update

Staying Ahead with Saul Ewing

7 | 06

Insurance Practice Group

Think Twice Before Filing – Once a Proof of Claim is Filed with the Liquidator, it Cannot be Withdrawn

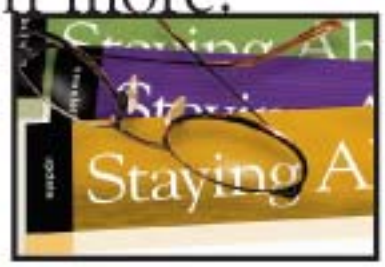
What happened?

Earlier this year, the Pennsylvania Supreme Court ruled, in *Koken v. Reliance Insurance Co., Appeal of Mawson & Mawson, Inc.*, 893 A.2d 70 (Pa. 2006), that a third party claimant who filed a proof of claim in the Reliance Liquidation could not withdraw his proof of claim. The Court ruled that Pennsylvania's insurance insolvency statute did not permit withdrawal of a third party proof of claim, and once filed, the proof of claim released the insured from liability to the third party claimant in the amount of the Reliance policy limit.

What does it mean?

While Pennsylvania's insurance insolvency statute does not specifically say that third party proofs of claim cannot be withdrawn, *Mawson* makes it clear that such claims are irrevocable once filed with the liquidator, unless the liquidator avoids coverage. Since Pennsylvania's insurance insolvency statute is based upon the NAIC's Insurer Receivership Model Act and there is very little authority nationally addressing the question of whether a third party claimant can withdraw a proof of claim, the impact of *Mawson* will likely not be limited to Pennsylvania.

Learn more.



Turn the page to find out more.

In *Koken v. Reliance Insurance Co., Appeal of Mawson & Mawson, Inc.*, 893 A.2d 70 (Pa. 2006) ("*Mawson*"), the Pennsylvania Supreme Court ("Court") addressed a question of first impression, and that is whether a third party claimant is permitted to withdraw a third party proof of claim once it is filed with the statutory liquidator under Pennsylvania's insurance insolvency statute (the "Act"). The Court responded in the negative, indicating that withdrawal of a third party proof of claim is prohibited. The Court's decision reversed a ruling by the Pennsylvania Commonwealth Court ("Commonwealth Court") which held that withdrawal of a third party proof of claim was permissible.

Facts

In *Mawson*, a truck owned by Mawson & Mawson, Inc. ("Insured") collided with a car driven by Richard Ruhl ("Ruhl") in Jun. 1997.[1] When the accident occurred, the Insured had $1,000,000 in primary insurance coverage through Reliance Insurance Company ("Reliance"), and $10,000,000 in excess insurance coverage through Federated Insurance Company ("Federated").[2] In Aug. 1998, Ruhl filed a personal injury action against the Insured in county court.[3] During discovery, the Insured revealed that its primary carrier was Reliance, but did not disclose its excess coverage with Federated.[4]

In Oct. 2001, the Commonwealth Court ordered Reliance into liquidation, after which the statutory liquidator ("Liquidator") notified all potential claimants against Reliance, including third party claimants like Ruhl, of their right to pursue claims in the liquidation by filing a proof of claim.[5]

In Jan. 2002, Ruhl filed a proof of claim with the Liquidator, which contained the standard release of the insured, which in this case, released the Insured from liability up to its Reliance policy limit.[6] Despite the filing of the proof of claim, discovery continued in Ruhl's tort action against the Insured, as neither sought a stay.[7]

In Nov. 2002, the Pennsylvania Property and Casualty Guaranty Association ("Guaranty Association") notified the Insured that it received the proof of claim and advised the Insured to retain counsel to protect its exposure in Ruhl's tort action, as a jury award would likely exceed the Guaranty Association's $300,000 statutory limit.[8] In Nov. 2002, one day before trial in the tort action, the Guaranty Association tendered its $300,000 limit to Ruhl and notified the Insured that the Guaranty Association would no longer defend the Insured.[9] The trial was continued by the Insured until Jan. 2003.[10]

In Dec. 2002, Ruhl notified the Insured that he had withdrawn his proof of claim prior to acceptance by the Liquidator, while the Liquidator informed Ruhl that his proof of claim had instead been designated as inactive.[11]

Procedural History

In Jan. 2003, the Insured filed a petition with the Commonwealth Court to enforce Ruhl's proof of claim, asserting that under Section 221.40(a) of the Act, Ruhl's filing of the proof of claim released the Insured's exposure to liability up to its Reliance policy limits.[12]

After Federated agreed to assume the Insured's defense in the tort action under its excess policy, a jury returned a verdict and awarded damages in favor of Ruhl for $367,770.[13]

In Feb. 2003, Ruhl filed an answer to the petition to enforce, alleging that the Insured failed to disclose its $10,000,000 excess insurance policy with Federated, and argued that the proof of claim release language was not effective until the Liquidator accepted coverage, which Ruhl claimed did not occur before "withdrawal."[14] The Commonwealth Court directed the parties, as well as the Liquidator, to brief the question of whether and when a third party claimant may withdraw a filed proof of claim and its attendant release.[15]

After briefing and oral argument, the Commonwealth Court issued an opinion denying the Insured's petition to enforce and directed the Liquidator to permit Ruhl to withdraw his proof of claim and release.[16]

Analysis

The Court reversed the decision of the Commonwealth Court, holding that it was an error to permit Ruhl to withdraw his proof of claim.[17]

The Court focused its analysis on the language of Section

221.40(a) of the Act, which provides that:

> Whenever any third party asserts a cause of action against an insured of an insurer in liquidation the third party may file a claim with the liquidator. The filing of the claim shall operate as a release of the insured's liability to the third party on that cause of action in the amount of the applicable policy limit, but the liquidator shall also insert in any form used for the filing of third party claims appropriate language to constitute such a release. The release shall be null and void if the insurance coverage is avoided by the liquidator.[18]

The Court noted that the issue of whether a proof of claim filed by a third party claimant during a liquidation under Section 221.40(a) may be withdrawn is a question of statutory construction.[19] The Court emphasized that use of the word "shall" in Section 221.40(a) is crucial, and in most contexts, including the case before it, its meaning is absolutely clear.[20] The word "shall" denotes a mandatory, not permissive instruction, particularly when a statute is unambiguous.[21] The Court found there to be no ambiguity in Section 221.40(a), and therefore concluded it mandatory for an insured to be released from liability in accordance with the Act once the third party files a proof of claim.[22]

In addressing Ruhl's argument that the statute does not specifically state that a third party who tenders a proof of claim cannot subsequently withdraw it, the Court reiterated that the statute commands that the filing operate as the release.[23] The Court indicated that the argument raised by Ruhl does not expose an ambiguity in the statute, nor does it warrant interpreting it in a way that negates the statute's affirmative language.[24] Moreover, the Court commented that because the statute explicitly recognizes just one way to nullify the release, *i.e.*, where the liquidator avoids coverage, strongly suggests that the legislature knew how to recognize an exception, and intended no other exceptions other than the one listed.[25]

The Court also found persuasive the fact that the Act is based on the NAIC's Model Insurance Receivership Act ("Model Law"), which was in turn drawn from Wisconsin's insurance insolvency statute ("Wisconsin Statute").[26] The Court found helpful comments by the Wisconsin legislature to Section 645.64(1) of the Wisconsin Statute, which is materially identical to Section 221.40(a) of the Act.[27] Those comments note that Section 645.64(1) of the Wisconsin Statute provides for a third party claimant to make a choice between pursuing a claim against the insured and making a claim in the liquidation.[28] The Wisconsin legislature points out that forcing such a choice is neither harsh nor unnecessary.[29] Rather, the third party claimant has ample opportunity to determine whether the insured is individually financially responsible.[30] If he is, the claimant can proceed against the insured, instead of taking his chances in the liquidation.[31] If the insured is of questionable solvency, the claimant can claim in the liquidation.[32]

Two significant goals of the Act are to "minimize legal uncertainty and litigation," and to provide "equitable apportionment of unavoidable loss."[33] The Court acknowledged that the Act creates a difficult decision for a third party claimant, but one that is fair given the burden an insolvency places on insureds, creditors, and the public alike.[34] The fact that the Act fixes the point of that decision at the time a third party claimant files a proof of claim creates an expectation of some measure of security for the third party claimant and the insured.[35] Based on these reasons, the Court concluded that enforcement of the Act according to its plain and unambiguous terms, *i.e.*, not permitting withdrawal of a third party proof of claim, is fully consistent with the legislative purpose of the Act.[36]

Impact

This case addresses only whether a third party claimant can withdraw a proof of claim, and not whether an insured or first party claimant can. The impact of this case will likely not be limited to Pennsylvania, as there is very little authority nationally that addresses the ability of a claimant to withdraw a proof of claim in a liquidation proceeding. In addition, since the Act is based upon the Model Law, which a number of jurisdictions have also adopted, other states will likely consider this case if faced with the same issue. Consistent application of Section 221.40(a) with other states' corresponding provisions is

essential to the success of a model or uniform statutory scheme such as the Model Law, which is designed to promote consistent and uniform interpretations across state lines. In addition to *Mawson*, it appears that Florida is the only other state with case law on point, and Florida courts have also concluded that third party proofs of claim cannot be withdrawn.[37]

The lesson to be learned from *Mawson* is that third party claimants should carefully consider a decision to file a third party proof of claim before filing. Due diligence should be performed to determine whether the insured is "judgment proof" or of doubtful solvency. If the insured is, it is likely a better choice to seek relief from the estate of the liquidator by filing a third party proof of claim. However, if the insured has sufficient financial assets, it may be worth the chance for a third party claimant to instead elect to proceed directly against the insured, outside the liquidation. Once that election is made however, the decision is irrevocable, unless the liquidator avoids coverage.

Footnotes

1 *Mawson*, 893 A.2d at 71.
2 *Id.* at 72.
3 *Id.*
4 *Id.*
5 *Id.* at 72-73.
6 *Id.* at 73.
7 *Id.*
8 *Id.* at 74.
9 *Id.*
10 *Id.*
11 *Id.*
12 *Id.* at 74-75.
13 *Id.* at 75.
14 *Id.*
15 *Id.*
16 *Id.* at 77.
17 *Id.* at 86.
18 40 P.S. § 221.40(a) (emphasis added).
19 *Mawson* at 80.
20 *Id.* at 81-82.
21 *Id.* at 81.
22 *Id.* at 82.
23 *Id.*
24 *Id.*
25 *Id.*
26 *Id.* at 83-84.
27 *Id.* at 84-85.
28 *Id.*
29 *Id.* at 84.
30 *Id.* at 85.
31 *Id.*
32 *Id.*
33 *Id.* at 85.
34 *Id.*
35 *Id.*
36 *Id.* at 85-86.
37 *See Ramos v. Jackson*, 510 So. 2d 1241, 1241-1242 (Fla. Dist. Ct. App. 1987); *see also In re International Forum of Florida Health Benefit Trust*, 607 So. 2d 432, 441 (Fla. Dist. Ct. App. 1992).