The Insurance Receiver

PROMOTING PROFESSIONALISM AND ETHICS IN THE ADMINISTRATION OF INSURANCE RECEIVERSHIPS

SPRING 2004

Volume 13, Number 1

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President's Message

I. George Gutfreund, CA, CIRP, CIR-ML

I would like to begin by thanking the membership for re-electing me to the IAIR Board of Directors for a second term last year, and to the Board for their confidence in electing me as President for the 2004 year. I am honored by this appointment and hope to be able to live up to the high standards set by those who have preceded me. I would like to thank Bob Greer for his efforts and accomplishments during the past year.

Many thanks, also, to retiring Board members Steve Durish and Jim Gordon. Steve has made tremendous contributions to the organization as Education Chair, and through his efforts our education programs have been first rate and acclaimed by all. Jim has been the Association Secretary for the past number of years and has assisted in finding and liaising with our Executive Director.

A hearty welcome to IAIR's new Board members, Francine Semaya of Cozen O'Connor and Daniel Watkins, CIR-ML, of the law offices of Daniel L. Watkins – who has also been elected as Secretary of the Association. I would also like to welcome back returning Board members Trish Getty, AIR-Reinsurance, of Randall America who has also been elected First Vice President of the Association, Daniel A. Orth, III, of the Illinois Life and Health Insurance Company Association, who has been elected Second Vice President of the Association, and Francesca Bliss of the New York State Insurance Department.

IAIR has come a long way over the past 12 years, and last year was no exception with the Association being asked to participate on an NAIC Accreditation Task Force in order to review the whole accreditation process in the insurance receivership/liquidation marketplace. In addition, IAIR passed a new Code of Ethics at its recently held annual general meeting. Looking forward to the coming year, I would like to see IAIR continue to progress in this area and hopefully we can develop and implement a disciplinary procedure to go along with our Code of Ethics. I would also like to see the Association develop standards of professional practice, and to continue with our education programs in two areas: (a) the creation of a course of study leading to appropriate tests and/or exams resulting in the awarding of a CIR or AIR designation, and (b) the ongoing delivery of roundtables and educational programs directly sponsored by IAIR or jointly with NOLGHA, NCIGF or NAIC for the professional development of our members and all those who practice in the insurance insolvency arena. Through these educational programs we can hopefully demonstrate to the community at large that we are very objective in granting our designations, and avoid the criticism of the process being subjective. I would also like to see the visibility of IAIR members as professionals raised both domestically and internationally. In order to accomplish this, and to bring greater worth to the organization, I humbly ask that all of our members who are qualified – and there are a significant number – apply this year for a designation. This will help us to ensure true value to our designations and also help us in the accreditation process. One of the main criticisms that we have received through the NAIC accreditation process is that there are not designated CIRs or AIRs in each of the 50 states. Based on our membership, and based on the knowledge of experience of our members, I feel that this is a goal that could easily be reached over the coming year and/or the following year.

I would also like to see the large insurance states become more involved in IAIR, and new IAIR members of these states obtain IAIR designations. Moreover, I would like to see the continued growth of our international membership and to look at the establishment of a chapter system. Presently, the London market has run excellent programs and we have to find a better way of integrating their activities with the North American activities. IAIR has become an international think tank of knowledge pertaining to insurance restructuring, run off and receiverships/liquidations, and it provides the facility for its members to network and to become more knowledgeable in order to deliver a better product and/or services to policyholders, creditors and stakeholders. Parts of the insurance insolvency community have had a lot of criticism directed at them over the past few years, but let us not become totally defensive: let us use such criticisms constructively in order to improve the level of professionalism within our association.

IAIR is a professional organization dedicated to promoting professionalism and ethics in the administration of insurance receiverships/liquidations. This is your organization and the organization needs your support to ensure that the many successful services we provide to our clients, educational programs we offer and professional opportunities continue. Every volunteer brings a personal touch. Whether it is through helping with the programs or coming to events or meetings, your presence will help to define our Association. Please come out to participate. Every little bit helps and we will all benefit. Please contact any member of the Board of Directors, committee chairs or myself to offer your services. Each of us would love to hear your ideas and/or suggestions. With your help we can collectively work for the good of our Association.

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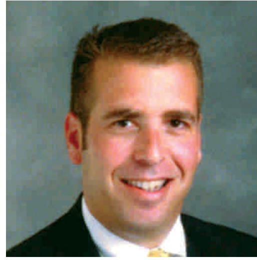
Commentary from the Editor

Jerry Capell [1]



I am not an advocate for federal regulation of insurance receiverships. There are many substantive benefits to the current state system. However, as recently reported by the RAA, Rep. Richard Baker (R-LA), Chariman of the Capital Markets Subcommittee of the House Financial Services Committee said hearings could begin next month on insurance regulatory changes.

In this context, I went back to the last edition of the Insurance Receiver and read again Commissioner Holly Bakke and Doug Hartz's article on the State Guaranty Associations (SGAs) cash crisis as well as the article by Ed Wallis. Both clearly highlight the fact that there is a substantial opportunity for IAIR and the NAIC to improve the operation of the receivership and guaranty fund systems.

Consider for a moment that the California Insurance Guaranty Association (CIGA) is planning to issue bonds to finance their claim paying obligations. In turn, CIGA will pay the bondholders interest. At the same time, assets for some of the estates sit in the bank accounts of other parties earning interest for third parties rather than for the estates or the estate creditors. There is an effective double penalty to the creditors of the estates and the consumers of insurance products who fund the SGAs.

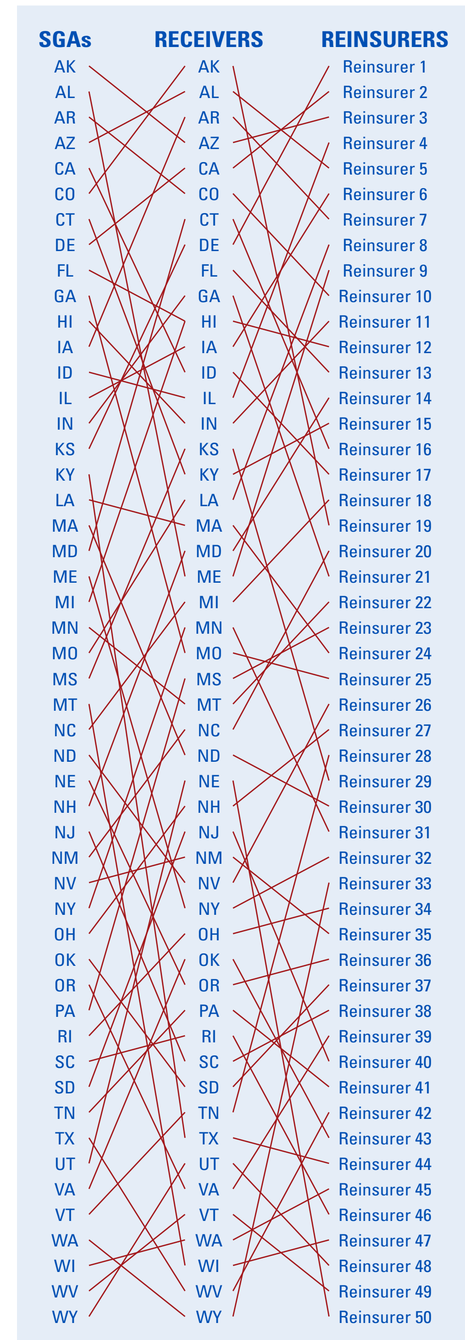
While most claims are covered by the SGAs, let's not forget the little guy. There are individual creditors of these estates waiting anxiously for their money. They are trying to pay their rent, raise their families, pay their taxes, etc.

These problems are not surprising when one considers that the "system" is attempting to administer by some estimates as many as 1,000 receiverships, each with one or more SGAs and numerous reinsurers. When one considers the volume of transactions the figures are astounding. Yet consider that most of these transactions occur through an almost staggering variety of processes, computer systems and methods. There are few standards and common platforms. Other than the implementation of the Uniform Data Standard (UDS), everything varies by state and estate. Figure 1 depicts a simplified view of today's receivership environment.

It would be disingenuous not to acknowledge that there are success stories. Some estates have been exceedingly well managed and have made substantial if not complete distributions to their creditors.

Yet it appears a growing crisis looms. Some have argued that changes are needed to the model law to provide for creditor committees using the Federal Bankruptcy Code as a model. Others believe that we should adopt United Kingdom Schemes of Arrangement, focus on making the entire receivership process more transparent, find ways to take Government out of the Receivership process entirely, and/or utilize internet-based receivership communication as is being done in the United Kingdom, (e.g., filing of proofs of claim on-line, email notification to claimants, etc.). It seems all of these ideas are worthy of debate and discussion.

Figure 1



[1] Jerry Capell is a Director in the Chicago office of Navigant Consulting, Inc. and a co-chairperson of the IAIR Publication Committee. The views expressed in this article are those of the author alone. They do not necessarily reflect the views of Navigant Consulting or any of its employees, clients, or IAIR.

From the Editor

Jerry Capell

However, at least in the short term, the most effective means to improving the system is through the use of a *shared technology platform.* Improving and speeding the flow of information among guaranty funds, receivers and reinsurers is in the best interests of all. *Figure 2* provides a simplified view of a shared technology platform. In this model, documents would be stored and available on-line according to defined security rules. Underlying systems could provide meaningful and timely reports. Logjams in the process could be quickly identified and resolved and the cycle time from the payment of claims to the collection of reinsurance could be dramatically reduced. Costs associated with billing, collecting, auditing, reserving, etc. would also be dramatically reduced. The savings for all process participants (SGAs, receivers and reinsurers) could be dramatic.

The technology to implement this type of solution exists and has been successfully deployed in a variety of business environments for years to rationalize processes like those outlined in *Figure 1.* IAIR and the NAIC have a tremendous opportunity to lead in implementing these types of process enhancements. My hope is that we can make these types of solutions a priority for our organization this year.

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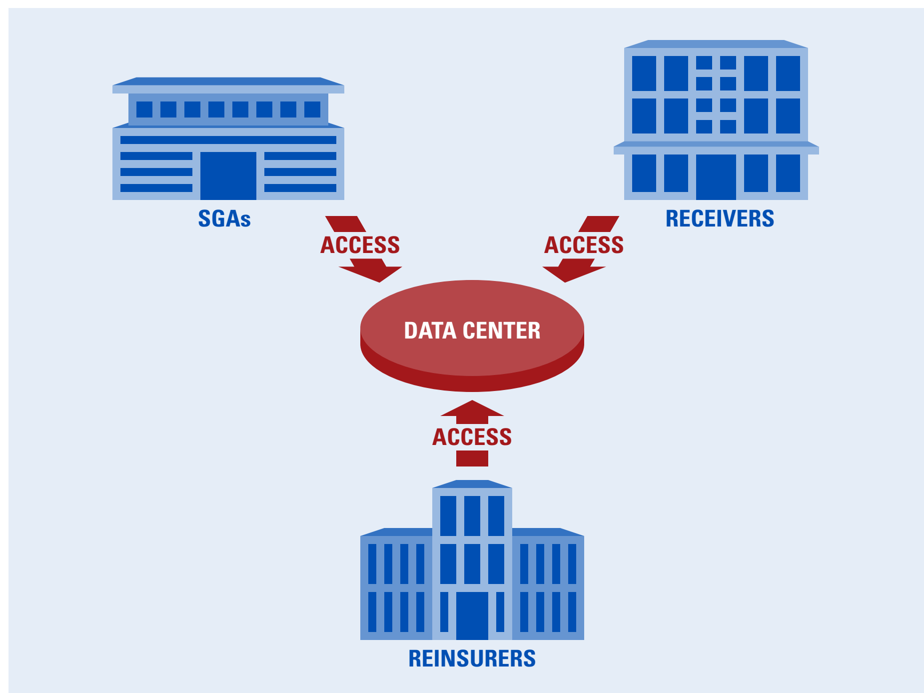
Figure 2



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The Insurance Receiver is published quarterly by the International Association of Insurance Receivers, 174 Grace Boulevard, Altamonte Springs, FL 32714, Tel: 407.682.4513, Fax 407.682.3175, Email: IAIRHQ@aol.com.

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View from Washington

Charlie Richardson

As this article is being written in January, I was tempted to write just two words: "Presidential Politics." This big election year, like every other one each four years, will be dominated by the ins and outs of election strategy and issue positioning for the campaigns for House, Senate and President.

Therefore, here are a few things that have been on the Congressional agenda/mind the last few months, many of which will remain there into the election. The two biggest developments last year in most members' minds were the passage of Medicare reform/prescription drug legislation (P.L. 108-173) by President Bush on December 8 and the Supreme Court's 5-4 decision on December 10, holding that most of the McCain-Feingold campaign finance law passed constitutional muster – specifically, the "soft-money" ban and restrictions on campaign advertising by outside groups.

1. **Terrorism.** On December 1, the U.S. Treasury Department published a proposed rule outlining procedures for insurers to follow in filing claims for losses under the Terrorism Risk Insurance Program. Written comments by insurers and other interested parties were due December 31.

2. **Fair Credit Reporting Renewal Now "FACT."** A significant legislative success for the financial services industry in 2003, the "FACT" Act (P.L. 108-159), signed by the President on December 4, makes permanent federal preemptions that underpin the United States' credit reporting system. The Federal Trade Commission and the Federal Reserve Board jointly issued December 24 interim final rules and a notice of proposed rulemaking regarding dates in which certain provisions of the law go into effect.

3. **Bulls Eye: Class Action Bill Part of Republican "Tort Reform" Agenda.** Senate Republican leaders intend to make passage of a bill governing class action lawsuits a priority in 2004. The "Class Action Fairness Act of 2003" (S. 1751) could hit the Senate floor this Spring. Recently, Senate Majority Leader Bill Frist (R-TN) struck a potential bargain with at least three Senate Democrats who originally voted the bill down in October 2003.

4. **Asbestos Liability Reform.** The asbestos liability reform bill, dubbed the "FAIR" Act (S.1125), has been the source of intense behind-the-scenes negotiations since its introduction in May 2003. Interested parties such as businesses, insurers and labor unions continue to struggle over the size and scope of a federal trust fund to compensate workers injured as a result of exposure to asbestos. The House will wait for the Senate.

5. **Medical Malpractice Reform.** Despite failure to limit debate and vote on medical malpractice legislation (S.11) in July 2003, Senate Republicans have vowed to hold additional cloture votes in 2004. The House passed H.R. 5, called the "HEALTH" Act, in March 2003. H.R. 5 places limits on punitive damages and establishes a cap on non-economic damages.

6. **Federal Charter – Advocates Speak.** The American Bankers Insurance Association, American Council of Life Insurers, American Insurance Association and Financial Services Roundtable wrote an eight-page letter to Rep. Richard Baker (R-LA) on December 12, 2003, outlining the basic principles of their approach to an optional federal charter. The letter is the result of a request made by Baker, who chairs the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (a new name adding "Insurance"!), during a November 2003 hearing on insurance regulation. On October 22, the Senate Commerce Committee held a hearing on federal regulation of the insurance industry. Top committee Democrat Ernest "Fritz" Hollings (D-SC) said his bill, the "Insurance Consumer Protection Act of 2003" (S-1373), would establish a federal regulator. Insurance regulation is likely to be a continuing legislative topic for Congress in 2004. Each of you should also read the NAIC's "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan" issued last September. It is an excellent summary of the NAIC's efforts to reform state regulation on its own.

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Is a Reinsured a "Policyholder" under U.S. Insurance Insolvency Priority Statutes?

Deborah L. Cotton [1]

Introduction

When faced with a newly-insolvent assuming reinsurance company, a ceding insurance company creditor (which will be referred to herein as the reinsured) often inquires whether it has the same status as the insolvent reinsurance company's direct policyholders. Most U.S. state insolvency statutes are silent on the issue. However, an increasing number of state legislatures have clarified the answer to the reinsureds' question, and seven state courts have specifically addressed the issue. Other state courts have addressed similar issues in insurance company insolvencies and the totality of the case law should be persuasive in states that have yet to consider the question.

The National Association of Insurance Commissioners Insurers Rehabilitation and Liquidation Model Act (the "NAIC Model Act") and state insurance insolvency statutes typically include distribution hierarchies. Such hierarchies provide the priority in which distributions from an insolvent insurer's general assets will be made, and include as a separate category those claimants whose claims derive from insurance policies and contracts written by the insolvent insurer. The following are two common formulations of the "policyholder" priority category:

"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."[2]

"Claims by policyholders, beneficiaries, and insureds, including the federal or any state or local government if such government is a named policyholder, beneficiary or insured under the policy, arising from and within the coverage of and not in excess of the applicable limits of insurance policies and insurance contracts issued by the [insolvent insurance] company… ."[3]

This type of claim is generally referred to in the U.S. insurance industry as a "policyholder-level" claim or a "policyholder" claim. "Policyholder" claimants are entitled to receive distributions from an insolvent insurer's general assets prior to any distributions to general creditors of the insolvent insurer. U.S. insolvency statutes do not typically include a definition for "policyholder," although the NAIC Model Act and 14 states' insolvency statutes [4] currently include specific wording to exclude from the "policyholder" priority one or more of reinsurance, reinsureds, "parties to a reinsurance agreement" or "obligations of the insolvent insurer arising out of reinsurance contracts."

Seven states' courts have specifically addressed whether a party to a reinsurance contract is a "policyholder" for purposes of the insurance insolvency priority statute. [5] While there is some differentiation in the language used in various states' statutes describing the "policyholder" priority, in each state in which the issue has been litigated, the ultimate outcome was that reinsureds were not included within the "policyholder" class.

This article summarizes the statutory and legal bases for the holdings in the seven state court decisions that have directly addressed the issue. There also is authority from several additional states, [6] under earlier laws requiring bonds to be filed or trusts to be created with the states for use in paying "policyholders" in the event of the insolvency of an insurer, holding that reinsureds differed from direct insureds for purposes of payments from such bonds or trusts. [7] Finally, this article discusses case law from Pennsylvania holding that surety bond holders are not "policyholders," which decisions could be of influence if Pennsylvania courts were presented the question.

[1] Deborah L. Cotton is Counsel in the Chicago office of Sidley Austin Brown & Wood LLP. The views expressed in this article are those of the author alone. They do not necessarily reflect the views of Sidley Austin Brown & Wood LLP, or any of its individual partners, counsel, associates, or its clients.

[2] NAIC Model Act, Section 47(C).

[3] Delaware Ins. Code, T. 18, §5918(e)(3).

[4] See NAIC Model Act, Section 47(C); Alaska Ins. Code §21.78.260(4); Arizona Ins. Code §20-629(A)(3); California Ins. Code §1033(d)(3); Connecticut Ins. Code §38a-944(a)(3); Delaware Ins. Code T. 18, §5918 (e)(3)(a); Hawaii Ins. Code §431:15-332(2)(A); Kentucky Ins. Code §304.33-430 (3)(a); Maine Ins. Code 24-A §4379(3); Michigan Ins. Code §500.8142(1)(b); New York Ins. Law §7434(a)(1)(ii); North Carolina Ins. Code §58-30-220 (2); Oklahoma Ins. Code T. 36, §1927.1(B)(3)(a); Rhode Island Ins. Code §27-14.3-46(3), (7); and Utah Ins. Code §31A-27-335(2)(c)(iv).

[5] Courts in the states of Colorado, Illinois, Indiana, New Jersey, North Carolina, Ohio, and Tennessee have considered the issue. *See* Northwestern National Insurance Company v. Kezer, 812 P.2d 688, 1990 Colo. App. LEXIS 361 (Ct. App. Colo. 1990); In Re Liquidations of Reserve Insurance Company, 122 Ill. 2d 555, 524 N.E.2d 538 (Ill. 1988); Foremost Life Insurance Company v. Department of Insurance, 274 Ind. 181, 409 N.E.2d 1092 (Ind. 1980); In the Matter of the Liquidation of Sussex Mutual Insurance Company, 301 N.J. Super. 595, 694 A.2d 312 (N.J. Super. 1997); State ex rel. Long v. Beacon, 87 N.C. App. 72, 359 S.E.2d 508 (Ct. App. N.C. 1987), aff'd. 87 N.C. App. 171, 360 S.E.2d 134 (Ct. App. N.C. 1987); Covington v. Ohio General Insurance Company, 2001 Ohio App. LEXIS (Ct. App. Ohio 2001), *overruled, 99* Ohio St.3d 117, 2003 Ohio LEXIS 1505 (Ohio 2003); Neff v. Cherokee Insurance Co., 704 S.W.2d 1, 1986 Tenn. LEXIS 648 (Tenn. 1986).

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Decisions of Courts in Seven States Specifically Addressing the Issue of Whether Reinsureds are Policyholders under the Insurance Insolvency Priority Statutes.

Courts in the seven states that have considered the precise issue have all ultimately held that reinsureds and holders of reinsurance contracts are distinct from holders of direct insurance policies for purposes of insurance insolvency priority statutes, regardless of whether the proceedings at issue were rehabilitation or liquidation proceedings, and regardless of the varying wording of the "policyholder" priority statutes.

Colorado

In the view of the Colorado Court of Appeals in the case of Northwestern National Insurance Company v. Kezer, *supra,* a fronting insurer was held not to be entitled to be included with the class of:

> *"claims by policyholders, beneficiaries, and insureds, liability claims against insureds covered under insurance policies and insurance contracts issued by the [insolvent insurance] company and claims of the Colorado insurance guaranty association… ."*

The plaintiff insurer was deemed to be neither "similar to a guaranty association," nor to be entitled to "policyholder" status through subrogation rights acquired through payments to the direct policyholders (even though such payments would have been reimbursed by the insolvent reinsurer had the reinsurer not become insolvent). The court also disagreed with the plaintiff insurer's argument that when it paid the direct policyholder, it was subrogated to the insured's rights under the policy which was reinsured by the insolvent. The court specifically noted that the payments made to the direct policyholders were under the plaintiff's policies, not under policies or contracts issued by the insolvent insurer. Finally, the Northwestern court stated that:

> *"the purpose [of the priority statute] is to provide preferred protection to individual policyholders and claimants who, unlike a reinsured company, had little means of analyzing the risks involved in dealing with the now insolvent concern. Based upon these considerations, the courts have uniformly agreed that a reinsurance contract does not constitute a policy of insurance under the [priority] statute. … The reinsurance agreement to which Aspen was a party is not a policy of insurance, and plaintiff is not a policyholder."*[8]

Illinois

The Illinois decision of In Re Liquidations of Reserve Insurance Company, *supra,* provides the most detailed explanation of the differences between reinsureds and direct policyholders. In the context of the liquidations of two Illinois-domiciled insurers, the reinsureds sought to be included within the statutory language giving priority to:

> *"claims by policyholders, beneficiaries, insureds and liability claims against insureds covered under insurance policies and insurance contracts issued by the [insolvent insurance] company."*

The Illinois Supreme Court described a reinsurance contract as one entered into only by and between certain insurance companies, that a "reinsurance agreement is distinct from and unconnected with the original insurance policy," that the entity whose loss is insured is not a party to the reinsurance contract, that a reinsurance contract is not a contract to insure those who face the risk of loss by fire or any of the hazards classified under section 4 of the Illinois Insurance Code, and is an agreement "by one insurance company to reimburse the original insurer should it be compelled to pay under the policy of direct insurance the insured who suffered the original loss."[9] The Illinois Supreme Court examined several other

[6] *See, e.g.,* Maurer v. International Re-Insurance Corporation, 31 Del. Ch. 352, 74 A.2d 822 (Del. Ch. 1950), *applications to intervene denied,* 32 Del. Ch. 447, 86 A.2d 360 (Del. 1952); Aetna Casualty and Surety Company v. International Re-Insurance Corporation, 117 N.J. Eq. 190, 175 A. 114 (N.J. Super. 1934); and cases cited in In Re Liquidations of Reserve Insurance Company, 122 Ill.2d 555 at 564, including Cunningham v. Republic Insurance Company, 127 Tex. 499, 94 S.W.2d 140 (Tex. 1936) and Shepherd v. Virginia State Insurance Company, 120 Va. 383, 91 S.E. 140 (Va. 1917).

[7] For example, the Delaware Chancery Court in Maurer, in the context of ancillary receivership proceedings related to an insolvent reinsurer, rejected claims by the reinsureds that they were eligible to participate in the distribution of funds deposited by the reinsurer with the state insurance commissioner "in trust for the common benefit and security of all its policyholders." The court's discussion was not based upon statutory construction, or the "rights of the claimants to participate in the general funds in the hands of the receiver," but instead focused on definitions and the contractual terms and conditions of the reinsurance agreements, including the uses of the terms "insurance" and "policy." In the court's view, "contracts *of* reinsurance" were not synonymous with "contracts *for* reinsurance," the latter being merely treaties upon which future risks would be reinsured, when incurred. Maurer, 74 A.2d 822 at 828. The court determined that the reinsureds were parties to contracts for reinsurance, or contracts for risks that might later be assumed while the contracts were in force, but which were not "policies." *Id.* Implicit in this statement is the concept that, had the court found the reinsureds to be parties to contracts *of* reinsurance, the reinsureds might have been found to be holders of "policies." The Maurer case may be of limited value because it was not based on the construction of an insurance insolvency priority statute, and because Delaware is among the states in which the priority statute now clarifies the status of reinsureds. Nonetheless, Maurer is among the decisions demonstrating that, under multiple legal analyses, U.S. courts have most often found parties to reinsurance arrangements not to be "policyholders."

[8] Northwestern, 812 P.2d. at 692.

[9] In Re Liquidations of Reserve, 524 N.E.2d at 541.

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provisions of the Illinois Insurance Code and determined, first, that reinsurance was different in form and substance from insurance and, second, that when the legislature intended reinsurance to be included in a particular provision of the Insurance Code, it was specifically mentioned; therefore, the omission of a reference to reinsurance in the priority statute was deemed to be intentional and to reflect a legislative intent to include only direct insureds. The language of the Illinois priority statute is typical, which might make the In Re Reserve case of persuasive value in a state that has yet to consider this issue.

Indiana

Under a similar analysis to that employed in the Illinois case, the Indiana Supreme Court in Foremost, *supra*, concluded, in a liquidation proceeding, that reinsureds were not within the class of "claims by policyholders, beneficiaries, and insureds arising from and within the coverage…of insurance policies and contracts issued by the [insolvent] company." The Court specifically noted that reinsurance was a well understood concept in the insurance industry, and that the legislature could have included ceding companies along with the policyholders, beneficiaries, and insureds, if such was their intention. Furthermore, the Court did not accept the plaintiffs' argument that as a reinsured, it should be treated as equivalent to a guaranty association.

New Jersey

Under a priority statute that included "claims by policyholders, beneficiaries, and insurers arising from and within the coverage…of insurance policies and contracts issued by the [insolvent] company," the New Jersey Superior Court in Sussex, *supra,* concluded that neither the legislative history nor the priority statute's purpose to protect direct policyholders supported a determination that the word "insurers" was intended to include reinsureds. The court did not accept the argument that the word "insurer" was a typographical error and that it should have been "insured" and that "insureds" would then include reinsureds. The court stated that whether the statute "is read literally to include 'insurers' or read liberally to include 'insureds' only, the legislative history and case law applying the UILA [Uniform Insurers' Liquidation Act] lead to the inescapable conclusion that reinsureds were not intended to be given the same priority status as primary policyholders and direct insureds."[10] Finally, the Sussex court concluded that "courts in this jurisdiction and other have consistently rejected the notion that reinsureds enjoy the same status accorded 'insureds' in liquidation proceedings under the UILA," *citing* 19A Appleman, Insurance Law and Practice §10726 (Supp. 1996-97), for the proposition that "[c]laims arising out of reinsurance are considered separate from and subordinate to claims of policyholders."[11]

North Carolina

In the North Carolina case, Long v. Beacon, *supra,* the priority statute gave precedence to "claims…for benefits under policies and for losses incurred, including claims of third parties under liability policies…but excluding claims of…*reinsurers* [and] claims of other insurers for subrogation… ." The reinsureds of the insolvent reinsurer claimed the word "reinsurer" in the exemption to the policyholder priority statute was literally intended only to exempt *reinsurers* and not *reinsureds.* The court refused to read the statute so narrowly and instead deemed the word "reinsurers" to refer to any party involved in a reinsurance transaction, whether as ceding or as assuming insurers, and, therefore, concluding (as had the appellate court when faced with the same argument) that all such parties were excluded from "policyholder" status. In the course of its decision, the Long v. Beacon court stated that"the public policy considerations favoring protection of policyholders are not applicable, however, to the business of reinsurance."[12]

Ohio

In the Ohio case, the Court of Appeals of Ohio issued its decision in Covington v. The Ohio General Insurance Company, *supra,* in the context of an insurance company liquidation proceeding, determining that reinsureds were included as holders of "policies" for purposes of the Ohio insurance insolvency priority statute. [13] The Ohio Court of Appeals stated that it was relying upon the unambiguous and plain language of the Ohio priority statute, which provided for priority payment with respect to "all claims under policies for losses incurred, including third party claims." In addition to the appellate court's holding that the statutory language was unambiguous and that several dictionaries define "policies" in such a way as to include both insurance and reinsurance, the appellate court also deemed it to be of significance that the exception for reinsureds included within the priority statute of the NAIC Model Act had not been adopted by the Ohio legislature. The appellate court deemed such omission to indicate that the legislature intended reinsureds to be included as policyholders.

[10] Sussex, 301 N.J. Super. 595 at 609.

[11] *Id.* at 610.

[12] Long, 87 N.C. App. 72 at 77.

[13] Ohio Ins. Code, R.C. §3903.42.

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On appeal, however, the Ohio Supreme Court reversed, concluding that the Ohio General Assembly "did not intend the words 'claims under policies for losses incurred' to include a claim under a reinsurance agreement. First the General Assembly uses different terms when referring to consumer insurance policies and reinsurance agreements. Second, including reinsurance claims in [the "policyholder" class] would not be consistent with the other types of ["policyholder"] claims." The Court finished its analysis by stating that "[i]n short, the purpose of the priority for ["policyholder"] claims is to protect consumers who have purchased direct insurance and those in related situations, rather than to protect reinsured insurance companies."

Tennessee

In the Tennessee case, Neff, *supra,* the plan of rehabilitation placed direct policyholders in a class (that of parties having "claims for benefits under policies and for losses incurred") prior to the class of "general creditors, including claims of other insurers for subrogation." The rehabilitator placed all reinsureds in the latter class. The court determined that only direct policyholders rather than reinsured insurance companies were intended to be protected by the priority statute. That determination was based upon (i) its review of the insurance code as a whole, (ii) the legislative history of the priority statute, (iii) a 1973 amendment to the priority statute and (iv) the long standing practice of the Tennessee insurance commissioner in insurance company insolvency proceedings to classify reinsurance companies as general creditors of insolvent insurance companies.

Pennsylvania Decisions on Surety Bond Holders

The Pennsylvania courts have not directly addressed the narrow issue of whether reinsureds are "policyholders" for purposes of the Pennsylvania priority statute. [14] However, in the course of the rehabilitation proceedings with respect to Mutual Fire Insurance Company, [15] the Pennsylvania Commonwealth Court stated that "the equitable purpose of rehabilitation and liquidation is to protect first of all consumers of insurance" [16] and determined that holders of surety bonds were not "policyholders" under the Pennsylvania priority statute. Therefore, the surety bond holders were not"within the same claimant class as 'direct book' policyholders [would be] were the insolvent insurer in liquidation" instead of rehabilitation. The court also explored the nature of surety bonds, concluding that tripartite surety bonds were more in the nature of commercial guarantee instruments, rather than bilateral contracts of insurance. Because reinsurance agreements also could be described as more in the nature of a commercial guarantee than a direct contract of insurance, similar reasoning could apply to prevent reinsurance agreements from being within the statutory priority for "claims under policies."

The Commonwealth Court in Grode approved the rehabilitation plan, [17] which established, among the classes of claims and their priority of distribution, separate classes for each of the following: policyholders (Class 4), surety bond lenders (Class 5), and general unsecured claims, including claims of cedents and reinsurers (Class 6). The only specific comment offered in the Grode decision regarding reinsureds is that "we find the creation of both Class 5 and Class 6 to be a proper exercise of the Rehabilitator's discretion. … No one can dispute that [the] consumer is not possessed of equal bargaining power, knowledge, or resources as that of the reinsurance entities and financial institutions which comprise the other major creditor classes in this proceeding." [18]

Conclusion

In several insurance contexts, including insurance insolvency, reinsureds or parties to reinsurance agreements have been held, under statutory construction, public policy, or a combination of analyses, not to be within the term "policyholder." Given the increasing number of state legislative clarifications on this issue and the decisive outcomes of the seven court decisions addressing the specific issue, it seems clear that parties to reinsurance agreements are not destined to be accepted as part of the class of "policyholders" that the state legislatures sought to protect in enacting the priority of distributions in the insurance insolvency statutes.

[14] Penn. Ins. Code, 40 P.S. §221.44. The Pennsylvania priority statute provides that the second class of priority shall be for "[a]ll claims under policies for losses wherever incurred, including third party claims… ."

[15] Grode v. Mutual Fire, Marine, and Inland Insurance Company, 132 Pa. Commw. 196 , 572 A.2d 798 (Commw. Ct. Pa. 1990).

[16] *Id.,* 132 Pa. Commw. 196 at 203.

[17] In the course of the rehabilitation of Mutual Fire, the Pennsylvania Supreme Court, in Foster v. Mutual Fire, Marine, and Inland Insurance Company, 531 Pa. 598, 614 A.2d 1086 (Pa. 1992), generally approved the rehabilitation plan litigated in the Grode decision. Although the thrust of the Foster decision regarded a different issue (the determination that the setoff rights of cedent companies with respect to an insolvent reinsurer could be limited due to the equitable and the permissive, rather than mandatory, nature of setoff), within the plan of rehabilitation presented to the Foster court for review was the identical distribution scheme that included reinsurers and cedents as part of Class 6 along with general unsecured creditors.

[18] Grode, *supra* at 215.

The Case for Transparency: Why the Courts Should Find a "Common Interest" Between Cedent and Reinsurer

Robert N. Hermes and Amy B. Kelley [1]

The relationship between a ceding company and its reinsurer requires close cooperation and mutual trust. The reinsurer is almost entirely dependent upon the ceding company for information concerning the risk that is the subject of the reinsurance. The ceding company, in turn, relies upon the reinsurer to fairly and promptly pay claims in accordance with the reinsurance contract between them. In light of case law in certain jurisdictions, however, there has been an erosion of this relationship as ceding companies have begun to withhold information that has historically been made available to reinsurers. Without sufficient information to adequately assess the legitimacy of those claims, reinsurers are reluctant to promptly pay claims and more likely to contest claims. This situation is not sustainable and the courts that are responsible for the current state of affairs need to rethink their view of the relationship between a ceding company and its reinsurer. Specifically, cedents and reinsurers must attempt to focus the courts' attention on public policy considerations that are at odds with the judicial opinions giving rise to this problem.

At the heart of this problem is the explosion of mass tort litigation. Policyholders in coverage disputes with their insurers are seeking to discover information relating to their insurer's reinsurance coverage. These policyholders are seeking to discover not only the details of the reinsurance relationship, but also any and all documents that their insurer has provided to its reinsurer in the course of the reinsurance relationship, including otherwise privileged materials (e.g., exposure analyses, defense assessments by coverage counsel, and reserve recommendations, to name a few). Policyholders have argued, with some success, that insurers waive their right to assert a claim of privilege on any documents that have been disclosed to their reinsurers. Although the majority of courts find that an insurance company and its reinsurer have a "common interest" such that the parties may share privileged information while still maintaining their expectation of confidentiality vis-à-vis third parties, a few courts have held to the contrary. Moreover, a majority of courts have refused to find a "common interest" when the issue has arisen in the context of a reinsurer trying to obtain disclosure of the privileged documents in the first instance. There is absolutely no justification for this distinction. Courts declining to find a "common interest" in either context fail to appreciate the significance of the duties and obligations that distinguish a reinsurance relationship from other contractual business relationships. It is these duties and obligations – among them the duty of utmost good faith and the follow the settlements doctrine – that justify application of the common interest doctrine even where other business relationships might fall short.

The Common Interest Doctrine

Although the precise elements of the attorney-client privilege vary from state to state, it is generally accepted that confidential communications between an attorney and her client conducted for the purpose of securing or rendering legal assistance are privileged against disclosure. In addition, the work product doctrine provides that material may be protected from disclosure if it is prepared by or for a party in preparation for trial if it contains or discloses the mental impressions, conclusions, opinions, or legal theories of the party's attorney. These protections are not, however, absolute. In most circumstances, the voluntary delivery of a privileged communication to one who is not a party to the privilege vitiates or "waives" the privilege.

There are certain situations, however, in which disclosure may occur without constituting a waiver of the privilege. One such situation is where the parties in question share a "common interest." The common interest doctrine generally holds that a party may share privileged documents with another party with whom it shares a "common interest," while still maintaining the ability to assert the privilege as against other third-parties. The communications are privileged vis-à-vis third parties, but are not privileged in a subsequent controversy between the original disclosing parties. *(See 8 J. Wigmore, Evidence § 2312 (1961)).* Unfortunately, there is little uniformity in how the common interest doctrine is applied by the courts. Thus, it is often difficult to predict whether parties will be found to posses the requisite "common interest."

[1] Robert N. Hermes is a partner at Butler Rubin Saltarelli & Boyd LLP. Amy B. Kelley is a senior associate at Butler Rubin Saltarelli & Boyd LLP. The views expressed in this article do not necessarily reflect the views of Butler Rubin Saltarelli & Boyd LLP, any of its individual partners, counsel, or associates, or those of its clients.

The Case for Transparency: Why the Courts Should Find a "Common Interest" Between Cedent and Reinsurer

Robert N. Hermes and Amy B. Kelley

In its original formulation, the common interest doctrine applied in situations where two parties shared a common attorney. *(See 8 J. Wigmore, Evidence § 2312 (1961)).* A number of courts have, however, expanded the "common interest" doctrine to include situations where parties represented by separate counsel engage in a common legal enterprise – the so called "joint defense privilege." Other courts have further expanded the doctrine to include communications between entities that have parallel interests but are not actively pursuing a common legal strategy. The seminal case expanding the "common interest" doctrine in this manner is *Duplan Corp. v. Deering Milliken, Inc.* [2] In *Duplan,* the court held that "a community of interest exists among different persons or separate corporations where they have an identical legal interest with respect to the subject matter of a communication between an attorney and a client concerning legal advice." According to the *Duplan* court, "[t]he key consideration is that the nature of the interest be identical, not similar, and be legal, not solely commercial."

The courts have struggled with how to apply the common interest doctrine in the context of the relationship between a ceding company and its reinsurer. There are courts that have employed a quite limited view of the common interest doctrine and have refused to find a "common interest" in the context of a reinsurance relationship. In *Allendale Mutual Insurance Co. v. Bull Data Systems, Inc.,* [3] for example, a federal district court stated, albeit in dicta, that a cedent's disclosure of privileged information to a reinsurer waives any privilege that might have applied to the information. According to the *Allendale* court, the "common interest" doctrine is limited to situations where clients face "a common litigation opponent." The *Allendale* court concluded that the documents sought by the policyholder in the case before it were all created in the "ordinary course of business" and therefore that "*Allendale* waived any privileges that might have existed when, in the ordinary course of business, it disclosed the information contained in the documents to its reinsurers."

The majority of courts, however, find to the contrary and have rejected attempts by policyholders to argue that the disclosure of privileged information to a reinsurer results in the waiver of the privilege. These courts find a clear "common interest" between a ceding company and its reinsurer. Thus, in *Durham Industries, Inc. v. North River Insurance Co.,* [4] a federal district court refused to permit a policyholder to obtain discovery of information that had been shared between the ceding company and its reinsurer, holding that "where the reinsurers bear a percentage of liability… their interest is clearly identical to that of [the ceding company]." Similarly, in *Pfizer Inc. v. Employers Insurance. Co. of Wausau,* [5] a New Jersey court relied on the principles of the common interest doctrine (while not specifically referring to the doctrine by name) in declaring that the insurer did not waive the attorney-client privilege by sharing otherwise privileged communications with its reinsurers. The special master in *Pfizer* held that "[t]he interests of the parties to the communications have qualitatively identical interests in the eventual outcome, and it would not be socially useful for the law to require production of their communications transmitted during the litigation itself and concerning the litigation." The special master noted that "[i]t is natural that an insurer should keep its reinsurers abreast of events in coverage litigation." To find that the insurer had nevertheless waived privilege would "discourage candor, and stifle a flow of helpful and legitimate information which has value only if the parties to the communications can rely on confidentiality."

Although the majority of courts endorse application of the common interest doctrine in the context of what courts and commentators have labeled the "defensive" use of the doctrine, i.e., an effort to prevent the disclosure of privileged documents to a policyholder, the majority of courts have rejected application of the common interest doctrine in the "offensive" context, i.e., an effort by a reinsurer to compel production of privileged documents from the insurance company. In other words, the majority of courts have declined to find that reinsurers have a legal right to obtain disclosure of privileged documents based on the reinsurers' "common interest" with the insurance company.

For example, in *North River Insurance Co. v. Philadelphia Reinsurance Corp,* [6] a federal district court denied a reinsurer's motion for production of privileged materials from the insurer's underlying coverage dispute with its policyholder. The court found that "the common interest

[2] 397 F. Supp. 1146, 1172 (D.S.C. 1974).

[3] 152 F.R.D. 132 (N.D. Ill. 1993).

[4] No. 79 Civ. 1705, 1980 WL 112701, *3 (S.D.N.Y. Nov. 21, 1980).

[5] No. C-108-92 (N.J. Super., Middlesex Co.), available in Vol. 8 Mealey's Lit. Rep. Reinsurance No. 20 (Feb. 25, 1998).

[6] 797 F. Supp. 363, 367 (D.N.J. 1992).

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doctrine is completely unlashed from its moorings in traditional privilege law when it is held broadly to apply in contexts other than where there is dual representation." Similarly, in *North River Insurance Co. v. Columbia Casualty Co,* [7] another federal district court, in a suit to recover defense costs allegedly due under a reinsurance contract, rejected the reinsurer's argument that it was entitled to documents from an underlying ADR proceeding that would otherwise be privileged because it shared a "common interest" in the proceedings with the cedent. In granting the cedent's motion for a protective order, the *Columbia* court explained, "[w]hat is important is not whether the parties theoretically share similar interests but rather whether they demonstrate actual cooperation toward a common legal goal." The court further held that "[t]his rationale applies with even greater force in the reinsurance context," since the reinsurer does not have a duty to defend that would at least imply some level of cooperation in the litigation. Accordingly, the Columbia court found that there was no common interest between the parties because (1) they were not represented by the same counsel [in the ADR proceedings], (2) the reinsurer did not contribute to its cedent's legal expenses, (3) the reinsurer did not exercise any control over the cedent's conduct of the proceedings, (4) the parties did not coordinate litigation strategy in any way, and (5) the parties' legal interests sometimes diverged as demonstrated by the instant litigation.

At least one case in the analogous insurance coverage context has, however, held to the contrary. In *Waste Mangement, Inc. v. International Surplus Lines Insurance Co.,* [8] the Illinois Supreme Court held that even when the insured hired its own lawyer in the underlying case and was engaged in coverage litigation against its insurers, the insured still maintained a "common interest" with the insurance company. Accordingly, the court held that the attorney-client privilege and work-product doctrines did not bar disclosure of the defense counsel's files to the insurer. The court found the "common interest" of the insured and its insurer in minimizing the liability to the third-party plaintiffs sufficient to warrant production of the privileged documents to the insurer.

The Cedent-Reinsurer Relationship

As the cases demonstrate, there is little consensus among the courts addressing these issues. One thing that is clear, however, to anyone who is familiar with the rights and obligations of ceding companies and reinsurers is that the courts that have refused to extend the common interest doctrine to the reinsurance relationship – whether to prevent disclosure to a policyholder *or* to require disclosure to a reinsurer – fail to comprehend the nature of the relationship between a ceding company and its reinsurer.

The reinsurance relationship is marked by certain customs and practices that distinguish the connection between a ceding company and its reinsurer from other business relationships. Principal among those customs and practices is the duty of "utmost good faith," which requires each party to the reinsurance contract to provide a full and timely disclosure to the other party. For the ceding company, that means providing all known information concerning the risks that are the subject of the reinsurance contract and providing a full and timely notice of every claim. As explained by one court:

> *Reinsurance works only if the sums of reinsurance premiums are less than the original insurance premium. Otherwise, the ceding insurers will not reinsure. For the reinsurance premiums to be less, reinsurers cannot duplicate the costly but necessary efforts of the primary insurer in evaluating risks and handling claims. Reinsurers may thus not have actuarial expertise, or actively participate in defending ordinary claims. They are protected, however, by a large area of common interest with ceding insurers and by the tradition of utmost good faith, particularly in the sharing of information.*

Unigard Security Insurance Co. v. North River Insurance Co. [9] Characterizing the ceding insurer and the reinsurer as "joint venturers," the *Unigard* court emphasized the importance of the ceding insurer providing the reinsurer with a "prompt and full disclosure" and noted that without that disclosure "reinsurance would become unavailable."[10]

Indeed, the cedent's good faith obligation to provide information is critical given another core component of the reinsurance relationship – the obligation of the reinsurer to "follow the settlements" of the ceding insurer. This obligation, sometimes referred to as the "follow the

[7] No. 90 Civ. 2518 (MJL), 1995 WL 5792 (S.D.N.Y. Jan. 5, 1995).

[8] 579 N.E.2d 322, 327 (Ill. 1991).

[9] 4 F.3d 1049, 1054 (2d Cir. 1993) (citations omitted).

[10] Id. at 1054, 1066; see also Reliastar Life Ins. Co. v. IOA Re, Inc., 303 F.3d 874, 878 (8th Cir. 2002) ("To arrange their business otherwise would result in greatly increased costs for both reinsurance and the underlying policies themselves.").

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fortunes" doctrine, requires the reinsurer to indemnify the cedent for all payments reasonably within the terms of the original policy, even if not technically covered by it. *International Surplus Lines Insurance Co. v. Certain Underwriters at Lloyd's of London.* [11] In other words, the follow the settlements doctrine "requires reinsurers to reimburse the reinsured (or cedent) for payment of the settled claims so long as the payments were made reasonably and in good faith." *Id.* In this manner, the follow the settlements doctrine ensures the transfer of risk from the ceding company to the reinsurer and puts the ceding company in a position where it can comfortably settle and pay claims. As described by the *ISLIC* court:

> *This standard is purposefully low. Were the Court to conduct a de novo review of [the cedent's] decision-making process, the foundation of the cedent-reinsurer relationship would be forever damaged. The goals of maximum coverage and settlement that have been long established would give way to a proliferation of litigation. Cedents faced with de novo review of their claims determinations would ultimately litigate every coverage issue before making any attempt at settlement. Such a consequence this Court will not abide.*

Id.

The follow the settlements doctrine, therefore, serves the important public policy goal of ensuring the fair and timely payment of insurance claims to injured parties. In order for this public policy goal to be met, however, the reinsurer must be in a position to assure itself that claims are being properly managed. Absent an insurer's ability to share information freely with its reinsurer without fear of waiving privilege, the reinsurer may find itself in a position where it is hesitant to pay because it has not been provided with sufficient information to enable it to determine whether a particular claim was reasonably paid or settled. Indeed, without adequate information available, reinsurers may not be willing to underwrite particular policies in the first instance and, if they do, the economic impact on the marketplace could be significant.

For these reasons, the courts need to harmonize their application of privilege law with the follow the settlements doctrine. Courts need to recognize the alignment of the insurer and reinsurer and apply the common interest doctrine in a way that allows the transparency necessary to permit reinsurers to be kept fully informed so that ceding companies can be confident that their reinsurers are behind them if a settlement with an insured seems reasonable. The courts can still protect privilege vis-à-vis policyholders. Indeed, insurers should not have to choose between keeping reinsurers informed and maintaining privilege vis-à-vis their insureds. The strict interpretation of the "common interest" doctrine applied by some courts is in clear tension with the ceding company's obligation to provide information and the reinsurer's need for such information in order to pay claims. The mere fact, emphasized by some courts, that the reinsurer is not a party defendant should be of no significance. Rather, the courts should focus on the fact that the reinsurer will, if the claim is covered by the reinsurance, share in any liability suffered by the insurer. Thus, the reinsurer has a vested interest in the cedent's coverage and litigation decisions.

This same reasoning applies with equal force when a reinsurer seeks to compel the production of privileged documents in the possession of the ceding insurer. To the extent that those documents relate to issues of underwriting or issues relating to the settlement of particular claims, the reinsurer has a right to and a need for these documents. It does not serve the public interest to permit the insurer to rely on the common interest doctrine when avoiding the production of privileged documents to its policyholders but then reject application of the doctrine when the reinsurer is seeking production of the privileged documents in the first instance. The courts denying reinsurers' efforts to obtain such documents wrongly focus on the fact that the insurance company and reinsurer are in an adverse position at the time the request for documents is made. The proper focus is on the relationship of the insurer and the reinsurer at the time the privileged communication was made. In most cases, the reinsurer will have been entirely dependent upon the ceding company's judgment in underwriting the policy or resolving the claim at issue. Therefore, the reinsurer will not have the information needed to make an informed decision about whether a claim is covered by the reinsurance agreement. Indeed, even if the reinsurer was operating under a reservation of rights at the time it sought the privileged information, the insurer would still have been acting on behalf of the reinsurer in underwriting the policy, and investigating and settling the claim. The fact that a subsequent dispute may arise between the insurer and reinsurer does not abrogate the "common interest" and should not affect the court's judgment.

Although courts in the United States have been slow to authorize the "offensive" use of the common interest doctrine, at least one court in the United Kingdom

[11] 868 F.Supp. 917, 921 (S.D. Ohio 1994); see also *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992).

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has endorsed this concept, recognizing the relationship between the follow the settlements doctrine and the common interest doctrine. In *Commercial Union Assurance Co. v. Mander,* [12] the court held that a "contract of reinsurance which contains a 'follow [the] settlements' clause does create a community of interest between insurer and reinsurer in the original claim "such that an insurer" cannot withhold from the reinsurers on the ground of privilege documents brought into being for the purposes of handling the original claim, even if they would be subject to legal professional privilege as against a third party."[13] Similar reasoning should be used by courts in the United States when presented with a reinsurer's request to compel the production of privileged documents from its reinsured, even where there is a dispute between the insurer and reinsurer. If the courts are concerned with the potential for waiver as to third-parties, the courts can take steps to ensure that such waiver does not take place. Thus, in a recent case, a federal district court judge granted a reinsurer's motion to compel the production of privileged documents but specifically set forth in his order that the insurer's production of documents "does not constitute a waiver by [the insurance company] of the attorney/client privilege and/or the work product doctrine with respect to those documents." *Travelers Casualty & Surety Co. v. Constitution Reinsurance Corp.* [14]

In sum, those courts that have refused to permit reinsurers access to privileged documents should rethink their view of the relationship between a ceding company and its reinsurer. The same public policy considerations that have led to judicial recognition of the doctrines of utmost good faith and follow the settlements, argue for application of the common interest doctrine in the context of the relationship between a ceding insurer and its reinsurer. The failure to recognize a "common interest" in this context may place a tremendous burden on insurance companies who find themselves facing increased litigation with their reinsurers, more unpaid claims, and higher reinsurance premiums.

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[12] 2 Lloyd's Rep. 640 (June 12, 1996).

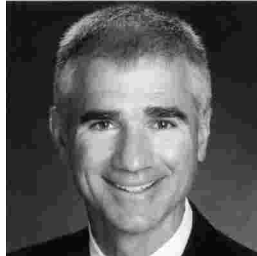
[13] The court, however, declined to order production of the documents to the reinsurer because the reinsurer was seeking to rescind the very contract that created the "community of interest" in the first instance.

[14] No. 01-71057 (E.D. Mich. June 13, 2003), available in 14-6 Mealey's Litig. Rep. Reinsurance 3 (July 17, 2003). Although the Travelers court declined to determine whether the insurance company and the reinsurer had a "common interest," as the reinsurer had argued, the court did find that in failing to produce documents relating to the insurer's allocation of a $137 million settlement, the insurance company was "abusing the attorney/client privilege."

Meet Our Colleagues

Joe DeVito

Richard T. Freije, Jr.



Dick Freije has been a part of Baker & Daniels' Insurance and Financial Services Team since he graduated from the Indiana University School of Law in 1984. Dick's focus spans a wide array of insurance corporate and regulatory services for all types of insurance companies, managed care entities and other insurance related enterprises. He has significant insurance insolvency and troubled company experience, serving both the Indiana Insurance Department and the National Organization of Life and Health Insurance Guaranty Associations. Dick has represented NOLHGA in connection with a number of multi-state life insurance company insolvencies, including Coastal States Life Insurance Company, Life of Indiana, Mutual Security Life Insurance Company, New Jersey Life Insurance Company and Old Colony Life Insurance Company. He has also represented the Indiana Insurance Commissioner in his or her capacity as a receiver for nine life and property and casualty insurers and an HMO. Recently Dick has worked with the Indiana Insurance Department in connection with a number of troubled insurance companies either in or on the verge of supervision or other regulatory proceedings.

Dick also spends significant time with other individuals and entities interested in the insurance and financial services and managed care industries and provides counsel on strategic planning, strategic alliances, mergers and acquisitions and on regulatory, reinsurance, and general corporate issues. Dick served as the Senior Vice President, Chief Administrative and Legal Officer for Indianapolis Life Insurance Company during 2000 and 2001 and led Indianapolis Life's successful demutualization and combination with AmerUs Group Co.

Dick's wife, Brenda, also works for Baker & Daniels and is a member of the Employee Benefits Team where she specializes in health and other insurance employee benefit matters. Dick has five children and spends his free time coaching youth basketball and being involved in church related activities. Dick also has an engineering degree from Purdue University.

Lowell E. Miller, CPA, FLMI

Lowell Miller is Executive Director for the North Carolina Life & Health Insurance Guaranty Association and has managed the Association as a one-person office since 1995. He brought 25 years of insurance industry financial experience to that position. He was awarded the CPA designation in 1978 in Illinois after completing the Certificate in Accounting program at the University of Baltimore. Previously, he received a BA in English from Goshen (Ind.) College. He received the FLMI designation from LOMA in 1980. His accounting and financial experience ranges from internal audit, management reporting, investment accounting, statutory reporting and SEC reporting. Before forming his own accounting and consulting practice in 1988 he was Vice President, Controller for an insurance holding company in Raleigh, North Carolina that included both life and health and property and casualty companies. However, most of his experience was on the life side.

Lowell joined the International Association of Insurance Receivers after attending an insolvency workshop and being impressed by the quality of those sessions. He has also appreciated the educational quality of the Roundtable sessions. His interest in serving on the Board is in response to and appreciation for the quality of the programs and the organization.

Lowell and his wife, Bonnie, have both worked in the insurance industry their entire careers. They have three adult children. They enjoy touring the national parks and scenic nature areas.

He enjoys reading and attending sports events.

Meet Our Colleagues

Joe DeVito

James J. Walsh

James Walsh is a partner in the Ann Arbor office of Bodman, Longley & Dahling LLP, a major Michigan law firm headquartered in Detroit. Jim joined Bodman in 1977, after serving as a law clerk for two judges on the Michigan Court of Appeals. Jim's legal education was at Louisiana State University, where he was an editor of the law review.

Since 1994, Jim has served as lead litigation counsel for Michigan's Commissioner of Financial and Insurance Services in the Confederation Life Insurance Company (CLIC) insolvency.

In addition to representing the Commissioner in the rehabilitation plan confirmation hearing, pursuing claims on behalf of CLIC's U.S. branch and defending claims against the estate, Jim obtained an injunction prohibiting policyholder suits against CLIC's auditors, officers and others, to preserve those claims for the estate. Jim also argued the appeal that upheld the injunction, Comm'r of Ins v Arcilio, 221 Mich App 54 (1997).

Jim has also represented B.N. Bahadur as conservator and debtor-in-possession and, later Stuart A. Gold as liquidating agent, of MCA Financial Corp. The collapse in 1999 of MCA, a Michigan-based mortgage lender and servicer, resulted in one of the state's largest ever Chapter 11 cases. Jim has handled all significant litigation on behalf of the bankrupt estate.

Over the years, Jim has also developed a unique niche practice representing billboard companies. He currently represents all major outdoor advertising firms that operate in Michigan and for many years has served as counsel to the Outdoor Advertising Association of Michigan, the trade association for the billboard industry in the state.

Dan Watkins, CIR-ML

Dan Watkins is an attorney in Lawrence, Kansas specializing as a receiver for troubled insurance companies. Since 1997, he has worked with the Kansas Insurance Department and Kansas courts as special deputy receiver in eight life and health, property and casualty, and workers compensation rehabilitations and insolvencies, of which The Centennial Life Insurance Company liquidation was the most prominent. A CIR-Multiple Lines, Dan was recently elected to the IAIR Board of Directors on which he will serve as Secretary.

After graduating from law school at the University of Kansas in 1975, Dan served for nine years in Kansas government as an assistant attorney general, general counsel for the Department of Transportation and Chief of Staff for the Governor. Prior to his insolvency work, his private practice focused primarily on business transactions.

In managing insolvent companies, he works closely with affected guaranty associations and has successfully litigated with and recovered assets from holding companies, officers and directors, accountants, reinsurers, reinsurance intermediaries, insurance companies and others. He works closely with the Kansas Insurance Department on emerging or potential troubled company issues.

Dan is very active in civic affairs, a natural evolution from working as a VISTA Volunteer in South Florida from 1969–72. His volunteer board activities include stints chairing the community mental health center and endowment, the Lied Center for Performing Arts, the Lawrence Chamber of Commerce, Jayhawks (KU Alumni) for Higher Education, Union Pacific Depot Restoration, St. John's Parochial School and the Kansas Development Finance Authority.

Dan especially enjoyed coaching his four sons and their classmates in youth soccer, baseball and basketball, allowing him to vicariously relive his own athletic days. Now that his boys are college age and beyond, his athletic endeavors have narrowed to riding his bike on the Kansas River levee near his home. He and his wife, Phyllis, restored and live in an 1894 Queen Anne Victorian home in a national historic district next to downtown Lawrence.

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Receivers' Achievement Report

Ellen Fickinger

The **OSD** continues to manage the reinsurance run-off for **American Mutual Reinsurance, In Rehabilitation (AMRECO).** Total Claims and Reinsurance Payments inception total $4,534,000 and LOC Drawdown disbursements total $9,613,386. Another company under OSD supervision is **Centaur Insurance Company, In Rehabilitation.** Total claims paid inception to date for Loss & Loss Adjustment Expense total $53,294,714, Reinsurance Payments total $4,945,493 and LOC Drawdown disbursements total $13,876,555.

W. Franklin Martin, Jr. (PA) reported that as of 9/30/03 **Fidelity Mutual Life Insurance Company, In Rehabilitation (FML)** showed a statutory surplus in excess of $92 million after reserving for all policyholder liabilities and paying all but two smaller creditor claims. Claims continue to be paid at 100% and policyholders have full access to their cash value. The Rehabilitator is paying out approximately $42.5 million in policyholder dividends in 2003 and has obtained court approval to pay approximately $30 million in dividends for 2004.

The Commonwealth Court approved, on a preliminary basis, the Third Amended Plan for Rehabilitation on August 20, 2003. The Bid Process, as approved by the Court, for selection of an investor began in September. Once an investor is selected, final approval by the Court will be necessary.

efickinger@osdchi.com

Ellen Fickinger, Chair

Reporters:

Northeastern Zone: J. David Leslie (MA); W. Franklin Martin, Jr. (PA)
Midwestern Zone: Ellen Fickinger (IL); Brian Shuff (IN)
Southeastern Zone: Mary Schwantes (FL); James Guillot (LA);
Mid-Atlantic Zone: Joe Holloway (NC)
Western Zone: Mark Tharp, CIR (AZ); Evelyn Jenkins (TX)
International: Jane Dishman (England); John Milligan-Whyte (Bermuda)

Our achievement news received from reporters for the third quarter of 2003 is as follows:

RECEIVERS' ACHIEVEMENTS BY STATE

FLORIDA (Mary Schwantes, State Contact Person)

New Estates	Date of Order	Type of Order	Primary Line of Business
Nationwide Public Employees Trust	8/5/03	Liquidation	Unauthorized Entry Health Care Coverage
Superior Insurance Company	8/29/03	Rehabilitation	Property & Casualty

Early Access Distributions

Estate	Early Access Distributions to the Florida Insurance Guaranty Association (FIGA)	Early Access Distribution to the Florida Workers Compensation Insur. Guar. Assoc. (FWCIGA)
American Risk Assurance and National United Insurance	3,000,000.00	
Associated Business & Commerce		3,000,000.00
Casualty Insurance	500,000.00	
Charter American Insurance	1,000,000.00	

Receivers' Achievement Report

Ellen Fickinger

Estate	Early Access Distributions to the Florida Insurance Guaranty Association (FIGA)	Early Access Distribution to the Florida Workers Compensation Insur. Guar. Assoc. (FWCIGA)
First Alliance Insurance		500,000.00
First Miami Insurance	1,000,000.00	
Florida Employers Safety Association		1,500,000.00
Florida Worker's Comp. Fund		3,500,000.00
FTBA Mutual, Inc.		1,000,000.00
General Insurance Company	2,000,000.00	
Great Republic Insurance	1,000,000.00	
Guardian Property & Casualty	4,000,000.00	
International Bankers Insurance	1,000,000.00	
Ocean Casualty Insurance	1,000,000.00	
Trans-Florida Casualty	1,200,000.00	
United Business Owners SIF		1,500,000.00
Totals	**15,700,000.00**	**11,000,000.00**

Significant Reinsurance Recoveries

Estate	Amount of Reinsurance Recovery
USEC-SIF	2,906.09
Great Republic Insurance Co.	40.13
FESA-SIF	197,413.31
Florida Workers' Compensation Fund	1,226.06
Ares Insurance Co.	220,602.17
Associates Business & Commerce Ins.	933,478.94
Caduceus SIF	119,311.96
First Southern Insurance	169,847.49
FTBA Mutual	215,016.88
Fidelity National Ins. Co.	1,628.00
First Alliance Insurance Co.	3,926.88
Total	**1,865,397.91**

Discharged Estates

Estate	Date of Discharge
Reliance Insurance Company	4/14/03

ILLINOIS (Mike Rauwolf, State Contact Person)

Receivership Estates Closed

Name of Insurer	Category	Licensed	Year Action Commenced	Payout Percentage
Inter-American Ins. Co. of IL.	Life	Yes	1,991	Class A 100.0000% 4,885,744.00 Class D 31.2785% 43,550,660.00 Class D–PH not covered by GA's 35.0526% 21,948,184.00

Receivers' Achievement Report

Ellen Fickinger

Distributions: Disbursements to policy/contract creditors, Early Access & other funds paid to Guaranty Funds or Associations

Estate	Loss And Loss Adjustment Expense	Early Access Distribution	Return Premium	Reinsurance Payments
Alpine Insurance Company	1,404	0	0	0
American Mutual Reinsurance Co.	0	0	0	4,503,499
Coronet	485	500,001	0	0
Delta Casualty Company	25	163,025	0	0
Gallant Insurance Company	180	0	0	0
Illinois Insurance Co.	1,460	0	0	0
Inland American Insurance Co.	118	69,155	0	0
Legion Indemnity Co.	1,129	0	0	0
Oak Casualty Insurance	222	0	0	0
Pine Top Insurance Co.	18,910,705	0	0	0
United Capitol Insurance Co.	0	206,820	0	0
Valor Insurance Co.	286	0	0	0
Western Specialty Insurance Co.	0	100,000	0	0

MARYLAND (James A. Gordon, CIR-ML, State Contact Person)

Distributions: Disbursements to policy/contract creditors, Early Access & other funds paid to Guaranty Funds or Associations.

Estate	Amount
PrimeHealth Corporation	88,178.51 (late filed claims)

PENNSYLVANIA (W. Franklin Martin, Jr., State Contact Person)

Receivership Estates Closed

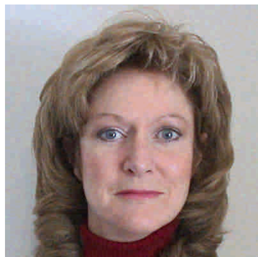
Name of Insurer	Category	Licensed	Year Action Commenced	Payout Percentage
Life Assurance Co. of PA	Liquidation	Yes	1991	32% to B claimants

Distributions: Disbursements to policy/contract creditors, Early Access & other funds paid to Guaranty Funds or Associations.

Estate	Guaranty Funds
PHICO Insurance Co.	6,083,500.00

Anaheim Roundtable Recap

Katherine L. Billingham, J.D., C.P.C.U.



The Roundtable discussion in Anaheim in December provided its audience with much insight into the economic experiences in California, thanks to Bob Fernandez and the excellent speakers he secured. As a bonus, Betty Patterson, from the Texas Department of Insurance (TDI), gave a summary of the changes that have taken place lately at the TDI and a status of the Highlands Insurance Company.

Bob Fernandez is Estate Trust Officer of the California Conservation and Liquidation Office, also known as the "CLO." His first speaker was the California Insurance Commissioner himself, John Garamendi.

John discussed a wide array of troubling issues that his staff has been addressing. The voting recall in California has raised many questions about policy issues. The CLO has a $15 billion "hole" in this year's budget and there will be a similar one next year. They do not have much direction yet from the Governor. In 2003, a total of 3,600 homes were destroyed by fires, resulting in 17,000 claims. This has been the worst fire year in the history of California. He anticipates a rapid increase in construction costs. Commissioner Garamendi does not think that the losses will result in significant financial problems for any specific carrier as the losses are broadly spread.

The California Workers Compensation program is the largest of any state and is a serious problem. The financial issues seen now are the result of a price war in the 1990's that was spawned by a legislative environment set to encourage competition. California has seen about 26 insolvencies to date that Commissioner Garamendi attributes to this brand of laissez faire. Many of the solvent carriers left California in the 1990's. The cost of such coverage in California is very expensive now. Between 1995 and 2003 medical costs have escalated at the rate of 17% annually. Claimants incur twice the medical expenses than in other states. He and his staff have suggested cost containment methods to the legislature and most of those suggestions were indeed adopted including a fee schedule and practice guidelines. The carriers were still reluctant to lower their rates but they have now turned the corner and the rates will be going down. So long as the carriers implement the cost containment procedures, there should be no financial impact for them. Note that California has no mandatory rate schedule. He is projecting a $5.5 billion savings in connection with the reforms.

Next the group heard from Fred Buck, CEO of the California CLO and Special Deputy Receiver. When ELIC and First Capital (life companies) were taken over in 1992, he was asked to review the conservation and liquidation procedures of the Office. As a result of his review and recommendations, the Office created the Conservation and Liquidation Office (which is not a part of the Office of the Special Deputy Receiver). In 2002 they closed five estates and in 2003 they will have closed 12.

His goal is to try to identify a financially troubled situation and respond sooner than has been done in the past. He intends to involve the guaranty associations earlier in the process and to get money distributed faster. The biggest problem facing the CLO is obtaining reinsurance data from the guaranty associations. Mr. Buck also addressed the historical challenge of reinsurers delaying the payment of claims, resulting in the insolvency of at least two companies. He intends to focus on this problem as well. He also is set to close Mission in 2004. First Capital Life closed this year and the CLO even made a distribution to shareholders!

From the California Insurance Guaranty Association (CIGA), the audience received a report from Larry Mulryan, its President. He relayed that Superior was the beginning of the "onslaught." The numerous workers compensation claims forced CIGNA to raise the assessment from 1% to 2% – but that was not enough. Then came Fremont – California had 70% ($1.6 billion) of that debacle.

The total current insolvencies at CIGA hover at $3.8 billion. Therefore, Fremont created serious funding needs. CIGNA borrowed from other accounts to pay workers compensation claims but will only be able to pay such claims through the third quarter of 2004 and are trying to figure out a long term solution. CIGNA considered raising the assessment, eliminating the claim categories or issuing revenue bonds. The latter option has passed the legislature and will take effect in 2004. The bonds will be tax free. Larry thinks the rates paid will be in line with the municipal bonds rates (approximately 4%). CIGNA is trying to move as quickly as possible to get ahead of other bonds that California will soon be issuing.

CIGA is now paying out $100 million per month in all lines. They have grown to 135 employees. They are looking at changing their IT in the next few months.

Anaheim Roundtable Recap

Katherine L. Billingham, J.D., C.P.C.U.

Larry is very focused on making the office run more efficiently.

Bob Fernandez has been the Trust Officer at the CLO for four years. He understands that reinsurance is an estate's largest asset and his interest lies in consolidation. Since the CLO has experienced staff reduction, when the Superior problem came about, Bob decided to bring in a firm. He interviewed a number of them and the successful candidate was Navigant Consulting. With that introduction, Bill Barbagallo, a Director from Navigant Consulting, addressed the group.

Bill is handling Superior for the CLO and is familiar with the book of business as he audited Superior when he was with Gen Re. He found it interesting to see Superior go from infancy to its demise. When he took over, much of the staff had already left. He had to marshal the information and make it conveyable. His focus was to "define the world" for the CLO. To accomplish the goal, Bill looked at all the contracts and puts the data into an effective billing system. Since brokers often do much of the billing, the in-house systems can be lacking, and brokers have little incentive to continue to service the accounts.

The CLO had invested heavily in the Mission billing system so they had decided to use that system. When he started in June he had to develop codes to tailor the system to fit Superior's business. Developing a good billing system takes significant time and effort.

There is often a large problem identifying reinsurer participation. In an ongoing situation, no one pays much attention to this issue but post receivership, those problems come home to roost. Some systems permit the transmission of a narrative of the claim to the reinsurer along with the billing which can expedite the process.

The actuarial issues in live companies are important. Navigant Consulting met with the actuaries and reviewed the assumptions made, and brought them current by reviewing the current laws, referenda, etc. (Bill noted that to effect valuable commutations a cedant has to accurately estimate its IBNR.) Then Navigant Consulting developed a new actuarial report by reinsurer.

Bill also developed reinsurer profiles to allow management to understand the liability and to develop strategy. With these profiles, the CLO can identify which reinsurers are financially unstable, which have been historically good at paying, which programs would be the easiest to commute, etc.

From the office of the Texas Department of Insurance (TDI), Betty Patterson, Director, Financial Oversight, gave an update. The TDI has about 1,000 employees now. They have a new SDR (Special Deputy Receiver) procedure: In the early 1990's, the legislature privatized the process. In the past they had a pool of potential receivers. Now they issue an RFQ (Request for Quote) to solicit interested parties to be a member of the pool. The TDI wanted to create a pool that would be there for three years which could be supplemented during that time. The pool currently has 25 to 30 entities. The pool is no longer limited to just individuals but the TDI still wants a named primary responsible party "PRP." The process for contracting with HUB is now more complicated. Now the TDI will only submit a Request for Proposal (RFP) for a Special Deputy Receivers to this pool. The TDI is also working on multistate coordination of receiverships.

Finally, Betty gave a report on Highlands Insurance Company (HIC). HIC had several companies that wrote a variety of business in most states. The TDI has been watching it for a few years while it was in runoff. They had hoped to let it continue but due to the Fuller Austin bankruptcy in California, where some carriers settled but HIC did not, California tried to attach HIC assets so the TDI stepped in. It is not an insolvency and does not trigger the Guaranty Fund. They are paying claims, including workers compensation. They have filed a petition for liquidation. There is a stay on the garnishment of the bank account (which is in Kansas City) until March 8th. They are continuing discussions with Fuller Austin. Betty is cautiously optimistic. The plan is to continue on. There will not be a hearing on the liquidation before March 8th.

In summary, the discussion was both informative and interesting and held the attention of the room. IAIR extends much thanks to Bob, Betty and to all the fine speakers who gave so generously of their time.

katherineb@ameritech.net

2004 Committees

Accreditation and Ethics

I. George Gutfreund,
CA, CIRP, CIR-ML, Chair
416.777.3054 or *ggutfreund@kpmg.ca*

This committee sets the qualifications for the AIR and CIR designations and reviews/ interviews all applicants. They also draft IAIR's Code of Ethics. This is a very active, hard-working committee that is always looking for input from new sources.

Amicus

Philip Curley, Chair
312.663.3100 or
pcurley@robinsoncurley.com

This committee comes into action when there is an amicus brief of interest to IAIR. They review the situation and present the Board with a suggested position for IAIR to take.

Bylaws

Francesca Bliss, Chair
845.807.5175 or *fbliss@ftr.com*

This committee is reponsible for the maintenance of IAIR's bylaws. The bylaws committee conducts periodic reviews of the organization's long range goals and, based upon membership input and consensus, drafts amendments to update the bylaws accordingly.

Education

Kristine Johnson, CPA, Chair
312.583.5713 or
kjohnson@navigantconsulting.com

The education committee is responsible for all educational programs sponsored and cosponsored by IAIR. These include, but are not limited to, the annual Insolvency Workshop, the Staff Training Seminar, the Joint Guaranty Fund workshop and the quarterly Roundtables in conjunction with the NAIC meetings. This is a very active committee which requires a large number of members to present interesting and timely educational programs.

Finance

Joe DeVito, MBA, CPA, Chair
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The finance committee assists the Executive Director in setting the annual budget and reviews the financial activity of IAIR.

International

Vivien Tyrell, Chair
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This committee was formed during 2000 to address the needs and concerns of IAIR's growing international membership. Since then the committee has sponsored several educational programs in London and they are working with members from other countries to determine the needs of the membership.

Marketing

Trish Getty, AIR-Reinsurance, Chair
770.754.1388 or
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The marketing committee is responsible for developing and implementing a marketing plan for IAIR. They have been instrumental in the creation of the Resource Directory and in bringing awareness of IAIR to the Insurance Commissioners.

Membership

Paula Keyes, Chair
407.682.4513 or *iairhq@aol.com*

The membership committee is responsible for setting the recruiting policy, initiating membership drives and handling promotional membership activities of IAIR. They also approve all applications for membership.

Nominations, Elections and Meetings

Michael Marchman, CIR-ML, Chair
770.621.3296 or *marchmann@aol.com*

This committee is responsible for the annual slate of officers and for handling the voting process together with the Executive Director.

Publications

Jerry Capell, Chair
312.583.5734 or
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This committee is responsible for publication of IAIR's quarterly newsletter, The Insurance Receiver, and the annual Membership Directory. They obtain the articles from the authors, edit, proofread, and advise the Executive Director on publication matters.

Website

Robert Loiseau, CIR-P&C, Chair
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The website committee is responsible for the material that is included on IAIR's website as well as establishing an advertising policy for the site that is consistent with the publications of the organization.

If you have any questions about these committees, please feel free to contact the chair person of that committee or IAIR headquarters at 407.682.4513.

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2003 Robert Greer, CIR-ML
2001–02 Elizabeth Lovette, CIR-ML
1999–00 Robert Craig, CIR-ML
1998 Douglas Hartz
1996–97 Richard Darling, CIR-ML
1995 Jeanne B. Bryant, CIR-ML
1994 Michael Miron
1991–93 Karen Weldin Stewart, CIR-ML

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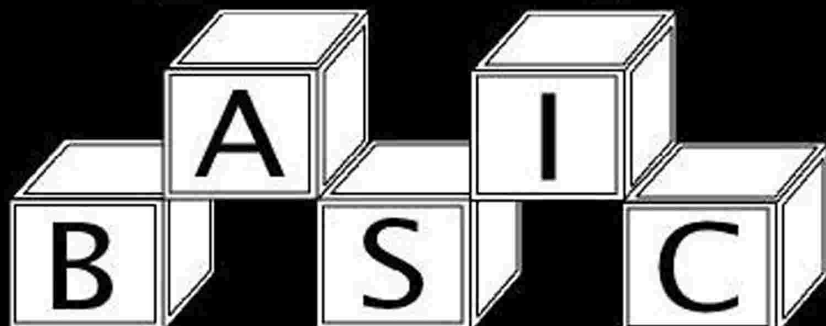

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