FEDERATION OF REGULATORY COUNSEL, INC.

INJUNCTIONS UNDER THE UNIFORM INSURERS LIQUIDATION ACT: MUST WE ALWAYS TAKE "NO" FOR AN ANSWER?

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Michael W. Teichman, Esq.
(302) 594-3331

In a 2013 order issued in *In re Indemnity Insurance Company*, the Delaware Court of Chancery held Jeffrey B. Cohen, the founder of a Delaware domiciled risk retention group, in contempt for violating an injunction issued in connection with a Seizure and Injunction Order issued pursuant to Delaware's insurance delinquency statutes. One of Cohen's actions that gave rise to this finding of contempt was Cohen's filing of lawsuits in state and federal courts in Maryland against the risk retention group and several of its key employees.[i] More recently, the Delaware Insurance Commissioner, as receiver for Freestone Insurance Company, sought a temporary restraining order and sanctions in *In the Matter of the Rehabilitation of Freestone Insurance Company* against a third party that initiated arbitration against Freestone and affiliated companies prior to the entry of the court's Rehabilitation and Injunction Order, yet post-receivership announced its intention to observe the injunction as to Freestone and proceed with arbitration only against the affiliates.[ii]

These actions give rise to two questions in states that have adopted the UILA: (i) are all aspects of all claims against an insurer in receivership subject to the Injunction, and (ii) does the injunction extend to affiliates of the insolvent insurer?

Background

In analyzing the scope and extent of the injunction, it is helpful to understand the purposes behind the UILA. The UILA was adopted by the National Conference of Commissioners on Uniform State Laws in 1939, largely in response to the numerous insurer insolvencies during the Great Depression.[iii] The Delaware Court of Chancery has described the purposes of the UILA as follows:

The UILA was created to facilitate coordination among the states for the orderly resolution of insolvent insurance companies. Because insurers are barred from seeking federal bankruptcy protection, the UILA establishes an alternative statutory scheme and provides its adopting states (the "States") with a "uniform method for processing claims against, and distributing assets of, distressed insurance companies" with assets and policyholders in multiple jurisdictions throughout the United States. A central purpose of this scheme is "to avoid dissipating a distressed insurer's assets by allowing it to be sued, and requiring it to defend, litigations scattered in many jurisdictions throughout the country."[iv]

Courts in other jurisdictions have described the purposes similarly:

The UILA was created to resolve some of the complexities of liquidating an insolvent insurance company with assets in multiple states.[v] Alabama adopted the UILA in 1971 in order "to effectuate its general purpose to make uniform the law of those states that enact it."[vi]

The purpose, thus, of the UILA is to provide for a uniform, orderly and equitable method of making and processing claims against financially troubled insurers and to provide for fair procedures for rehabilitating the business of such insurers and, if necessary, distributing their assets.[vii]

[Consolidating claims in one court] eliminates the risk of conflicting rulings, piecemeal litigation claims, and unequal treatment of claimants, all of which are of particular interest to insurance companies and policyholders, as well as other creditors.[viii]

[The states have a] paramount interest . . . in seeing that insurance companies domiciled within their respective boundaries are liquidated in a uniform, orderly and equitable manner without interference from external tribunals.[ix]

The drafters of the UILA identified six "embarrassments" that the uniform law was designed to address:

(1) the inefficient administration of the liquidation process caused by the appointment of receivers other than the various State Insurance Commissioners; (2) the lack of authority on the part of domiciliary receivers to proceed in nondomiciliary States leading to the dissipation of assets outside the home State and enabling out-of-State debtors to avoid their obligations; (3) the ineffective administration of the liquidation process caused by differences in the laws of the various States regarding the title and right to possession of the property of a defunct nonresident insurer; (4) the serious inconvenience in proving claims experienced by creditors living outside the defunct insurer's domicile; (5) the problems generated by diverse State laws governing preferences such as wage claims, compensation claims and tax claims; and (6) the inequity resulting from preferences obtained by diligent nondomiciliary creditors with advance information of an insurer's impending insolvency. (13 ULA [Master ed.], pp. 430–431.) Thus, the Uniform Insurers Liquidation Act was adopted with the main purpose in mind of providing a uniform system for the orderly and equitable administration of the assets and liabilities of defunct multistate insurers.[x]

Scope of the Injunction

The purpose of the anti-suit injunction found in state insurance codes that have adopted the UILA is typically expressed in the statutory provision itself as, *inter alia*, preventing interference with the Commissioner and preventing waste of the insurer's assets.[xi] In its 1999 amicus brief to the U.S. Supreme Court, filed in *McCarty v. Brown*, the National Association of Insurance Commissioners pointed out that the purpose of anti-suit injunctions in state insurer insolvency statutes was to: (1) allow the receiver to focus on the problems of the troubled company in a rehabilitation proceeding without the distraction of defending multiple suits in multiple jurisdictions; and (2) prevent creditors from helping themselves to the insurer's assets outside of a liquidation proceeding in the state of domicile.[xii]

In order for a state-issued injunction to have effect over a suing party in another jurisdiction, the court must have personal jurisdiction over the suing party.[xiii] Given that insurers typically engage in business activities across multiple states and jurisdictions, personal jurisdiction can be problematic.[xiv] So too can subject matter jurisdiction, in particular when the injunction is sought to be enforced against a person bringing a claim not against the insolvent insurer, but against its insured under a policy of casualty insurance.[xv]

Statutes enabling injunctions in support of the UILA are not necessarily automatic; rather, the court presiding over the receivership is empowered to issue an injunction as necessary to prevent waste or interference with the receivership.[xvi] However, with respect to claims against the insurer itself, claims sounding *in rem* are always subject to the injunction. Indeed, the UILA contains a provision prohibiting "a proceeding or action in the nature of an attachment, garnishment or execution."[xvii] It follows that many courts permit claims sounding *in personam* to proceed, distinguishing between the liquidation of a claim and the enforcement of the claim, and finding that merely maintaining an action to obtain a judgment, or the entry of same, is not an action against the *res* and, thus, not an attachment, garnishment or execution.[xviii] The distinction is commonly made in cases where the stay is sought to be enforced against a third party litigant bringing claims against an insured:

Here, however, the action is not directly against the troubled insurer, but against its insured under a liability policy. The insurer's assets are not directly at risk; preferences are not an issue; and the case for enforcing a Pennsylvania court's stay of Massachusetts litigation is a good deal less compelling than it might be in a direct action against the insurer.[xix]

The distinction between *in rem* and *in personam* jurisdiction has allowed the Delaware Court of Chancery to find that an arbitration that might result only in an award against the insolvent insurer, but not an execution on the assets of that insurer, was an action *in personam.* As such, the arbitration was not required to be enjoined but, rather, was subject to a stay that may be lifted, or not, in the discretion of the Court of Chancery: depending upon the impact of the litigation on the receivership process:

As a result, I find the plain meaning of § 5904(b) to be that collateral actions may be brought outside of the Court of Chancery, subject to this Court's ability to enjoin any or all such proceedings if the Court determines that they would interfere with the orderly liquidation or rehabilitation of the insurer.

This reading comports with the Order governing the proceeding here. In the 2007 Order, the Court enjoined any actions against Manhattan Re from commencing or proceeding in any forum other than the Court of Chancery, but allowed the Receiver to continue pre-existing actions in other forums if it elected to do so.[22] Consistent with the permissive nature of § 5904(b), however, the Court still retains the ability to lift the injunction for an action that the Court determines, upon application of a party, would not be inconsistent with the statute or its goal of ensuring the prompt and orderly rehabilitation of insurance companies.[xx]

Not all courts see the issue this way. In particular, the Alabama Supreme Court, in overturning a lower court decision, held that even the simple obtaining of a judgment by policyholders would give the judgment holders a priority over other insureds.[xxi] Nor is the outcome guaranteed, even in cases where the injunction is sought to be lifted for arbitration à la *Manhattan Re*. This proved to be the case in *Freestone,* where the Delaware Court of Chancery recently decided not to extend *Manhattan Re*. The court found it a "close call" but decided not to lift the injunction to permit arbitration to go forward against Freestone.[xxii]

Applicability to Affiliated Non-Insurers

As noted earlier, the Delaware Insurance Commissioner, as receiver of Freestone Insurance Company, initially sought sanctions against a third party for seeking to pursue arbitration even against affiliates of Freestone. Although the receiver ultimately dropped her objections and the court allowed these arbitrations to proceed, the receiver's show cause motion begs the question of when, and the extent to which, injunctions issuing under the UILA extend to claims against affiliates of insolvent insurers.

Precedent useful in delineating the outer limits of anti-suit injunctions issued in connection with insurer delinquency proceedings appear to fall into two general categories: (i) those that consider the impact of the action in question on assets of the insolvent insurer, and (ii) those that find reason to consolidate the non-insurer defendant into the insolvent insurer for purposes of the injunction.

Occasionally, courts will look to the *de facto* ownership by the insolvent insurer of assets held by subsidiary entities in order to extend jurisdiction of the delinquency proceeding to those entities. Thus, the New Jersey Appellate Division has held that foreclosure on real estate held by a partnership owned by an insolvent insurer was, effectively, foreclosure upon the assets of the insurer, in particular because the insolvent insurer had guaranteed the partnership's performance on the mortgage:

Even assuming the housing projects involved here are not, technically, direct assets of MBL—they are partnership assets in which MBL has a direct interest and further, because of the guarantees, foreclosure thereon would trigger deficiency judgments directly against MBL. Moreover, it is fairly evident that the investment in the properties are a substantial part of MBL's business, both through MBL's involvement in the partnerships which own the properties and through its separate unconditional guarantees. What actions appellants take affecting the properties directly concerns and impinges upon a substantial part of MBL's business.[xxiii]

The California appeals court reached a similar conclusion on similar facts, *i.e.* foreclosure proceedings against real estate held in partnerships owned by an insolvent insurer:

Such facts support two important conclusions. First, there was an identity of interest between ELIC and the Signature Partnerships which justified the trial court's assertion of *in rem* jurisdiction over partnership assets as well as an injunction prohibiting suits in other forums affecting such assets. Morgan Stanley's action against the Signature Partnerships was, in effect, an action against ELIC. Second, if the assets of the real estate investment entities were dissipated by litigation with partnership creditors, then there would be a negative impact upon the ability of the Commissioner to effect the reorganization and rehabilitation of ELIC.[xxiv]

What can be gleaned from these *de facto* ownership of assets cases is that courts are willing to extend jurisdiction over non-insurance affiliates of insolvent insurers when there is such identity of interest between the affiliate and the insurer that the assets held by the affiliate are, for all intents and purposes, assets of the insolvent insurer. It is the threatened attachment upon the *assets* that serves as the lynchpin of these cases.

We find that at least one state, Louisiana, has applied the doctrine of "single business enterprise" to find in one instance that affiliates of the insolvent insurer were subject to injunction, and that the assets of such affiliates would be considered the assets of the insolvent insurer:

The Insurance Code specifically provides for the liquidation of assets belonging to the insurance company. Upon finding that the corporate defendants constitute a "single business enterprise," the assets of each of the affiliated corporations are pooled together to satisfy the claims of their creditors. The trial court's judgment does not allow the Liquidator to regulate the non-insurer corporations. The court is simply allowing the Liquidator to gather the assets that are properly includable in the liquidation.[xxv]

Most states have not yet adopted this approach in the insurer receivership context. However, many, including Delaware, do recognize the traditional alter ego doctrine as grounds to pierce the corporate veil in cases involving the members of a corporate group.[xxvi] To state an alter ego claim under Delaware law, one must plead (1) that both entities "operated as a single economic entity" and (2) that an "overall element of injustice or unfairness" is present.[xxvii] The factors relevant to whether one or more companies constitute a "single economic entity" include: (1) undercapitalization; (2) failure to observe corporate formalities; (3) non-payment of dividends; (4) the insolvency of the debtor corporation at the time; (5) siphoning of the corporation's funds by the dominant stockholder; (6) absence of corporate records; and (7) the fact that the corporation is merely a facade for the operations of the dominant stockholder or stockholders.[xxviii] With respect to the second prong of the alter ego doctrine, piercing the corporate veil under the alter ego theory requires that the corporate structure cause fraud or similar injustice; effectively, the corporation must be a sham and exist for no other purpose than as a vehicle for fraud.[xxix]

So must we always take "no" for an answer?

While the injunction provisions penned into a typical UILA rehabilitation or liquidation order can be very broad, as they invariably are in Delaware, counsel should not assume that the injunction cannot be lifted, or that courts in reciprocal jurisdictions will invariably honor it. In order to avoid the injunction, it must be shown that the claim in question is *in personam*, not *in rem*; that it will not result in an attachment on the assets of the insolvent insurer; and, that litigating the claim in the preferred venue will not greatly interfere with the administration of the estate. Where possible, the best course is to seek leave of the court with jurisdiction over the delinquency proceedings; otherwise, be prepared to defend against a rule to show cause seeking the imposition of sanctions for violation of the injunction. Counsel pursuing claims against affiliates of insolvent insurers are at greater liberty to proceed but, again, sanctions have been sought in at least one case and counsel should be prepared to demonstrate that there is no basis on which to find that the assets of the affiliate are the *de facto* assets of the insurer, and that the affiliate in question is not a good candidate for consolidation or veil piercing.

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[i] *State v. Indemnity Ins. Corp., RRG,* C.A. No. 8601 (Del. Ch. Nov. 1, 2013).

[ii] The Receiver's Motion for Temporary Restraining Order and Motion for Rule to Show Cause in *In the Matter of the Rehabilitation of Freestone Insurance Company* were both filed under seal on May 16, 2014. Relief from the injunction was later sought both as to arbitration against Freestone, as well as arbitration against its affiliates.

[iii] Darryl C. Peck, *The Uniform Insurers Liquidation Act and Wisconsin Law,* 36 Marq L. Rev. (Spring 1953). *N.b.,* the UILA has been adopted in part or in whole in most U.S. jurisdictions. The newer NAIC Insurer Receivership Model Act has been adopted in six states.

[iv] *In re Rehab. of Manhattan Re-Ins. Co.*, 2011 WL 4553582, at *3 (Del. Ch. Oct. 4, 2011) (citing *Checker Motor Corp v. Exec. Life Ins. Co.*, 1992 WL 29806, at *2-3 (Del. Ch. Feb. 13, 1992)).

[v] *See Home Ins. Co. v. Montgomery County Comm'n*, 902 So. 2d 677, 678 (Ala. 2004), *citing Levin v. National Colonial Ins. Co.,* 1 N.Y.3d 350, 356, 806 N.E.2d 473, 476, 774 N.Y.S.2d 465, 468 (2004).

[vi] *Id., citing* Ala. Code § 27–32–22(b) (1975). *Ex parte Serio,* 893 So. 2d 1148, 1150 (Ala. 2004).

[vii] *In re Mut. Ben. Life Ins. Co.*, 609 A.2d 768, 774-75 (App. Div. 1992), *citing Ballesteros v. New Jersey Property Liab. Ins. Guar. Ass'n,* 530 F. Supp. 1367, 1370 (D.N.J.), *aff'd,* 696 F.2d 980 (3rd Cir.1982); *Superintendent of Ins. of State of N.Y. v. Int'l Equip. Leasing, Inc.*, 588 A.2d 883 (N.J. Super. App. Div. 1991). *See also Matter of Integrity Ins. Co.,* 573 A.2d 928, 932 (N.J. Super. Ct. 1990).

[viii] *See Munich American Reinsurance Co. v. Crawford*, 141 F.3d 585, 593 (5th Cir. 1988).

[ix] *G.C. Murphy Co. v. Reserve insurance Co.,* 429 N.E.2d 111, 117 (N.Y. 1981).

[x] *Id. at* 114-15 (citing 13 ULA [Master ed.], pp. 430–431).

[xi] *See, e.g.*, 18 *Del. C.* § 5904(b) (Delaware); Cal. Ins. Code § 1020 (California); N.Y. Ins. Law § 7419(a) (New York); C.G.S.A. § 38a-907 (Connecticut); 215 I.L.C.S. 5/189 (Illinois).

[xii] Amicus Curiae Brief of the National Association of Insurance Commissioners, *McCarty v. Brown*No. 99.292 (filed Sept. 16, 1999).

[xiii] *In re Mut. Benefit Life Ins. Co.,* 609 A.2d 768, 775-776 (N.J. Super. Ct. App. Div. 1992).

[xiv] An analysis of issues impacting personal jurisdiction is beyond the scope of this paper.

[xv] *Griffin v. Three and One Cab Co.,* No. 09-L-9614 (Cir. Ct. Cook County. Ill. June 5, 2013); *see also Ex parte Noble Trucking Co., Inc.* 675 So. 2d 356, 357-359 (Ala. 1996).

[xvi] *See Supra* note xi. By contrast, the NAIC Insurer Receivership Model Act contains provisions imposing an automatic stay of claims against the insolvent insurer.

[xvii] *See, e.g.,* 18 *Del. C.* § 5919.

[xviii] *Hoiness-La Bar Ins. v. Julian Const. Co.,* 743 P.2d 1262, 1268 (Wyo. 1987); *Hawthorne Sav. F.S.B. v. Reliance Ins. Co. of Illinois,* 421 F.3d 835, 855 (9th Cir. 2005), *op. amended and superseded sub nom. Hawthorne Sav. F.S.B. v. Reliance Ins. Co. of*

Illinois, 433 F.3d 1089 (9th Cir. 2006); *Fuhrman v. United Am. Insurers*, 269 N.W.2d 842, 846 (Minn. 1978); *In re Nat'l Heritage Life Ins. Co.*, 656 A.2d 252, 259–60 (Del. Ch.1994); *Slotkin v. Brookdale Hosp. Ctr.*, 357 F. Supp. 705, 707-08 (S.D.N.Y. 1972); *Webster v. Superior Court*, 58 P.2d 596, 599 (Cal. 1988).

[xix] *Int'l Church of the Foursquare Gospel v. City of Fitchburg*, 2003 WL 22699792 (Mass. Super. June 30, 2003).

[xx] *In re Rehab. of Manhattan Re-Ins. Co.*, 2011 WL 4553582, at *3 (Del. Ch. Oct. 4, 2011)

[xxi] *Ex parte United Equitable Life Insurance Co.,* 595 So. 2d 1373, 1375 (Ala. 1992); *Ex parte Serio*, 893 So. 2d 1148, 1152 (Ala. 2004); *G.C. Murphy, supra*, at 116; *Superintendent of Ins. of State of N.Y. v. Int'l Equip. Leasing, Inc.*, 588 A.2d 883, 888 (N.J. Super. App. Div. 1991); *Koken v. Legion Ins. Co.*, 865 A.2d 1, 7 (Pa. Commw. Ct. 2004).

[xxii] *In the Matter of the Liquidation of Freestone Insurance Company*, C.A. No. 9547-VCL (Del. Ch. Oct. 30, 2014) (TRANSCRIPT).

[xxiii] *In the Matter of Mut. Ben. Life Ins. Co.,*609 A.2d 768, 779 (N.J. App. Div. 1992).

[xxiv] *Garamendi v. Executive Life Ins. Co.,* 21 Cal. Rptr. 2d 578, 588 (Cal. App. 1993).

[xxv] *Green v. Champion Ins. Co.*, 577 So. 2d 249, 259 (La. Ct. App. 1991) *writ denied,* 580 So. 2d 668 (La. 1991).

[xxvi] *In re Moll Industries, Inc.,* 454 B.R. 574, 587 (Bankr. D. Del. 2011) (citing *Off. Comm. of Unsecured Creditors v. Highland Capital Management, L.P. (In re Broadstripe, LLC),* 09–50966, 444 B.R. 51, 101 (Bankr.D.Del.2010)(citing *Harper v. Delaware Valley Broadcasters, Inc.,* 743 F. Supp. 1076, 1085 (D.Del. 1990), *aff'd,* 932 F.2d 959 (3d Cir. 1991)); *see also Mabon, Nugent & Co. v. Texas American Energy Corp.,* Del.Ch., C.A. No. 8576, Berger, V.C., mem. op. at 11, 1990 WL 44267 (Apr. 12, 1990); *Harco National Insurance Co. v. Green Farms Inc.,* Del.Ch., C.A. No. 1131, Hartnett, V.C., slip op. at 10–15, 1989 WL 110537 (Sept. 19, 1989) (implicitly adopting the alter ego theory and noting that the Delaware courts had not to date explicitly adopted the theory); *but see Skouras v. Admiralty Enterprises, Inc.,* 386 A.2d 674, 681 (Del. Ch. 1978) (implicitly recognizing the theory).

[xxvii] *See supra In re Moll Industries,*.

[xxviii] *In re Broadstripe, LLC,* 444 B.R. 51, 102 (Bankr. D. Del 2010); *see also Harco Nat. Ins. Co. v. Green Farms. Inc.*, 1989 WL 110537 (Del. Ch. 1989).

[xxix] *Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A.2d 1175, 1184 (Del. Ch. 1999) (citing *Outokumpu Eng'g Enterprises, Inc. v. Kvaerner EnviroPower, Inc.,* 685 A.2d 724, 729 (Del. Super. 1996)).