liability to members of that class except to the extent of the retained funds and any other undistributed funds. No subclasses shall be established within any class except as provided in Section 24A(12). No claim by a shareholder, policyholder or other creditor shall be permitted to circumvent the priority classes through the use of equitable remedies. The order of distribution of claims shall be:

[. . .]

- C. Class 3. All claims under policies including claims of the federal or any state or local government for losses incurred, ("loss claims") including third party claims, claims for unearned premiums, and all claims of a guaranty association, for payment of covered claims or covered obligations of the insurer. All claims of a guaranty association for reasonable expenses other than those included in Class 2. All claims under life and health insurance and annuity policies, whether for death proceeds, health benefits, annuity proceeds, or investment values shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligation of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to his employee shall be treated as a gratuity.

Notwithstanding the foregoing, the following claims shall be excluded from Class 3 priority:

- (1) Obligations of the insolvent insurer arising out of reinsurance contracts;
- (2) Obligations incurred after the expiration date of the insurance policy or after the policy has been replaced by the insured or canceled at the insured's request or after the policy has been canceled as provided in this Act. Notwithstanding this subsection, earned premium claims on policies (other than reinsurance agreements) shall not be excluded;
- (3) Obligations to insurers, insurance pools or underwriting associations and their claims for contribution, indemnity or subrogation, equitable or otherwise;
- (4) Any claim which is in excess of any applicable limits provided in the insurance policy issued by the insolvent insurer;
- (5) Any amount accrued as punitive or exemplary damages unless expressly covered under the terms of the policy; and

Drafting Note: In some jurisdictions the courts have held that coverage for punitive or exemplary damages may not be excluded from liability policies.

- (6) Tort claims of any kind against the insurer, and claims against the insurer for bad faith or wrongful settlement practices.

Rehabilitation and Liquidation Model Act, NAIC, Model Laws, Regulations and Guidelines, Vol. III, p. 555 (as amended and reprinted in 1994). This is the version that was adopted by the NAIC at its 1994 Winter National Meeting. It was not subsequently amended until the 1996 Spring National Meeting.

R.C. 3903.42(B) reads as follows:

3903.42 ORDER OF DISTRIBUTION OF CLAIMS

[. . .]

(B) Class 2. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium or other premium refunds.

R.C. 3903.42 (eff. 12-4-95).

A comparison of these two sections demonstrates that they are not related structurally. In fact, R.C. 3903.42 is taken word for word from Section 42, Paragraph C. of the old NAIC *Insurer's Supervision, Rehabilitation and Liquidation Model Act* that was adopted in 1978. *Insurer's Supervision, Rehabilitation and Liquidation Model Act*, NAIC, *Model Laws, Regulations and Guidelines*, p. 555 (1978). The only difference from the 1978 section is that the Ohio legislature added the very last sentence to R.C. 3903.42. The Ohio Court of Appeals apparently assumed that R.C. 3903.42(B) was adopted from Section 46 of the current NAIC Model Act. The court stated "[t]he origins of R.C. 3903.42 can be traced in part to the

Rehabilitation and Liquidation Model Act promulgated by the National Association of Insurance Commissioners.” The Court of Appeals then held that since subparagraph 1 of Paragraph C of the Model (excluding from Class 2 priority those obligations arising out of reinsurance contracts) was not recited in R.C. 3903.42 then this was indicative of a legislative intent to include reinsurance obligations within this priority classification. The court stated “[w]e conclude that the omission of this exclusionary language evidences the legislature’s intent to include reinsurance.” *Amicus curiae* believes that this language was never included in the language the legislature considered when it drafted R.C. 3903.42 to begin with, so it could not have been excluded, and thus the absence of subparagraph 1 should not lead to any conclusions as to legislative intent.

Proposition of Law No. 2: A contract of reinsurance is properly termed a “treaty” and the use of the term “policy” usually denotes a legislative intent to exclude treaties of reinsurance.

R.C. 3903.42 assigns Class 2 priority to “[a]ll claims under policies for losses incurred” *Amicus curiae* believes that the use of the term “policies” in this context, and within the general scheme of Chapter 3903, was not meant by the Ohio legislature to encompass reinsurance obligations. While the terms “policies” and “policy” are general in nature, courts look to legislative intent to determine if the term is meant to encompass reinsurance obligations. The Tennessee Supreme Court recited a number of holdings wherein it was noted that contracts of reinsurance are considered different in nature from ordinary insurance policies. *Neff v. Cherokee Ins. Co.*, 704 S.W.2d 1, 4-5 (Tenn. 1986). In a different context the Texas Court of

Civil Appeals stated that “[r]einsurance contracts are not policies of insurance, nor contracts of insurance, as that term is generally understood.” *Stradley v. Southwestern Life Ins. Co.*, 341 S.W.2d 195, 198 (Tex. App. 1960) (quoting *Cunningham v. Republic Ins. Co.*, 127 Tex. 499, 94 S.W.2d 140 (Tex. App. 1936)).

A contract of reinsurance is usually termed a “treaty.” The standard definitions of “reinsurance treaty” do not use the term “policy” to define the relationship between the parties to a reinsurance contract. Black’s Law Dictionary defines “reinsurance treaty” as “a bilateral contract containing mutual covenants which codify the ongoing process of one insurance company’s transfer of risk to another.” *Black’s Law Dictionary* 892 (abridged 6th edition 1991). Barron’s defines “reinsurance treaty” as a “contract between the reinsurer and the ceding company stipulating the manner in which the insurance written on various risks is to be shared.” *Barron’s Dictionary of Insurance Terms* 399 (3rd edition 1995). Neither use the term “policy” in their definitions to describe the reinsurance relationship.

Furthermore, the Ohio legislature has stated “ [t]he purpose of sections 3903.01 to 3903.59 of the Revised Code is the protection of the interests of insureds, claimants, creditors, and the public generally” R.C. 3903.2(D). Yet, UMC is not an “insured,” it is a “reinsured.” *Black’s Law Dictionary* 892 (abridged 6th edition 1991). Since UMC is not an insured, it can be argued that it must be a general creditor.

CONCLUSION

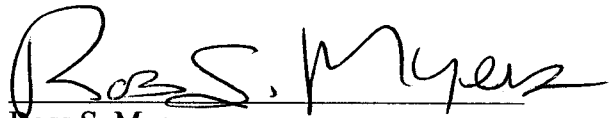
The decision to grant reinsurance claims the same priority as those of general policyholders can result in greatly reduced payments to those ordinary policyholders having claims against liquidated companies such as Ohio General. The state guaranty fund will be called upon to make increased payments to compensate those policyholders, a result the NAIC members do not believe was intended by the Ohio legislature. In effect, an insurance company that makes a sophisticated business decision to cede blocks of business to a failed reinsurer thus benefits from a system designed and intended to protect ordinary insurance consumers. The insurance companies are rewarded for what may have been bad business decisions. Ordinary insurance consumers are not equipped to evaluate the solvency of insurance companies.

Insurance companies have the assets and sophistication to make very detailed and precise evaluations of their reinsurers. They often contract with multiple reinsurers and certainly have the ability to use sophisticated financial analysis tools to determine which ones to cede which blocks of business to and at what level of reinsurance, with the level of premium oftentimes determined by the strength and reputation of the reinsurer. The members of the NAIC do not believe that state liquidation laws were intended to give experienced, sophisticated insurers the same protection as ordinary consumers. The Tenth Appellate District's interpretation of Ohio's priority statute sets a precedent that, if followed, would be very harmful to insurance consumers nationwide and would burden guaranty funds throughout the country.

The members of the National Association of Insurance Commissioners believe the protection of insurance consumers is the ultimate goal of any insurance regulatory system. Thus, statutes enacting an insurance regulatory system should be interpreted with that legislative purpose in mind. Wherefore, *amicus curiae* asks that this Honorable Court rule in favor of

Appellant to ensure that the intent of the Ohio legislature to protect the general public is not frustrated.

Respectfully submitted,

A handwritten signature in black ink that reads "Ross S. Myers". The signature is written in a cursive style with a horizontal line underneath the name.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by regular U.S. mail, first class postage prepaid, upon the following this 8th day of April, 2002:

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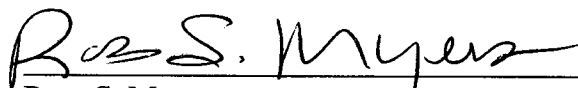
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