DIRECT ACTIONS AND SETOFF: THE NEXT GENERATION[1]

by Robert M. Hall[2]

Prior generations have observed the origin and development of the law governing insurers which have assumed reinsurance from, or ceded reinsurance to, insolvent insurers. Historically, two issues have dominated the stage. The first is the effort by policyholders and claimants to collect reinsurance proceeds directly from the reinsurer in an effort to avoid, in whole or in part, the impact of the insolvency of the policy issuing company (a "direct action"). The second issue is the ability of insurers to net off mutual debits and credits with insolvent insurers to which they ceded or from which they assumed reinsurance ("setoff").

While both direct actions and setoff have been greatly clarified by past case law, these issues may develop in unexpected ways, presenting new and discrete legal issues. This paper examines some of the more significant cases representing the next generation of direct action and setoff issues.

I. DIRECT ACTIONS

A. Prior Law

When an insurer becomes insolvent, it may take several years for the receiver to begin making payments to policyholders and claimants. Policyholders and claimants whose claims are not covered by guaranty funds, in whole or in part, may be under significant financial pressure and, as a result, may pursue a direct action against the insolvent's reinsurers.

Case law has confirmed that reinsurance is a contract of indemnity by which the reinsurer reimburses the cedent for the losses it has paid. However, under credit for reinsurance laws, reinsurance contracts must contain an insolvency clause for the cedent to take financial settlement credit for the reinsurance. Pursuant to the insolvency clause, the reinsurer pays the receiver of the cedent the amount which is allowed in the receivership regardless of whether it is actually paid to claimants.[3]

Unless the reinsurance contract evidences an intent to directly benefit a claimant or insured, such parties lack the privity necessary to collect reinsurance recoverables.[4] Neither can the policyholder or claimant recover from the reinsurer on the basis that the ceding insurer is the agent of the reinsurer for purposes of assuming risk nor as a third party beneficiary of the reinsurance contract.[5]

Case law indicates some exceptions to this usual direct action rule. One exception arises where the reinsurance contract indicates an intent to benefit the insured or claimant directly. *See Osborn v. Gerling Global Life Ins. Co.*, 529 So.2d 169 (Miss. 1988) (coverage provided by reinsurer to cedent characterized as "coinsurance" in reinsurance contract); O'Hare v. Pursell Construction Co., 329 S.W.2d 614 (Mo. 1959) (reinsurer agreed to assume 100% of the cedent's liabilities under certain policies and to adjust and settle all claims under such policies); *Foremost Life Ins. Co. v. Dept. of Ins.*, 395 N.E.2d 418 (Ct. App. Ind. 1979) (reinsurer which assumed 100% of the risk on certain policies and serviced the policyholders jointly liable to insureds with cedent); *Mitchell v. State*, 223 So.2d 792 Ct. App. Fla. 1969) (language in a facultative certificate making it subject to the terms, clauses and conditions of the policy held to be an agreement by the reinsurer to be bound by the conditions of the underlying policy); *First Nat'l Bank v. Higgins*, 357 S.W.2d 139 (Mo. 1962) (ambiguous language in the reinsurance contract concerning assumption of liability interpreted as assumption of the cedent's obligations under the policy rather than an indemnification of the cedent's paid losses); *Homan v. Employers Reins. Co.*, 136 S.W.2d 289 (Mo. 1939) (same). Additional examples of what may be exceptions to the general direct action rule are cut-throughs, guarantee endorsements and assumption agreements.[6]

Case law indicates that reinsurers do not violate statutes governing claim handling by failing to negotiate losses with claimants and policyholders since they are obligated to pay reinsurance payables to the cedent's receiver. Also, reinsurers are not vicariously liable for similar failures of their cedents. *Am. Re-Ins. Co. v. Ins. Comm'r*, 696 F.2d 1267 (9th Cir. 1983). As will be examined *infra*, the same result does not necessarily follow if the reinsurer chooses to engage directly in claims defense settlement negotiations with claimants and policyholders.

B. More Recent Law

Since the above principles were established, the issues involved in direct action case law have evolved and become focused on more discrete fact situations.

1. Involvement in Claim Handling

Some of the exceptions suggested in earlier case law have become reality in a new generation of direct action decisions. A case in point is *Venetsanos v. Zucker, Facher & Zucker*, 638 A.2d 1333 (Sup. Ct. N.J. 1994). As part of a fronting relationship, Homestead Insurance Company ("Homestead") assumed 100% of the risk under a Mutual Fire and Inland Marine Insurance Company ("Mutual") boat policy. Homestead, its officers, employees and affiliates, produced the business, underwrote it, adjusted and settled claims and, generally, acted as if Homestead was the policy issuing company. When Mutual was placed in receivership, the assignee of a policyholder filed an action against Homestead not for reinsurance recoverables, but for failure: (a) to negotiate a settlement of the underlying case in good faith within the policy limits; and (b) to advise the policyholder of the existence of risk in excess of those limits.

The *Venetsanos* court recognized the usual direct action rule that reinsurance proceeds are payable to the receiver of the cedent rather than the policyholders or cedents. *Id*. at 1339. However, the complete fronting nature of the transaction caused the court to uphold a summary judgement in favor of the policyholder's assignee, imposing the obligations of a primary insurer on Homestead:

- Here, Mutual, the local admitted insurer, merely provided the use of its policy for a consideration in order to enable a non-admitted carrier and its affiliates to solicit and evaluate risks, sell policies, wholly insure, and wholly control payments of claims on risks in this state. We will not consign a New Jersey insured or its uncompensated victim-assignee exclusively to uncertain and probably inadequate recourse against an insolvent insurer in a foreign rehabilitation proceeding in such circumstances, particularly where the reinsuring agreement is unavailable.

Id. at 1339. As a result, the reinsurer created privity with the insured by conduct, just as earlier cases held that it might be created by contract.

It is not clear what the result would have been if the policyholder's assignee in *Venetsanos* had been seeking reinsurance recoverables rather than damages for a separate tort. Nonetheless, this case suggests that reinsurers may have significant exposure in fronting relationships in which the reinsurer controls the placement and underwriting of the business as well as the adjustment and settlement of claims.

A case which takes this line of analysis a step further is *Keightley v. Republic Ins. Co*., No. 03-96-00073-CV (Ct. App. Tex. May 8, 1997). In this case, Republic Insurance Company ("Republic") reinsured 100%[7] of the risk of National County Mutual Fire Insurance Company ("National") on the policy in question. Due to National's financial difficulties, Republic took over National's claims handling functions by assigning a claims manager for National's insureds, adjusting and settling claims, hiring defense counsel and establishing and funding a bank account in National's name for payment of claims.

The assignee of the policyholder did not seek reinsurance recoverables from Republic. It brought various statutory and common law claims against Republic for refusal to settle within the limits of the policy. Republic moved for summary judgment based on the policyholder's lack of privity with Republic.

Noting that the plaintiff sought damages based on Republic's wrongful conduct rather than under the reinsurance contract, the court rejected Republic's motion for summary judgment on one statutory deceptive trade practices count and one common law negligence count that did not require privity between Republic and the insured. The clear implication for reinsurers is that if they assume claim handling functions for their cedents, they face liability if they perform these functions poorly.

2. Assumption Agreements

Another opportunity for a direct action against a reinsurer lies in agreements by which the reinsurer agrees to assume the obligations of the policy issuing company. *Nationwide Mut. Ins. Co. v. Home Ins. Co*., No. C2-95-CV-850 (S.D. Ohio March 25, 1997), involved a series of assumption agreements. Nationwide Insurance Company ("Nationwide") was a member of an insurance and reinsurance pool known as the Rutty Pool. The Home Insurance Company ("Home") agreed to assume Nationwide's rights and obligations as part of the Rutty Pool into the American Foreign Insurance Association ("AFIA") which Home managed. Some years later, various members of the CIGNA Group purchased Home's interest in AFIA and agreed to pay AFIA's obligations.

When Home suffered financial reverses, Nationwide sought to go around Home and have CIGNA pay its Rutty Pool losses. CIGNA sought summary judgement based on lack of privity and language in the AFIA purchase agreement to the effect that such agreement created no rights in third parties. The court found that Nationwide was not a third party beneficiary of the purchase agreement. However, the court denied summary judgement on the basis that CIGNA had specifically agreed to assume Home's obligations to Nationwide with respect to the Rutty Pool.

3. Claims by Agents

Language in reinsurance contracts may also create exposure to claims by an agent of the cedent. *Windward Agency, Inc. v. Cologne Life Reins. Co*., No. 95-CV-7830, 1996 U.S. Dist. LEXIS 9794 (E.D. Pa. July 11, 1996) is a case in point. In *Windward*, the agency contract was cancellable on termination of the cedent's reinsurance treaty with Cologne Life Reinsurance Company ("Cologne"). When the agency contract was cancelled, the agent arbitrated a claim against the cedent and then filed suit against Cologne for tortious inference with contract, breach of the reinsurance contract and civil conspiracy.

Cologne sought summary judgement based on Windward's lack of third party beneficiary status under the reinsurance contract. The court declined to grant summary judgement, noting ambiguous language in the relevant treaty. While the treaty stated that it did not confer any rights on any party other than Cologne and the cedent, it also specifically recognized Windward's rights to commissions and to inspect Cologne's records. The moral of the story is that reinsurance contracts should focus solely on the relationship between the ceding and assuming insurers and avoid granting rights to the agent or the contractor of the cedent.

4. RICO Action Against Reinsurers

RICO is a four letter work that can spell liability for a cedent's unlawful activity. In *Clark v. Security Life Ins. Co.*, No. 95V-261 (Super. Ct. Ga. Aug. 6, 1996), an agent for Security Life Insurance Company ("Security") falsified an insurance application. When the insured event occurred, the insurer attempted to rescind the policy. The insured sued Security alleging, among other things, a conspiracy under the Georgia Racketeering Influenced and Corrupt Organizations Act ("RICO"), GA. Code Ann. § 16-14-6(c)(1996) between Security and its reinsurers to engage in a fraudulent scheme to sell unapproved, pseudo group insurance.

Just prior to trial, it was determined that Security was not authorized to issue the policy in question. The jury found a conspiracy between Security and its reinsurers and awarded damages of $14.9 million, plus $1.5 million in punitive damages against Security, but not against the reinsurers. Since reinsurers were not defendants in the trial, there was no testimony by reinsurers to refute the characterization of reinsurance as being a partnership with Security or co-insurance. The jury verdict has been appealed to the Georgia Court of Appeals and the Reinsurance Association of America has filed an *amicus curiae* brief in this proceeding. A separate action is being pursued under the RICO statute by the plaintiff in the *Clark* case against the reinsurers of Security using the evidence submitted in the prior action. *Robinson v. Security Life Ins.*, No. 95-CV-212 (M.D. Ga. Nov. 14, 1996)

II. SETOFF

A. Prior Law

The principle of setoff arose in ancient Rome, became part of the British common law and bankruptcy law and was transported to the United States where it has become part of the bankruptcy law as well as state law governing the receiverships of insurance companies.[8] In general, this principle allows two parties to set off mutual debits and credits between them arising out of different transactions and to pay the balance to the proper party. Debits and credits are mutual if: (1) both arise before or after the receivership (mutuality of time); and (2) the parties are acting in the same legal capacity, *e.g.*, as contracting principals (mutuality of capacity). Should the debits and credits arise out of the same transaction, the principle of recoupment would allow a similar netting of debits and credits, although mutuality would not be required.[9]

The issue of setoff between ceding and assuming companies became extremely controversial in the 1980's due to the 225 property and casualty insurers that became insolvent from 1984 to 1990 followed by the 141 life and health insurers that became insolvent from 1989 to 1991.[10] Since reinsurance is often the largest asset in the insolvent estate, setoff became a high stakes issue for receivers and for insurers that ceded to or assumed reinsurance from an insurer in receivership. This led to three landmark rulings that resolved most of the major issues of the day.

The first such ruling was *Stamp v. Ins. Co. of N. Am.*, 908 F.2d 1375 (7th Cir. 1990). In this case, the court ruled that members of a reinsurance pool could set off unearned premium and losses to the pool against losses due from the pool to the insolvent to the extent that the contracts which produced the credits and debits were in force prior to the receivership.

Stated differently, the court ruled that such credits and debits were mutual.

The second major setoff case was *Midland Ins. Co. v. Superintendent*, 590 N.E. 2d 1186 (N.Y. 1992). In this case, Kemper Reinsurance Company ("Kemper Re") reinsured Midland Insurance Company ("Midland") and its affiliates pursuant to a treaty and, in a separate transaction, Kemper Re issued a facultative certificate to Midland. When Midland became insolvent, Kemper Re set off premium due under the treaty against losses due under the facultative certificate. The New York Court of Appeals ruled: (1) that to be set off, the debits and credits did not have to arise out of the same transaction; (2) the insolvency clause does not conflict with the statutory and contractual right of setoff; (3) payment of losses to the receiver after the liquidation order does not destroy mutuality; and (4) the fact that Midland affiliates had the right to cede business to Kemper Re did not destroy mutuality since they did not actually do so. On this latter point, the court stated: "Midland alone, therefore, contracted the debit for unpaid premiums, and notwithstanding his conclusory assertions, defendant has failed to make a record establishing that the affiliates were jointly liable for those premiums. Thus the requisite mutuality of identity exists between Kemper Re and defendant, as the liquidator of Midland." *Id.* at 1192. The quoted language suggests mutuality of identity as a subset of mutuality of capacity for purposes of setoff.

The final installment in the trilogy of major setoff cases is *Prudential Reins. Co. v. Superior Court*, 842 P.2d 48 (Cal. 1992). At issue in this case were two sets of reinsurance contracts. Through the "Relation A" contracts, Prudential Reinsurance Company ("Prudential") reinsured Mission Insurance Company ("Mission") and various of its affiliates. Through the "Relation B" contracts, Mission reinsured Prudential and its subsidiary, Gibraltar Insurance Company ("Gibraltar"). The *Prudential* court ruled that: (1) setoff was not an unlawful preference prohibited by the statute governing priority of distribution of estate assets; (2) the appointment of the receiver did not destroy mutuality for purposes of setoff; (3) debits and credits which arose under contracts in effect prior to the receivership are mutual; (4) the insolvency clause does not conflict with the contractual and statutory right of setoff; and (5) that Gibraltar should not be able to set off debits owned by Prudential on Relation A contracts to which Gibraltar was not a party since Gibraltar was not a principal reinsurer under such contracts. On this latter point, the court stated: "we refuse to expand the section 1031 setoff to debits in the absence of an express mutual agreement that the subsidiary would be deemed a mutual debtor-creditor of the parent." *Id.* at 60.

The decision of the *Prudential* court on the affiliate issue is most significant in that it appears to approve group-to-group setoff as long as all members of each group are named parties to all relevant contracts. In addition, the language of the *Prudential* court quoted above appears to approve "contractual mutuality" by which parties can agree by contract that certain debits and credits are mutual which otherwise would not be mutual.

B. <u>More Recent Law</u>

Earlier setoff decisions have generated a second tier of issues which have yielded a more recent series of decisions.

1. <u>Affiliate Setoff</u>

Both prior and subsequent to *Prudential*, there was substantial controversy concerning the ability of groups of insurers to set off debits and credits. At one extreme, some argued for aggregate "group-to-group" setoff as the most efficient means of resolving all issues among the various insurers. At the other extreme, some argued for "company-to-company" setoff as the only means of preserving true mutuality between parties.

Further complicating the issue is a wide variety of reinsurance contractual language which sometimes treats groups of companies as a single entity. This makes it difficult to sort out the parties' respective rights and obligations, especially when: (a) one member of the group purchased reinsurance for all others, *e.g.*, acted as a pool; (b) some members of a group are insolvent and some are not; (c) it is not entirely clear which member of the group has made a claim or received a payment; and (d) the books and records of the insolvent group are in poor condition or are not being shared.

Affiliate setoff was revisited subsequent to *Prudential* in *Mission Ins. Co. v. Imperial Casualty and Indem. Co.*, 48 Cal. Rptr.2d 209 (1995). In this case, there were a group of contracts (Section I) by which Imperial Casualty and Indemnity Company ("Imperial") and Mission Insurance Company ("Mission") engaged in reciprocal reinsurance transactions. There was another group of contracts (Section II) by which Imperial reinsured Mission, Mission National

Insurance Company ("Mission National") and Holland America Insurance Company ("Holland"). The Section II reinsurance contracts contained language which collectively defined Mission, Mission National and Holland as one party and allowed the reinsurer to set off mutual debits and credits with such party. The *Imperial* court followed the *Prudential* court in disallowing setoff of the amounts owed to Imperial by Mission National and Holland since such companies were not principal reinsurers of Imperial.

Absent a statutory resolution,[11] disputes over affiliate setoff are likely to continue. There is little case law in states other than California. Both the *Prudential* and *Imperial* decisions appear to allow some degree of affiliate setoff as long as all relevant companies are parties to the contracts in question. Finally, *Prudential* appears to offer insurers the opportunity to create contractual mutuality, where it would not otherwise exist, among affiliates by express agreement of the parties. Given the financial stakes involved, reinsurers likely will seek further judicial clarification of the affiliate issue in the future.

2. Transfer of Setoff Rights

Many state statutes governing setoff in the insurer insolvency context prohibit transfer of an obligation of an insolvent insurer with the intent of creating a setoff.[12] Presumably this would prevent a general creditor from selling a receivable to an insurer which owes payables to the estate.

This transfer limitation was addressed in *Swiss Re Life Co. Am. v. Gross*, 479 S.E. 2d 857 (Va. 1997). In this case, certain reinsurance agreements provided the reinsurer with a setoff against the estate and the reinsurer purchased additional reinsurance agreements which increased the setoff after the cedent was placed in receivership. The court allowed setoff of the earlier reinsurance agreements but not the later acquired ones, noting that rights under the later acquired treaties "were necessarily limited by the effect of" the receivership and that "debts owed by the insurer cannot be acquired for the purpose of obtaining a set off." Id. at 862. However, there was no finding by the court that the later acquired reinsurance contracts were purchased for the purpose of creating setoff.

The California statute governing transfer of setoff rights is somewhat different from most in that it does not require that the transfer of the obligation be for the purpose of creating setoff.[13] As a result, the receivership court supervising the Mission liquidation proceeding disallowed setoff created as a result of the merger of Allstate Insurance Company and Northbrook Excess and Surplus Lines Insurance Company. *Quackenbush v. Mission Ins. Co.*, C572724 (Cal. App. Dep't. Super. Ct. Jan. 27, 1997). Allstate is appealing this decision on the basis that the merger did not effect a "transfer" of the obligations in question.

3. Premium Setoff Restrictions

Some contend that in updating their statute with respect to setoff by insurers, certain states failed to eliminate or differentiate a provision intended to limit the ability of agents and brokers to set off premiums due to the insolvent insurers. Such a provision[14] was at issue in *Albany Ins. Co. v. Stephens*, 926 S.W.2d 460 (Ct. App. Ky. 1995). The court held that this provision on its face prohibited the cedent from setting off premiums due an insolvent reinsurer against losses due from the reinsurer. The impact of this decision has been diluted, at least in Kentucky, by a subsequent legislative change which would allow premium setoff in a reinsurance context on a going forward basis.[15]

4. <u>Reinsurance Pools</u>

The credits and debits at issue in *Stamp v. Ins. Co. of N. Am.*, 908 F.2d 1375 (7th Cir. 1990) arose from participation in a reinsurance pool by both the cedent and reinsurer. When one pool member wrote a policy, a portion of the risk on such policy was ceded to the pool and the premium was distributed to pool members by the pool manager. The presence of a pool in the *Stamp* fact situation had no negative impact on the court's finding of mutuality.[16]

The issue of reinsurance pools arose in a slightly different fact situation in *Stephens v. Fed. Ins. Co.*, No. 93 Civ. 4222 (JSM), 1995 U.S. Dist. LEXIS 17680 (S.D.N.Y. Nov. 27, 1995). In this case, Federal Insurance Company ("Federal") sought to set off debits due under a retrocession from the insolvent reinsurer against credits due to the Chubb Pool of which Federal was a member and which ceded reinsurance to the insolvent reinsurer. The pool consisted of seventeen insurers with a separate entity acting as the pool's agent or manager. The court had no difficulty in concluding that this fact situation fulfilled the necessary mutuality requirements.[17]

5. <u>Setoff in Rehabilitations</u>

The rehabilitation of American Mutual Reinsurance Company ("AMRECO") produced an important decision on the power of a receiver to regulate setoff in an effort to avoid the liquidation of an insurer. *In re Rehabilitation of Am. Mut. Reins. Co.*, 606 N.E.2d 32 (App. Ct. Ill. 1992). In this case, the receiver adopted a rehabilitation plan without objection after notice and hearing. The plan called for AMRECO to make loss payment to cedents every 90 days using a small amount of cash and the rest in interest bearing surplus notes. For each such period, AMRECO's retrocessionnaires were billed for their proportionate share of the losses and were allowed to assert setoff rights to net down such bills. Any balance due after the setoff would be paid to AMRECO.

American Hardware Mutual Insurance Company ("American Hardware") objected to this arrangement due to timing differences in the development of losses. American Hardware believed that its setoff rights might not crystalize until it had paid all or the balance of its debits on assumed business. As a result, it requested that AMRECO withhold any surplus notes due to American Hardware so that such notes could be used to set off American's future pool obligations.

The *American Mutual* court overruled the objection noting American Hardware failed to object to the rehabilitation plan and that the payment structure proposed by American Hardware would undercut the cash flow requirements necessary to rehabilitate AMRECO. In addition, the court found that American's Hardware statutory setoff rights could be regulated in a manner consistent with the rehabilitative effort.[18]

Another setoff decision involving an insurer in rehabilitation is *Foster v. Mut. Fire, Marine and Inland Ins. Co.*, 614 A.2d 1086 (Pa. 1992) *cert. denied* 506 U.S. 1087. In this case, the court ruled that Pennsylvania's setoff statute, Pa. Stat. Ann. tit. 40, § 221.32(a) (1992), does not apply to rehabilitations and that common law setoff is an equitable right which may be subordinated to the effort to rehabilitate an insurer.

III. Future Direction of Direct Action and Setoff Case Law

It is highly unlikely that developing direct action case law will reverse the basic propositions that: (a) reinsurance contracts are contracts of indemnity; (b) reinsurers are bound to pay reinsurance proceeds to the receiver of an insolvent cedent; and (c) ordinary reinsurance contracts do not grant a right of action against reinsurers to policyholders and claimants.

It is likely, however, that reinsurers will be held to be liable to policyholders and claimants for their actions when they become directly involved with such parties. This can occur when the reinsurer steps into the role of the insurer or other situations, such as cut-through arrangements, in which the insured is encouraged to look to the security and services of the reinsurer as a reason to enter an insurance relationship.

As is the case with direct actions, it is highly unlikely that future case law on setoff will reverse the basic propositions that: (a) insurers and reinsurers may set off mutual debits and credits in the insolvency context; (b) such rights are not limited to a single contract and apply to debits and credits under contracts in existence at the time of the order of liquidation; (c) setoff does not violate the insolvency clause; and (d) setoff may be asserted against the receiver who stands in the shoes of an insolvent insurer.

Efforts will continue to sort out remaining setoff issues, especially the permissible scope of affiliate setoff and the role of setoff in rehabilitations. However, the single largest setoff issue yet to be resolved involves setoff of future credits against current debits. This can arise if a cedent owes premiums to an insolvent reinsurer but believes it will have reinsurance recoverables in the future on claims which are reported but not liquidated or which are unreported. Variations on this factual theme are likely to generate significant setoff litigation in the foreseeable future.

ENDNOTES

1. This article was previously published by Mealey's Reinsurance Reports.

2. Mr. Hall practices insurance and reinsurance law, and is active in both arbitrations and mediations. The views expressed in this article do not represent the opinions of Mr. Hall's clients. Copyright 1997 Robert M. Hall. Comments and questions can be addressed to *robertmhall@erols.com*.

3. *See generally*, T. Darrington Semple, Jr. and Robert M. Hall, *The Reinsurer's Liability in the Event of the Insolvency of a Ceding Property and Casualty Insurer*, 21 Tort & Ins. L. J. 407, 407 - 412 (1986) [hereinafter "Semple"].

4. *Id*. at 414 - 415.

5. *Id*. at 415 -416.

6. *Id*. at 411-412.

7. The fact of the 100% reinsurance was not mentioned in the decision but has been confirmed with Republic Insurance Company. In Texas, licensed insurers sometimes "sponsor" county mutuals or Texas lloyd's which are allowed to deviate on casualty and property rates respectively. Often, such sponsorship includes complete administrative control of the county mutual or Texas lloyd's as well as assumption of most or all of the risk. Such sponsorship was not involved in this case.

8. Stephen W. Schwab, Debra J. Anderson *et al*., *Onset of An Offset Revolution: The Application of Set-Offs in Insurance Insolvencies*, Dick. L. Rev. 457, 455 - 462 (1991).

9. *Id*. 453 - 454, 462 - 463 and 478 - 483. *See also*, Semple at 419 - 424.

10. Debra J. Hall and Robert M. Hall, *Insurance Company Insolvencies: Order Out of Chaos*, J. of Ins. Reg. 145, 146 - 7 (1993).

11. Some states have enacted amendments to their setoff statutes which clarify affiliate setoff. *See, e.g*. Iowa Code § 507C.30 2(a)(3) (1996) (prohibits setoff of an obligation to an affiliate of the insolvent or any other entity or association).

12. *See, e.g.*, Va. Code Ann. § 38.2-1515 (B)(2) (Michie 1996) which prohibits setoff when the "obligation of the insurer to the person was purchased by or transferred to the person with a view of its being used as an offset."

13. Cal. Ins. Code § 1031 (b) (West 1996) prohibits setoff when "the obligation of the person in liquidation to the other person was purchased by, or transferred to, the other person."

14. Ky. Rev. Stat. Ann. § 304.33-330(d) (Michie 1995) provided that "no setoff or counterclaim shall be allowed in favor of any person where the obligation of the person is to pay premiums, whether earned or unearned, to the insurer" (amended 1996).

15. Ky. Rev. Stat. Ann. § 304.33.330 (d) (Michie 1996) prohibits setoff where: "The obligation of the person is to pay earned premiums to the insurer. However, nothing in this subsection shall restrict the right of a person to set off premium due to or from the insurer pursuant to a reinsurance contract in any delinquency proceeding commenced against an insurer after July 15, 1996."

16. The court noted: "The Liquidator maintains that Illinois used its insolvency rules to protect policyholders. If so, then Illinois must protect the integrity of reinsurance pools, which spread risk more effectively and so yield great benefits for policyholders." *Id.* at 1380.

17. The court noted:

- Although the Chubb Pool treaties were formally entered into by an agent representing Federal and other insurance companies, one need not look far beneath the surface of the transaction to get to the "real fact" that Federal is indeed a party to the Chubb Pool Treaties. Therefore, the mutuality requirement is fulfilled because both Delta Re and Federal were parties to the relevant contracts. *Id.* at *10.

18. Viewing section [215 ILCS 5/] 206 in this context, we do not find any language to prohibit the regulation of setoff rights provided for in the Amended Plan. In fact, while the section indicates when setoff is not allowed, there is no reference in the provision regarding how it should be applied in instances where it is allowed. *Id.* at 36.