Claim Estimation in Liquidations:

Integrity – the Final Chapter?

by

Robert M. Hall

[*Mr. Hall is a former law firm partner, a former insurance and reinsurance executive and acts as an insurance consultant and expert witness as well as an arbitrator and mediator of insurance and reinsurance disputes. The views expressed in this article are those of the author and do not reflect the view of his clients.* *Questions or comments may be addressed to the author at bob@robertmhall.com.*]

I. Introduction

The insurance company liquidations of the 1980's (*e.g.* Mission, Transit Casualty and Integrity) carry with them a legacy of long tail claims and corresponding issues with reinsurance recoverables. It may take decades for IBNR to ripen in non-contingent and liquidated claims. In the meantime, estates remain open eating up assets with administrative costs and reinsurers go out of business.

This had led several liquidators to develop plans to estimate claims actuarially and to force payment of such estimates by reinsurers. This creates a number of practical problems. The first, and most obvious, is that actuarial projections of long tail claims are always estimates that vary within a wide range. A second, and even more difficult problem, is estimating the nature of claims, their size and the year(s) in which the losses take place so as to determine which reinsurers to bill and for how much. However, the initial (and perhaps final) issue is whether liquidation statutes allow receivers to estimate claims and collect from reinsurers on that basis. The purpose of this article is to examine case law on point.

II. Mission Insurance Company

Under § 1025 of the California Insurance Code, unliquidated or undetermined claims may be filed in the receivership proceeding but shall not be paid until they are "definitely determined, proved and allowed." Nonetheless, the receiver of Mission claimed broad discretion to protect claimants with long tail claims, reduce administrative costs and collect reinsurance recoverable more rapidly from

reinsurers. This discretion, the receiver claimed, meant only that he had to enact a reasonable liquidation plan and that it was irrelevant whether a different plan might be better.

The Reinsurance Association of America (hereinafter "RAA") challenged the claim estimation plan and the Court of Appeal of California flatly rejected the receiver's arguments:

> While the Commissioner's policy and economic arguments may be persuasive, they cannot trump section 1025's express language. The Commissioner notes that actuarial estimates are used to assess the value of future liabilities, and are relied on in the insurance industry to set reserves and estimate future losses. The point of section 1025, however, is to preclude *present payment* of such contingent and unliquidated claims (emphasis in the original).[1]

An insolvent affiliate of Mission, Holland-America Insurance Company, was domiciled in Missouri. Advocates of claim estimation were able to convince the legislature in that state to approve a claim estimation procedure. § 375.1200.2 R.S.Mo. reads as follows:

> If the fixing or liquidation of any claim or claims would unduly delay the administration of the liquidation or if the administrative expense of processing and adjudication of a claim or group of claims of a similar type would be unduly excessive when compared with the moneys which are estimated to be available for distribution with respect to such claim or group of claims, the determination and allowance of such claim or claims may be made by an estimate. Any such estimate shall be based upon actuarial evaluation made with reasonable actuarial certainty or upon another accepted method of valuing claims with reasonable certainty. (emphasis added)

The liquidator of Holland-America developed a liquidation plan which included claim estimation and payment of reinsurance recoverable based thereon. Again, the RAA challenged the plan based on the arguments that reinsurer's indemnity obligations do not include IBNR and that such claims are both contingent and unliquidated. In *Angoff v. Holland-America Ins. Co.*, 937 S.W.2d 213 (Ct. App. Mo. 1996), the court upheld the plan based on the statute cited above:

> The Missouri insolvency statutes grant the receiver considerable discretion in evaluating and determining claims by estimation using actuarial evaluation or other accepted methods of valuing claims with reasonable certainty. We

> believe this includes determinations for IBNR losses to the extent that those types of claims can be determined with reasonable certainty.[2]

The RAA, however, took the issue back to the Missouri legislature and was able reverse, effectively, the *Angoff* case by adding the following to § 375.1220 R.S. Mo.:

> However, nothing in subsection 2 of this section or any other section of this chapter shall be construed as authorizing the receiver, or any other entity, to compel payment from a reinsurer on the basis of estimated incurred but not reported losses . . . .[3]

III. Integrity Insurance Company

The liquidator of Integrity adopted a liquidation plan which called for the estimation of IBNR and for reinsurers to pay claims based on such estimation. The RAA again challenged this plan with Debra Hall, then Senior Vice President and General Counsel of the RAA, trying the case, creating the record and working on the appeal. The trial court upheld the plan and the RAA and other reinsurer trade associations appealed arguing that IBNR is not a "claim" under relevant reinsurance contracts or within the meaning of New Jersey receivership statutes. More particularly, the RAA argued that the plan was in violation of N.J.S.A. 17:30C-28a which provides that no contingent claim shall share in the distribution of Integrity's assets unless such claim becomes absolute before the last day fixed for filing of claims.

In an unpublished opinion,[4] New Jersey Superior Court rejected the liquidator's plan:

> IBNR claims are actuarial estimates and are, therefore, not absolute. They are derived from standards of measurement that vary according to the judgment of the valuator. They are nothing more than an estimate of the value of a potential actual loss that accounts both for the possibility that the loss will not occur and for the possibility that the extent of the loss will differ from the actuarial estimate. Accordingly, IBNR claims are not absolute and are prohibited by the statute from sharing in the estate.[5]

The court labeled "alchemy" the liquidator's argument that the claims became absolute upon the liquidator's determination to settle the claims.[6]

On appeal, the New Jersey Supreme Court affirmed opinion of the Superior Court as to the meaning of "absolute" in N.J.S.A. 17:30C-28(a). The court commented:

> Because the process by which the Liquidator proposes to estimate IBNR claims of necessity entails looking outside of each claim to other similar claims in respect of their very existence, nature, extent and cost, IBNR claims fail to satisfy that most basic of requirements in order to be "absolute": that in order for a claim to participate in the liquidation of an insolvent insurer's estate, the claim, in each of its fundamental respects, must stand on its own, and not by reference to any other claim.[7]

After more than a decade of litigation, Integrity's effort at claim estimation was defeated.

IV. Conclusion

The laws of most states contain similar language concerning contingent and unliquidated claims i.e. that they cannot share in the distribution of the assets of an estate. The implication from the case law outlined above is that receivers cannot collect reinsurance recoverables on such claims until they become non-contingent and are liquidated. The courts in California and New Jersey have confirmed that this situation cannot be overcome by a liquidation plan by which claims are estimated and reinsurers are forced to pay claims based on such estimates.

As the Holland-America situation demonstrates, the legislature is the proper venue for the claim estimation debate. There receivers can argue the cost benefits of early closing of the estate while preserving recoveries for those with long tail claims. Similarly, reinsurers can argue the inequities of requiring reinsurers to pay theoretical claims of theoretical nature, size and date.

ENDNOTES

[1] *Quackenbush v. Mission Ins. Co.,* 46 Cal. App.4th 458, 467 (1996).
[2] 937 S.W.2d 213 at 217-8.
[3] § 375.1220.3.
[4] Docket No. A-6972—03T5 Superior Court of New Jersey, Appellate Division, October 2, 2006.
[5] Slip Op. at 8.
[6] Slip Op. at 10.
[7] 935 A.2d 1184, 1191 (N.J. 2007).