GOVERNOR'S OFFICE OF GENERAL COUNSEL

November 26, 2008

Michael F. Krimmel, Chief Clerk
Commonwealth Court
624 South Office Building
Harrisburg, PA 17120-0001

Re: ***Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania v. Legion Insurance Company***
No. 183 M.D. 2002

Dear Mr. Krimmel:

Enclosed for filing, please find an original and two (2) copies of the Petition to Appoint Referee to Resolve Disputes regarding Notices of Determination on Two (2) Proofs of Claim and Objections Filed by Arrowood Indemnity Company, as Successor in Interest to Security Insurance of Hartford regarding the above-referenced matter.

As directed by the Court, I am also enclosing the documents on a computer disk.

Very truly yours,

Preston M. Buckman
Special Funds Counsel

PMB:jlh
Encls.

IN THE COMMONWEALTH OF PENNSYLVANIA

JOEL S. ARIO **Insurance Commissioner of the Commonwealth of Pennsylvania,** **Plaintiff,** **v.** **LEGION INSURANCE COMPANY,** **Defendant.**	**DOCKET NO. 183 MD 2002**

ORDER

AND NOW, this ____ day of _____, 2008, upon consideration of the "Petition to Appoint a Referee to Resolve Disputes Regarding Notices of Determination on Two (2) Proofs of Claim and Objections Filed by Arrowood Indemnity Company, as Successor in Interest to Security Insurance Company of Hartford" filed by Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as Statutory Liquidator ("Statutory Liquidator") of Legion Insurance Company (In Liquidation)("Legion"), IT IS HEREBY ORDERED as follows:

1. _____, Esquire, is appointed Referee to hear objections, to make findings of fact, where appropriate and necessary, and to issue recommended decisions regarding:

Proofs of Claims and Objections ("Claims") 1380849 and 1380201

2. The Referee may be reached at the following address and phone number:

_____

_____

_____

_____

i. Until the Referee issues a recommended decision to the Court, all requests for pre-hearing conferences, motions, stipulations of fact and memoranda of law shall be submitted to the Referee and not to this Court.

ii. Objector has the responsibility to move the proceeding forward and will do so by requesting Referee to schedule a pre-hearing conference, which may be conducted by telephone. At that conference the parties will apprise Referee of whether an evidentiary hearing will be needed; whether the record can be established by stipulation; the legal issues in dispute; and a tentative schedule for the completion of the proceeding, including the filing of briefs, if any.

iii. The Referee will make all scheduling decisions relating to this matter, including the time and manner for establishing the record, for the filing of briefs and issue a written recommendation to the Court.

iv. The compensation for the Referee hereby appointed is set by the Court at the rate of $185.00 per hour, and shall be paid by the Statutory Liquidator from the estate of Legion Insurance Company (In Liquidation). Costs of the Referee are not reimbursable except upon prior approval of the Court, and requests will comply with the current billing guidelines established by the Pennsylvania Insurance Department for outside counsel retained in any receivership estate. The Referee shall submit to the Court an invoice for services after he/she has submitted a recommended decision, and he/she shall forward a copy of that invoice to the Statutory Liquidator, whereupon the Statutory Liquidator shall, in thirty (30) days, effect payment of said invoice from the estate of the Legion Insurance Company (In Liquidation), unless otherwise directed by the Court or unless the Statutory Liquidator shows cause to the Court, in writing, why payment should not be made.

v. The Statutory Liquidator shall forthwith serve a copy of this Order on the Objector, and his counsel, if any.

SO ORDERED:

_____

MARY HANNAH LEAVITT, J.

DATED: _____, 2008

IN THE COMMONWEALTH OF PENNSYLVANIA

JOEL S. ARIO
Insurance Commissioner of the Commonwealth of Pennsylvania,

Plaintiff,

v.

LEGION INSURANCE COMPANY,

Defendant.

DOCKET NO. 183 MD 2002

PETITION TO APPOINT REFEREE TO RESOLVE DISPUTES REGARDING NOTICES OF DETERMINATION ON TWO (2) PROOFS OF CLAIM AND OBJECTIONS FILED BY ARROWOOD INDEMNITY COMPANY, AS SUCCESSOR IN INTEREST TO SECURITY INSURANCE OF HARTFORD

Pursuant to Paragraph 6 of this Court's Order dated January 11, 2006, Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as the Statutory Liquidator ("Statutory Liquidator") of Legion Insurance Company (In Liquidation) ("Legion"), hereby petitions this Court to appoint a Referee to resolve the dispute between the parties with regard to the Liquidator's Notices of Determination ("NODs") on two Proofs of Claim ("POCs") submitted by the Arrowood Indemnity Company, as successor in interest to Security Insurance Company of Hartford ("Security"). Security's Objections are attached hereto as Exhibit A.

The POCs both relate to a reinsurance claim arising in connection with a Certificate of Property Facultative Reinsurance ("Certificate") assumed by Legion. Under the Certificate, Legion was the 100% reinsurer of property and casualty losses incurred under policies of insurance issued by Security pursuant to the Apartment Investment Management Company ("AIMCO Program"). Pursuant to the Certificate, Security paid Legion reinsurance premiums. Thereafter, Security submitted reinsurance claims to Legion under the AIMCO Program, but issues arose, and arbitration was instituted by Security to collect the reinsurance claims from Legion. Prior to the conclusion of the arbitration, or a final determination of the Panel, Legion was placed into rehabilitation, then liquidation. In accordance with this Court's Orders, Security filed two (2) alternative proofs of claim, one for return of premium (POC # 1380849) and the other for the payment of losses (POC # 1380201). The Statutory Liquidator evaluated both POCs as class E claims. Security timely objected to the Class E designation for both POCs.

Therefore, the Statutory Liquidator is seeking appointment of a referee and requesting that these two claims be confirmed as Class E priority under 40 P.S. §221.44(b).

The parties are unable to resolve their dispute. The Statutory Liquidator, therefore, respectfully requests that this Court appoint a Referee in accordance with Paragraph 6 of this Court's January 11, 2006 Order.

By: _____

Preston M. Buckman, Esquire (I.D. No. 57570)
Special Funds Counsel
Pennsylvania Insurance Department
Capitol Associates Building
Governor's Office of General Counsel
901 North 7th Street
Harrisburg, PA 17102
(717) 787-6009

Attorney for Plaintiff, Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as Liquidator of Villanova Insurance Company

Date: 11/26/08

EXHIBIT
A

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA,	:	
Plaintiff,	:	**Docket No. 183 M.D. 2002**
v.	:	
LEGION INSURANCE COMPANY,	:	
Defendant.	:	

RE: Objection of Security Insurance Company of Hartford to Liquidator's NOD In POC# 1380849

Security Insurance Company of Hartford ("Security"), through its successor-in-interest pursuant to a September 30, 2007 merger, Arrowood Indemnity Company, objects as follows to the Notice of Determination served by the Statutory Liquidator on or about June 17, 2008 with respect to the following Proof of Claim ("POC"):

POC No.:	1380849, a true and correct copy of which, together with supporting documentation, is attached hereto as Exhibit "1"
Claim Amount:	$13,060,312.39

I. INTRODUCTION

The instant POC was filed as an alternative to the primary POC filed by Security at POC# 1380201. Security's claim on the instant POC arises from paid claims and expenses under a reinsurance agreement between Legion and Security. In its Notice of Determination in the instant matter, the Liquidator accepted Security's POC in the full amount sought, but assigned the claim a Priority Class E designation. A true and correct copy of the Notice of Determination,

signed by the Claimant's authorized representative, is attached hereto as Exhibit "2".[1] The Liquidator then used its acceptance of the instant POC as the basis for refusing Security's primary POC.

The Liquidator's tactic of "accepting" Security's alternative POC while rejecting Security's primary POC is a reversal of Legion's position taken in a prior arbitration and before this Court in an intervention proceeding several years ago on the same facts and based on the same relationship between the parties. Nothing has changed since Legion, in these two (2) prior separate formal proceedings, firmly adopted the position that there was no valid reinsurance contract (and thus no earned or unearned premium).

The Commonwealth Court of Pennsylvania (the "Commonwealth Court") in an Order dated September 23, 2002 relied on the Legion Rehabilitator's stated position when it decided that Security's right to the $5,107,411.83 should be submitted through the claims procedure established by the Commonwealth Court, instead of litigated in the then-pending intervention proceeding. Legion's reversal of position – asserting now that there is in fact a valid reinsurance contract, and that Security's claim consequently is relegated to Class E as a reinsurance claim – plays fast and loose with this Court and constitutes the latest in the Liquidator's efforts to avoid paying anything at all to Security. Legion has from the very beginning vigorously sought to avoid its obligations to Security, which has caused a hardship to Security in meeting its obligations to its policyholders, many of whom are Pennsylvania residents.

Legion had knowledge when it filed pleadings in the arbitration and intervention proceedings -- in which it declared the invalidity of the Certificate -- that losses under the

[1] Security contemporaneously has filed its Objection to the Liquidator's Notice of Determination on its primary POC (POC# 1380201), which seeks the return of approximately $5.1million in funds paid by Security to Legion pursuant to a contract Legion consistently and continually has asserted, until now, is invalid. A copy of Security's Objection to the Liquidator's Notice of Determination on its primary POC is attached hereto as Exhibit "3" and incorporated herein fully by reference.

Certificate were significant. Through May 2001, when Legion filed its Statement of Position in the reinsurance arbitration, Security had paid $9,844,749.95 in claims and expenses with respect to the AIMCO program. And through August 2002, when Legion filed its verified Answer to the Petition to Intervene, claim and expense payments had increased to a staggering $11,407,829.92. In light of these significant amounts, it is no wonder Legion aggressively and consistently maintained its position that the reinsurance Certificate under which Security had paid those claims and expenses was invalid. That is until now, when flipping its position to assert that the Certificate is in fact valid results in the classification of Security's claims as Class E, rendering the claims valueless.

Security's Objection to the Liquidator's Notice of Determination should be sustained because the Liquidator is estopped from asserting in this proceeding that there is a valid reinsurance contract between the parties.[2]

II. FACTUAL AND PERTINENT PROCEDURAL BACKGROUND.

A. Security's Merger with Arrowood Indemnity, and its Run-Off.

In September 2003, Security ceased issuing insurance policies and was placed into run-off status by its owner. Prior to that, Security issued insurance policies in all fifty (50) states, and many of its policyholders are residents of the Commonwealth of Pennsylvania. Since being placed into run-off, Security has focused its efforts on satisfying the obligations owed to its policyholders, a commitment which extends to all of its Pennsylvania policyholders. In addition

[2] If an appointed Referee or the Court rules that the Liquidator is not estopped from asserting the validity of the reinsurance contract between Security and Legion as the basis for refusing Security's primary POC (POC# 1380201), then Security reserves the right to pursue payment on its alternative POC, notwithstanding this Objection and even though it appears as though any such effort would be futile. A cursory review of the most recent financial statements made available by the Liquidator strongly suggests that any claims assigned a Priority Class E designation will not be paid.

to its commitment to its policyholders, Security is dedicated to maintaining its solvency while satisfying its policyholder obligations.

In 2007, Security, which was then part of Royal and SunAlliance, was purchased by Arrowood Capital Corporation. Security's acquisition at that time was subject to regulatory oversight and was approved by the Delaware Insurance Commissioner. Moreover, the Delaware Insurance Department continues its oversight of Security while in run-off. As Security advances towards its objective of successfully achieving a "solvent run-off," the Delaware Insurance Department maintains close and frequent contact with the officers and staff responsible for managing Security's run-off operations.

B. The Certificate of Property Facultative Reinsurance.

On January 18, 2000, Global Managers, Inc. ("GMI"), Legion's purported authorized agent, entered into a Certificate of Property Facultative Reinsurance with Security ("the Certificate"). Under the Certificate, Legion was to be the 100% reinsurer of property and casualty losses in a program Legion initiated with the Apartment Investment Management Company ("AIMCO Program"), in which Security served as the issuing/fronting carrier and ceding company. See Exhibit "4". Under the terms of the Certificate, Legion received a Certificate Premium in the amount of $4,590,000.00 as a deposit, and minimum earned premium for the policy period. See Exhibit "4", at ¶ 9. Security paid funds to Legion for the reinsurance in the amount of approximately $7,678,440.00. See Exhibit "5" attached hereto and made part hereof (a summary of the flow of funds to and from Legion under the AIMCO program).

AIMCO cancelled the underlying policy on April 28, 2000, and on October 6, 2000, Legion returned to Security $2,570,928.17, which Legion asserted was the amount of unearned

premium paid by Security to Legion. Pursuant to the terms of Certificate, Security submitted claims consisting of $13,060,312.39 in losses and expenses to Legion for payment.

C. Security Commences Arbitration, and Legion Denies the Validity of the Certificate and is Placed Into Rehabilitation.

Based on the terms of the Certificate, Security commenced arbitration proceedings to enforce its rights. See Exhibit "4", at ¶ 13. The arbitration commenced on May 2, 2001 with an organizational meeting. At this meeting, Legion asserted that the Certificate was void because its agent, GMI, was terminated before the Certificate was finalized, leaving GMI with no authority to act on Legion's behalf.[3] Legion asserted that because GMI was unable to bind Legion to the Certificate, the Certificate was void. See Exhibit "6". Therefore, Legion asserted that it had no responsibility for paying the claims and expenses under the Certificate.[4]

During the arbitration, Security requested an interim award in the nature of pre-hearing security sufficient to satisfy a final award in Security's favor. Security raised the issue in light of the conduct of Legion and weak financial condition of Legion, as reflected in Legion's Annual Report for the year ending December 21, 2000. Legion responded to Security's request for pre-hearing Security on May 14, 2001 by representing that "Legion ... remains fiscally sound." See Exhibit "7".

Based on Legion's representations, on May 24, 2001, the Arbitration Panel denied Security 's request for pre-hearing security, but provided that if Legion's A.M. Best rating fell below "A-," or if Legion's statutory policyholder's surplus fell below 90% of PHS at December 31, 2000, "Legion shall forthwith post security in a form reasonably acceptable to [Security], in

[3] Legion also asserted that Security had notice that GMI had been terminated by Legion and had no authority to bind Legion. See Exhibit "6".

[4] Of course, it is unsurprising that Legion would in its Statement of Position in the reinsurance arbitration maintain that the Certificate was invalid, in light of the amounts Security was paying on claims. Legion filed its Statement of Position on April 26, 2001. Through May 2001, Security had paid $9,844,749.95 in claims and related expenses with respect to the AIMCO program, and Legion was well aware of that fact.

an amount equal to the losses incurred to date under the Certificate at issue in the arbitration." See Exhibit "8".

Contrary to Legion's representations, its financial condition continued to deteriorate, and the arbitration panel ordered it to post a letter of credit in the amount of unpaid losses and unearned premium under the Certificate. See Exhibit "9". After Security and Legion exchanged correspondence concerning the letter of credit, on March 22, 2002, the Arbitration Panel ordered Legion to "post [an] irrevocable letter of credit in favor of Security Insurance Company of Hartford in the amount of $11,696,370.87" by April 1, 2002. See Exhibit "10". Three days before Legion was required to post the irrevocable letter of credit (April 1, 2002), the Commonwealth Court by its Order dated March 28, 2002 placed Legion into Rehabilitation, thus abating Legion's duty to comply with the Arbitration Panel's Order.

D. Security Petitions to Intervene, Legion Maintains its Position With Respect to the Certificate, and The Commonwealth Court Enters its Order Recognizing Security's Right to Assert Without Prejudice that the Funds Held by Legion are Not an Asset of the Estate.

On July 18, 2002, Security filed with the Commonwealth Court an Application for Relief in the Form of a Petition to Intervene, For Declaratory Relief and the Imposition of a Constructive Trust, and/or Mandamus, and accompanying memorandum of law. As it had during the arbitration proceeding, Legion again took the position in its verified pleadings that there was no valid agreement between the parties:

> [I]t is denied that Legion, before Rehabilitation, was the 100% reinsurer of property and casualty losses in a program it initiated with the Apartment Investment Management Company (hereinafter "AIMCO Program"), in which Security served as the issuing carrier and ceding company. To the contrary, the Certificate of Property Facultative Reinsurance upon which Petitioner relies ("Facultative Reinsurance Certificate") and which upon information and belief is attached as Exhibit A to the Petition, **was entered into without the authority of Legion** with the knowledge of Security and its agents, First Capital Group (hereinafter "First Capital") and The Artis Group (hereinafter "Artis").

See Exhibit "11" attached hereto, a true and correct copy of the Rehabilitator's Answer to Security's Petition to Intervene, ¶ 3 (emphasis supplied) (this paragraph was incorporated by reference throughout the Rehabilitator's Answer).[5] Legion's Answer to Security's Application for Relief was verified by Kevin J. Kelly, Esquire, an authorized representative of the Rehabilitator of Legion. See Exhibit "11".[6]

On September 23, 2002, the Commonwealth Court, by granting Security's Petition to Intervene in the Rehabilitation and Liquidation proceedings (No. 183 M.D. 2002) (see Exhibit "12"), agreed that Security had the right to assert without prejudice (as it later did in its primary POC (POC# 1380201)), that the $5,107,411.83 was not an asset of the Legion Liquidation Estate.

E. Legion Is Placed Into Liquidation, and Security Submits its Primary and Alternative Proofs of Claim.

On July 28, 2003, Legion was placed into Liquidation and a POC filing deadline was set for June 30, 2005. Based on the Commonwealth Court's September 23, 2002 Order providing that Security had the right to do so without prejudice, and the position Legion took in the arbitration and Commonwealth Court Rehabilitation intervention proceedings, Security submitted a primary POC (POC# 1380201), on the basis that the approximately $5.1 million held by Legion was not an asset of the Legion Liquidation Estate. Alternatively, and in order to

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[5] Once again, it is predictable that Legion would continue in its position in the Commonwealth Court intervention proceeding that the Certificate was invalid. Legion filed its verified Answer to Security's Petition to Intervene on August 2, 2002. By that time, payments made by Security had swelled to a staggering $11,407,829.92, and Legion was fully aware of this fact.

[6] Legion's assertion, for its benefit, that the Certificate was invalid because GMI lacked the authority to bind it constitutes a judicial admission, which is an express waiver made in court or preparatory to trial by a party or his attorney, conceding for the purpose of trial the truth of the admission, and may be contained in pleadings, stipulations or similar documents. See Sherrill v. WCAVB (Sch. Dist. of Philadelphia), 624 A.2d 240, 243 (Pa. Cmwlth. 1993); Wills v. Kane, 2 Grant 60, 63 (Pa. 1853) ("When a man alleges a fact in a court of justice, for his advantage, he shall not be allowed to contradict it afterwards. It is against good morals to permit such double dealing in the administration of justice.").

otherwise preserve its rights under the Certificate, Security submitted an alternative POC (POC# 1380849). Security's filing of its alternative POC was a precautionary measure designed to protect against any risk in the unlikely event the law would for some then-unknown reason later compel a different result and thereby prejudice Security's rights under its primary POC. In its verified August 2, 2002 Answer to Security's Application for Relief, the Rehabilitator acknowledged the fact that Security was maintaining alternative theories of recovery against Legion. See Exhibit "11", ¶ 19.

The submission of an alternative POC like the one Security submitted specifically is permitted by the Department of Insurance. In its "Questions & Answers" publication relative to the Legion Liquidation, the Department of Insurance provides as follows in response to the question "May I file a contingent claim?":

> Yes. Under Pennsylvania law a person may file a claim even if it is a 'contingent claim.' A 'contingent claim' is one where the liability of the company is not yet determined or is dependent on the outcome of another event."

available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1 (emphasis supplied); see also "Notice of Liquidation" published by the Department of Insurance relative to the Legion/Villanova Liquidation ("A proof of claim must be filed even if a claim was made against Legion or Villanova prior to liquidation, and a separate proof of claim form must be filed for each claim you have.") (emphasis supplied), available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1; Instructions to Proof of Claim Form ("**YOU MUST FILE A SEPARATE PROOF OF CLAIM FORM FOR EACH CLAIM YOU MAKE.**") (emphasis in original), available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1. Security's alternative POC was submitted because the liability of Legion was "dependent on the outcome of another

event," namely an adjudication of Legion's claim that there was no valid reinsurance contract between the parties because Legion's agent had no authority to bind it. Not only is the submission of alternative POCs commonplace in Pennsylvania insurance company liquidations; it is also commonplace in the analogous Chapter 7 bankruptcy context. See, e.g., In re Heritage Leasing Corp., No. C/A 96-75946-W, 1998 WL 2016851 (Bankr. D.S.C. Sept. 17, 1998) (recognizing that creditor to Chapter 7 liquidation estate had submitted alternative POCs based on alternative theories of recovery).

Security's primary POC was submitted on June 28, 2005, claiming a right to be refunded $5,107,411.83, or the amount of funds Legion unlawfully refused to return to Security. Security's primary POC was based on its agreeing with Legion that there was never a valid reinsurance agreement between the parties, thus making Security responsible for all claims and expenses associated with the Certificate, i.e. $13,060,312.39. Security then submitted its alternative POC on June 29, 2005, asserting a claim for $13,060,312.39, or the full amount of claims and expenses associated with the Certificate. Security led with its primary POC, the success of which was premised on the absence of a valid reinsurance contract (as asserted by Legion in the arbitration and Commonwealth Court intervention proceedings), and followed with its alternative POC, the success of which was premised on the presence of a valid reinsurance contract and assets from the Legion Liquidation Estate for its payment.

F. The Liquidator Reverses His Position and Issues the Notices of Determination, Explicitly Recognizing the Validity of the Very Agreement it For Years, and Through Two (2) Formal Proceedings, Has Maintained Is Invalid.

By Notice of Determination dated June 17, 2008, the Liquidator accepted Security's alternative POC in the full amount sought, $13,060,312.39, and assigned it a Class E designation. That same day, the Liquidator refused to value Security's primary POC, and assigned it a Class E

designation as well. The basis for the Liquidator's Notice of Determination on Security's primary POC was its acceptance of Security's alternative POC:

> No value has been allowed for your claim because [t]his proof of claim for premium was valued at zero due to the acceptance of the paid loss POC.

See Exhibit "13". Of course, the Liquidator's sudden "acceptance" of Security's alternative POC# 1380849, which sought the full amount of claims and associated expenses submitted under the Certificate, is premised on an explicit acceptance of the validity of that reinsurance contract. This flatly contradicts the position Legion already took in the reinsurance arbitration and before the Commonwealth Court in the Rehabilitation intervention proceeding. Instead of evaluating and issuing Notices of Determination in accordance with its prior actions in this matter and the governing statutory law, the Liquidator chose to punt with respect to Security's primary POC, which if accepted would obviously result in Security's $5,107,411.83 claim not being subject to priority classification at all, since in the absence of a valid agreement those funds would not constitute an asset of the Legion Liquidation Estate.[7]

While certainly convenient, the Liquidator's actions constitute fast and loose handling of Security's legitimate and timely-filed claims, unilaterally placing Security in the position of a general creditor which likely will never be paid even a cent on the dollar, **on either Proof of Claim.**[8] The Liquidator's conduct in this matter clearly exceeds the bounds of reasonable

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[7] Any attempt by the Liquidator to characterize Security as a "general creditor" with respect to its approximately $5.1 million claim is equally unavailing. First, classification pursuant to the liquidation statutes presupposes that a claim is asserted against assets that properly are part of the liquidation estate. And second, "general creditor" status also presupposes the existence of a debtor/creditor relationship. Based on Legion's own position, there was no valid reinsurance contract between the parties, and therefore there cannot be a debtor/creditor relationship. Furthermore, Security has paid $13,060,312.39 in claims and associated expenses and is not seeking reimbursement from the Liquidator for that amount.

[8] A cursory analysis of the most recent financial statements made available by the Liquidator strongly suggests that claims with a Priority Class E designation will not be paid.

discretion it enjoys pursuant to the liquidation statutes, and negatively affects Security's obligations to its policyholders in run-off, many of whom are Pennsylvania residents.

Despite its purported attempt to do so, the Liquidator cannot change the facts to suit its position since he is legally estopped from doing so. Nor can the Liquidator change the shoes into which it has stepped by operation of law. Legion already has taken the position that there was no valid reinsurance contract and, thus, the $5,107,411.83 cannot possibly be an asset of the Legion Liquidation Estate. The Liquidator cannot now disavow the consequences of his prior actions to the detriment of Security merely because it suits his present purpose of refusing to pay back the $5,107,411.83 wrongfully withheld from Security.

III. ARGUMENT

In an insurance insolvency or liquidation proceeding under the Pennsylvania Insurance Department Act of 1921, as amended, the Commonwealth Court acts in a supervisory rule to "check" the Liquidator's exercise of discretion in carrying out his statutory duties in order to prevent abuse. Koken v. Legion Ins. Co., 831 A.2d 1196 (Pa. Cmwlth. 2003), adopted by Koken v. Villanova Ins. Co., 878 A.2d 51 (Pa. 2005) ("the Order of the Commonwealth Court is hereby AFFIRMED, on the basis of the Commonwealth Court opinion, Koken v. Legion Ins. Co., 831 A.2d 1196 (Pa. Cmwlth. 2003)); Foster v. Mutual Fire, Marine and Inland Ins. Co., 614 A.2d 1086, 1091 (Pa. 1992).

As this Court has observed, the Liquidator is not a "free agent. [H]e must follow the statutory mandates (as must this Court) and use 'reasonable discretion.'" Koken v. Legion Ins. Co., 831 A.2d at 1232. The Commonwealth Court's task in this proceeding is to insure that the Liquidator's actions are "consistent with equitable principles and serve the interests of policyholders." Id. at 1242.

As more fully discussed above, and below, the Commonwealth Court's supervisory role must be exercised in this case to prevent the abuse that is manifest in the Liquidator's fast and loose handling of Security's POCs. The Liquidator's actions are inconsistent, and indeed prohibited by, both legal and equitable principles and must not be permitted by this Court.

A. The Acceptance of Security's Alternative Proof of Claim for Paid Losses Is Based on a Legal Position the Liquidator is Estopped from Taking.

As discussed above, infra Sections II. C and D, Legion consistently, throughout the reinsurance arbitration and Commonwealth Court Rehabilitation intervention proceedings, took the position that there was no valid agreement between the parties. Legion asserted in the arbitration in 2002 that because GMI was unable to bind Legion to the Certificate, and Security knew that GMI had no authority, the Certificate was void. See Exhibit "6". In 2003, the Rehabilitator admitted and reaffirmed Legion's position, in its **verified** Answer to Security' Petition to Intervene, that the Certificate was invalid:

> the Certificate of Property Facultative Reinsurance upon which Petitioner relies ("Facultative Reinsurance Certificate") and which upon information and belief is attached as Exhibit A to the Petition, **was entered into without the authority of Legion** with the knowledge of Security and its agents, First Capital Group (hereinafter "First Capital") and The Artis Group (hereinafter "Artis").

Exhibit "11" at ¶ 3 (emphasis supplied).

As the Commonwealth Court has routinely observed, when an insurance company is placed into Liquidation, the Liquidator "steps into the shoes of the insurer" and functions as its successor. TIG Specialty Ins. Co. v. Koken, 855 A.2d 900, 912-913 (Pa. Cmwlth. 2004) (collecting Pennsylvania cases). Indeed, Judge Leavitt specifically has recognized that the Liquidator in this very matter has stepped into the shoes of Legion Insurance Company. Koken v. Legion Ins. Co., 831 A.2d 1196 (Pa. Cmwlth. 2003). Having done so, the Liquidator by operation of law succeeded to the legal position advanced by Legion itself during the arbitration,

and then by the Rehabilitator in the Commonwealth Court intervention proceeding. The Liquidator is estopped from now simply casting aside that position for its own convenience, to the detriment of Security.

Indeed, the Pennsylvania Supreme Court has held that a statutory liquidator is estopped from doing exactly what the Liquidator purports to do in this case, i.e., engage in a 180 degree tactical reversal where its purpose is conveniently served to the detriment of another party. In Commonwealth ex rel. Kelly v. Commonwealth Mut. Ins. Co., our Supreme Court held that the statutory liquidator was estopped from denying the validity of a contractual limitation where the Insurance Commissioner prior to liquidation of the Commonwealth Mutual Insurance Company had approved the very contract containing the limitation at issue. 299 A.2d 604, 606 (Pa. 1973).

The Liquidator's tack in this instance presents the other side of the same coin; here, the Liquidator purports to recognize the validity of an agreement it consistently has maintained is invalid, in two (2) separate proceedings in which this issue was raised. The Supreme Court's holding in Kelly is no less applicable here, and the reasons for not allowing the statutory liquidator to change its position in that case are even more compelling on these facts, where the Liquidator has essentially rendered Security's claims valueless.

In addition, the Liquidator's tactical reversal and calculated effort to avoid payment to Security squarely are prohibited by the doctrines of judicial and equitable estoppel. The Pennsylvania Supreme Court has explained the doctrine of judicial estoppel as follows:

> Judicial estoppel is an equitable, judicially-created doctrine designed to protect the integrity of the courts by preventing litigants from playing 'fast and loose' with the judicial system by adopting whatever position suits the moment. Unlike collateral estoppel or res judicata, it does not depend on relationships between the parties, but rather on the relationship of one party to one or more tribunals. In essence, the doctrine prohibits parties from switching legal positions to suit their own ends.

Sunbeam Corp. v. Lib. Mut. Ins. Co., 781 A.2d 1189, 1192 (Pa. 2001) (internal citations omitted). The Liquidator by accepting Security's alternative POC based on its recognition of the existence of a valid reinsurance contract between the parties is taking a position that is in flat contradiction of – not merely inconsistent with – the position Legion took in the reinsurance arbitration and in the Commonwealth Court Rehabilitation intervention proceeding. The Liquidator's tactic – which as noted all but ensures that Security is paid nothing, on either claim – is exactly what the doctrine of judicial estoppel was designed to prevent, i.e., the switching of a legal position to suit its own ends.

Similarly, the doctrine of equitable estoppel also bars the Liquidator's fast and loose handling of Security's claims. Equitable estoppel "applies to prevent a party from assuming a position or asserting a right to another's disadvantage inconsistent with a position previously taken." Blofsen v. Cutaiar, 333 A.2d 841, 843 (Pa. 1975). There are two elements of equitable estoppel, inducement and reliance. Novelty Knitting Mills, Inc. v. Siskind, 457 A.2d 502 (Pa. 1983). The inducement may be words or conduct, and the acts that are induced may be by commission or forbearance, provided that a change in condition results causing disadvantage to the one induced. Id. at 503-504. Once established, "the person inducing the belief in the existence of a certain state of facts is estopped to deny that the state of facts does in truth exist, aver a different or contrary state of facts as existing at the same time, or deny or repudiate his acts, or statements. In re Estate of Tallarico, 228 A.2d 736, 741 (Pa. 1967).

Based on the Liquidator's denial of the existence of a valid reinsurance contract between the parties, Security was induced to submit its POCs alternatively, leading with its primary POC, the success of which was premised on the absence of a valid reinsurance contract, and following with its alternative POC, the success of which was premised on the presence of a valid

reinsurance contract. Under the circumstances, there can be no doubt that Security's reliance on the Liquidator's prior position was justified, or that the manner in which the Liquidator has sought to dispense with Security's claims has disadvantaged Security.[9]

Accordingly, the Liquidator is estopped from asserting the validity of the Certificate as the basis for refusing Security's primary POC.

[9] Notwithstanding the fact that Security has paid $13,060,312.39 in property and casualty losses and related expenses under the AIMCO Program (paid losses on the reinsurance Certificate Legion has disavowed), Security has submitted this Objection to the Liquidator's Notice of Determination, which accepted the underlying alternative POC. In doing so, Security has opted – as it did when it initially submitted its POCs – to focus its efforts on seeking the return of its $5,107,411.83 from Legion (funds which never have been a part of the Legion estate). Unlike Security, the Liquidator has chosen to maintain entirely inconsistent positions in a calculated effort to have the best of both worlds, i.e., not having to pay Security on either claim.

IV. CONCLUSION

For the foregoing reasons, Security's Objection to the Liquidator's Notice of Determination with respect to its alternative POC (POC# 1380849) should be sustained, and Security's claim submitted with its primary POC (POC# 1380201) should be accepted in the full amount of $5,107,411.83, including but not limited to Security's attorneys' fees, costs and expenses associated with this Objection. Given the conduct of Legion and its statutory Rehabilitator and Liquidator, as more fully discussed above, the Court also should award Security interest on the $5,107,411.83 wrongfully withheld by Legion.

In the interest of economy and given the obvious interrelatedness of Security's primary and alternative POCs, Security respectfully requests that the proceedings with respect to its POCs be consolidated.

Respectfully submitted,

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Dated: August 13, 2008

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

JOEL S. ARIO, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA,	:	
Plaintiff,	:	**Docket No. 183 M.D. 2002**
v.	:	
LEGION INSURANCE COMPANY,	:	
Defendant.	:	

RE: ***Objection of Security Insurance Company of Hartford to Liquidator's NOD In POC# 1380201***

Security Insurance Company of Hartford ("Security"), through its successor-in-interest pursuant to a September 30, 2007 merger, Arrowood Indemnity Company, objects as follows to the Notice of Determination served by the Statutory Liquidator on or about June 17, 2008 with respect to the following Proof of Claim ("POC"):

POC No.:	1380201, a true and correct copy of which, together with supporting documentation, is attached hereto as Exhibit "1"
Claim Amount:	$5,107,411.83

I. INTRODUCTION

Security's claim arises from the Liquidator's wrongful refusal to return $5,107,411.83 in monies paid by Security to Legion. Security paid $5,107,411.83 to Legion originally pursuant to a reinsurance contract that Legion subsequently disavowed – both before and after the Insurance Commissioner was appointed Rehabilitator – as having never been validly entered into in the first place. Despite Legion's and the Liquidator's having taken this position, they refused to

return the $5,107,411.83 that Security had paid as consideration for the disavowed contract. Legion, and now the Liquidator who stands in Legion's shoes, have thereby converted these funds and never had any right to own or control them as a matter of law. The Liquidator's refusal to return these funds to Security is wrongful because, inter alia, if there was no agreement, then the $5,107,411.83 is not now and never has been a part of the Legion Liquidation Estate.

Legion has from the very beginning vigorously sought to avoid any alleged contractual obligations to Security under the reinsurance contract, including delaying any decision on the POC, which forced Security itself to pay off all of the claims to the policyholders, many of whom are Pennsylvania residents. This has caused hardship to Security in meeting its obligations to its policyholders. Now, after Security was required to pay all of the claims and expenses due to the Liquidator's refusal to return the money and his delay in addressing the POC, the Liquidator has devised a strategy to cause even further burden to Security through double-edged tactics whereby the Liquidator (i) issued the instant Notice of Determination refusing to address the merits of Security's right to return of the $5,107,411.83, and (ii) issued a second Notice of Determination purporting to actually change the facts he verified previously to this Court and in an arbitration proceeding by reversing his prior position of disavowing the reinsurance contract, and now saying the contract is valid. The result is designed to relegate Security to receiving absolutely nothing, because the claims are designated as Class E, which means they will never be paid out of any available estate funds.[1]

[1] The Liquidator's Notice of Determination in the instant matter, which valued Security's claim at $0 and assigned a Class E designation, was based not on the merits of who had the right to own and possess the funds, but rather on the Liquidator's purported "acceptance" of an alternative POC submitted by Security for the policyholder claims and expenses that Security had been required to pay while the Liquidator delayed any determination on the POC seeking return of the funds. A true and correct copy of the Notice of Determination, signed by the Claimant's authorized representative, is attached hereto as Exhibit "2". Security contemporaneously is filing its Objection to the Liquidator's Notice of Determination on its alternative POC (POC# 1380849), which documented and preserved any

The Liquidator's tactic of "accepting" Security's alternative POC while rejecting Security's primary POC is a reversal of Legion's position taken in a prior reinsurance arbitration and before this Court in an intervention proceeding several years ago on the same facts and based on the same relationship between the parties. Nothing has changed since Legion, in these two (2) prior separate formal proceedings, firmly adopted the position that there was no valid reinsurance contract (and thus no earned or unearned premium).

The Commonwealth Court of Pennsylvania (the "Commonwealth Court") in an Order dated September 23, 2002 relied upon the Legion Rehabilitator's stated position when it decided that Security's right to the $5,107,411.83 should be submitted through the claims procedure established by the Commonwealth Court, instead of litigated in the then-pending intervention proceeding. See supra pp. 7-8. Legion's sudden reversal of position after delaying for several years while Security paid off all of the policyholder claims and expenses – now asserting that there is in fact a valid reinsurance contract, and that Security's claim is relegated to Class E as a reinsurance claim – plays fast and loose with this Court and constitutes the latest in Legion's efforts to avoid paying anything at all to Security.

Security's Objection should be sustained and its primary POC should immediately be paid, together with interest and other relief as herein requested, because:

(1) the Liquidator's Notice of Determination on Security's primary POC fails to comport with the liquidation statutes and the September 23, 2002 Order of this Court;

(2) the Liquidator is estopped from asserting in this proceeding that there is a valid agreement between the parties; and

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possible claim to the $13,060,312.39 in claims and expenses that Security paid to policyholders, which would have been covered by the reinsurance contract that Legion and the Liquidator had, until now, determined was never entered into and was void ab initio. A copy of Security's Objection to the Liquidator's Notice of Determination on that alternative POC is attached hereto as Exhibit "3" and incorporated herein fully by reference.

(3) the $5,107,411.83 the Liquidator refuses to return to Security is not now and never has been an asset of the Legion Liquidation Estate.

II. FACTUAL AND PERTINENT PROCEDURAL BACKGROUND.

A. Security's Merger with Arrowood Indemnity, and its Run-Off.

In September 2003, Security ceased issuing insurance policies and was placed into run-off status by its owner. Prior to that, Security issued insurance policies in all fifty (50) states, and many of its policyholders are residents of the Commonwealth of Pennsylvania. Since being placed into run-off, Security has focused its efforts on satisfying the obligations owed to its policyholders, a commitment which extends to all of its Pennsylvania policyholders. In addition to its commitment to its policyholders, Security is dedicated to maintaining its solvency while satisfying its policyholder obligations.

In 2007, Security, which was then part of Royal and SunAlliance, was purchased by Arrowood Capital Corporation. Security's acquisition at that time was subject to regulatory oversight and was approved by the Delaware Insurance Commissioner. Moreover, the Delaware Insurance Department continues its oversight of Security while in run-off. As Security advances towards its objective of successfully achieving a "solvent run-off," the Delaware Insurance Department maintains close and frequent contact with the officers and staff responsible for managing Security's run-off operations.

B. The Certificate of Property Facultative Reinsurance.

On January 18, 2000, Global Managers, Inc. ("GMI"), Legion's purported authorized agent, entered into a Certificate of Property Facultative Reinsurance with Security ("the Certificate"). Under the Certificate, Legion would have been the 100% reinsurer of property and casualty losses in a program Legion initiated with the Apartment Investment Management Company ("AIMCO Program"), in which Security would have served as the issuing/fronting

carrier and ceding company. See Exhibit "1", Tab A. Under the terms of the Certificate, Legion received a Certificate Premium in the amount of $4,590,000.00 as a deposit, and minimum earned premium for the policy period. See Exhibit "1", Tab A at ¶ 9. Security paid funds to Legion for the reinsurance in the amount of $7,678,440.00. See Exhibit "4" attached hereto and made part hereof (a summary of the flow of funds to and from Legion under the AIMCO program).

AIMCO cancelled the underlying policy on April 28, 2000, and on October 6, 2000, Legion returned to Security $2,570,928.17, which Legion asserted was the amount of unearned premium paid by Security to Legion. See Exhibit "4". Pursuant to the terms of Certificate, Security submitted claims consisting of $13,060,312.39 in losses and expenses to Legion for payment. Legion paid no claims whatsoever and continues to wrongfully withhold the $5,107,411.83, which was paid to it when Legion led Security to believe that there was a valid Certificate.

C. Security Commences Arbitration, and Legion Denies the Validity of the Certificate and is Placed Into Rehabilitation.

Based on the terms of the Certificate, Security commenced arbitration proceedings to enforce its rights. See Exhibit "1", Tab A at ¶ 13. The arbitration commenced on May 2, 2001 with an organizational meeting. At this meeting, Legion asserted that the Certificate was void because its agent, GMI, was terminated before the Certificate was finalized, leaving GMI with no authority to act on Legion's behalf. Legion asserted that because GMI was unable to bind Legion to the Certificate, the Certificate was void. See Exhibit "1", Tab B.[2] Therefore, Legion

[2] Legion also asserted that Security had notice that GMI had been terminated by Legion and had no authority to bind Legion. See Exhibit "1", Tab B.

asserted that it had no responsibility for paying the claims and expenses under the Certificate.[3] Legion, despite its position that there was no valid agreement between the parties, did not return all of the funds Security had paid to Legion pursuant to the invalid, unauthorized and rescinded Certificate.

During the arbitration, Security requested an interim award in the nature of pre-hearing security sufficient to satisfy a final award in Security's favor. Security raised the issue in light of the conduct of Legion and weak financial condition of Legion, as reflected in Legion's Annual Report for the year ending December 21, 2000. Legion responded to Security's request for pre-hearing Security on May 14, 2001 by representing that "Legion ... remains fiscally sound." See Exhibit "1", Tab C.

Based on Legion's representations, on May 24, 2001, the Arbitration Panel denied Security 's request for pre-hearing security, but provided that if Legion's A.M. Best rating fell below "A-," or if Legion's statutory policyholder's surplus fell below 90% of PHS at December 31, 2000, "Legion shall forthwith post security in a form reasonably acceptable to [Security], in an amount equal to the losses incurred to date under the Certificate at issue in the arbitration." See Exhibit "1", Tab D.

Contrary to Legion's representations, its financial condition continued to deteriorate, and the arbitration panel ordered it to post a letter of credit in the amount of unpaid losses and unearned premium under the Certificate. See Exhibit "1", Tab E. After Security and Legion exchanged correspondence concerning the letter of credit, on March 22, 2002, the Arbitration Panel ordered Legion to "post [an] irrevocable letter of credit in favor of Security Insurance

[3] Of course, it is unsurprising that Legion would in its Statement of Position in the reinsurance arbitration assert that the Certificate was invalid, in light of the amounts Security was paying on claims. Legion filed its Statement of Position on April 26, 2001. Through May 2001, Security had paid $9,844,749.95 in claims and related expenses with respect to the AIMCO program, and Legion was well aware of that fact.

Company of Hartford in the amount of $11,696,370.87" by April 1, 2002. See Exhibit "1", Tab F. Three days before Legion was required to post the irrevocable letter of credit (April 1, 2002), the Commonwealth Court by its March 28, 2002 Order placed Legion into Rehabilitation, thereby abating Legion's duty to comply with the Arbitration Panel's Order.

D. Security Petitions to Intervene, Legion Maintains its Position With Respect to the Certificate, and The Commonwealth Court Enters its Order Recognizing Security's Right Without Prejudice to Assert that the Funds Held by Legion are Not an Asset of the Estate.

On July 18, 2002, Security filed with the Commonwealth Court an Application for Relief in the Form of a Petition to Intervene, For Declaratory Relief and the Imposition of a Constructive Trust, and/or Mandamus, and accompanying memorandum of law. As it had during the arbitration proceeding, Legion again took the position in its verified pleadings that there was no valid agreement between the parties:

> [I]t is denied that Legion, before Rehabilitation, was the 100% reinsurer of property and casualty losses in a program it initiated with the Apartment Investment Management Company (hereinafter "AIMCO Program"), in which Security served as the issuing carrier and ceding company. To the contrary, the Certificate of Property Facultative Reinsurance upon which Petitioner relies ("Facultative Reinsurance Certificate") and which upon information and belief is attached as Exhibit A to the Petition, **was entered into without the authority of Legion** with the knowledge of Security and its agents, First Capital Group (hereinafter "First Capital") and The Artis Group (hereinafter "Artis").

See Exhibit "5" attached hereto, a true and correct copy of the Rehabilitator's Answer to Security's Petition to Intervene, ¶ 3 (emphasis supplied) (this paragraph was incorporated by reference throughout the Rehabilitator's Answer).[4] Legion's Answer to Security's Application

[4] Once again, it is predictable that Legion would continue to assert in the Commonwealth Court intervention proceeding that the Certificate was invalid. Legion filed its verified Answer to Security's Petition to Intervene on August 2, 2002. By that time, payments made by Security had swelled to a staggering $11,407,829.92, and Legion was fully aware of this fact.

for Relief was verified by Kevin J. Kelly, Esquire, an authorized representative of the Rehabilitator of Legion. See Exhibit "5".[5]

On September 23, 2002, the Commonwealth Court, by granting Security's Petition to Intervene in the Rehabilitation and Liquidation proceedings (No. 183 M.D. 2002) (see Exhibit "1", Tab G), agreed that Security had the right to assert without prejudice (as it later did in its primary POC), that the $5,107,411.83 held by Legion was not an asset of the Legion Liquidation Estate.

E. Legion Is Placed Into Liquidation, and Security Submits its Proofs of Claim.

On July 28, 2003, Legion was placed into Liquidation and a POC filing deadline was set for June 30, 2005. Based on the Commonwealth Court's September 23, 2002 Order providing that Security had the right to do so without prejudice, and the position Legion took in the arbitration and Commonwealth Court Rehabilitation intervention proceedings, Security submitted a primary POC (POC# 1380201), on the basis that the approximately $5.1 million held by Legion was not an asset of the Legion Liquidation Estate. Alternatively, and in order to otherwise preserve its rights under the Certificate, Security submitted an alternative POC (POC# 1380849). Security's filing of its alternative POC was a precautionary measure designed to protect against any risk in the unlikely event the law would for some then-unknown reason later compel a different result and thereby prejudice Security's rights under its primary POC. In its verified August 2, 2002 Answer to Security's Application for Relief, the Rehabilitator

[5] Legion's assertion, for its benefit, that the Certificate was invalid because GMI lacked the authority to bind it constitutes a judicial admission, which is an express waiver made in court or preparatory to trial by a party or his attorney, conceding for the purpose of trial the truth of the admission, and may be contained in pleadings, stipulations or similar documents. See Sherrill v. WCAVB (Sch. Dist. of Philadelphia), 624 A.2d 240, 243 (Pa. Cmwlth. 1993); Wills v. Kane, 2 Grant 60, 63 (Pa. 1853) ("When a man alleges a fact in a court of justice, for his advantage, he shall not be allowed to contradict it afterwards. It is against good morals to permit such double dealing in the administration of justice.").

acknowledged the fact that Security was maintaining alternative theories of recovery against Legion. See Exhibit "5", ¶ 19.

The submission of an alternative POC like the one Security submitted specifically is permitted by the Department of Insurance. In its "Questions & Answers" publication relative to the Legion Liquidation, the Department of Insurance provides as follows in response to the question "May I file a contingent claim?":

> Yes. Under Pennsylvania law a person may file a claim even if it is a 'contingent claim.' A 'contingent claim' is one where the liability of the company is not yet determined or is dependent on the outcome of another event."

available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1 (emphasis supplied); see also "Notice of Liquidation" published by the Department of Insurance relative to the Legion/Villanova Liquidation ("A proof of claim must be filed even if a claim was made against Legion or Villanova prior to liquidation, and a separate proof of claim form must be filed for each claim you have.") (emphasis supplied), available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1 ; Instructions to Proof of Claim Form ("**YOU MUST FILE A SEPARATE PROOF OF CLAIM FORM FOR EACH CLAIM YOU MAKE.**") (emphasis in original), available at http://www.ins.state.pa.us/ins/cwp/view.asp?a=1285&q=542923&PM=1 . Security's alternative POC was submitted because the liability of Legion was "dependent on the outcome of another event," namely, an adjudication of Legion's claim that there was no valid reinsurance contract between the parties because Legion's agent had no authority to bind it. Not only is the submission of alternative POCs commonplace in Pennsylvania insurance company liquidations; it is also commonplace in the analogous Chapter 7 bankruptcy context. See, e.g., In re Heritage Leasing Corp., No. C/A 96-75946-W, 1998 WL 2016851 (Bankr. D.S.C. Sept. 17, 1998)

(recognizing that creditor to Chapter 7 liquidation estate had submitted alternative POCs based on alternative theories of recovery).

Security's primary POC was submitted on June 28, 2005, claiming a right to be refunded $5,107,411.83, or the amount of funds Legion unlawfully refused to return to Security. Security's primary POC was based on its agreeing with Legion that there was never a valid reinsurance agreement between the parties, thus making Security responsible for all claims and expenses associated with the Certificate, i.e., $13,060,312.39. Security then submitted its alternative POC on June 29, 2005, asserting a claim for $13,060,312.39, or the full amount of claims and expenses associated with the Certificate. Security led with its primary POC, the success of which was premised on the absence of a valid reinsurance contract (as asserted by Legion in the arbitration and Commonwealth Court intervention proceedings), and followed with its alternative POC, the success of which was premised on the presence of a valid reinsurance contract and assets from the Legion Liquidation Estate for its payment.

F. The Liquidator Reverses His Position and Issues the Notices of Determination, Explicitly Recognizing the Validity of the Very Agreement it For Years, and Through Two (2) Formal Proceedings, Has Maintained Is Invalid.

By Notice of Determination dated June 17, 2008, the Liquidator accepted Security's alternative POC (POC# 1380849) in the full amount sought, $13,060,312.39, and assigned it a Class E designation. That same day, the Liquidator refused to place a value on Security's primary POC (POC# 1380201), and assigned it a Class E designation as well. The basis for the Liquidator's Notice of Determination on Security's primary POC was its acceptance of Security's alternative POC:

> No value has been allowed for your claim because [t]his proof of claim for premium was valued at zero due to the acceptance of the paid loss POC.

See Exhibit "2". Of course, the Liquidator's sudden "acceptance" of Security's alternative POC# 1380849, which sought the full amount of claims and associated expenses submitted under the Certificate, is premised on an explicit acceptance of the validity of that reinsurance contract. This flatly contradicts the position Legion already took in the reinsurance arbitration and before the Commonwealth Court in the Rehabilitation intervention proceeding. Instead of evaluating and issuing Notices of Determination in accordance with its prior actions in this matter and the governing statutory law, the Liquidator chose to punt with respect to Security's primary POC, which if accepted would obviously result in Security's $5,107,411.83 claim not being subject to priority classification at all, since in the absence of a valid agreement those funds would not constitute an asset of the Legion Liquidation Estate.[6]

While certainly convenient, the Liquidator's actions constitute fast and loose handling of Security's legitimate and timely-filed claims, unilaterally placing Security in the position of a general creditor which likely will never be paid even a cent on the dollar, **on either Proof of Claim.**[7] The Liquidator's conduct in this matter clearly exceeds the bounds of reasonable discretion it enjoys pursuant to the liquidation statutes, and negatively affects Security's obligations to its policyholders in run-off, many of whom are Pennsylvania residents.

Legion had knowledge when it filed pleadings in the arbitration and intervention proceedings -- in which it declared the invalidity of the Certificate -- that losses under the

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[6] Any attempt by the Liquidator to characterize Security as a "general creditor" with respect to its approximately $5.1 million claim is equally unavailing. First, classification pursuant to the liquidation statutes presupposes that a claim is asserted against assets that properly are part of the liquidation estate. And second, "general creditor" status also presupposes the existence of a debtor/creditor relationship. Based on Legion's own position, there was no valid reinsurance contract between the parties, and therefore there cannot be a debtor/creditor relationship. Furthermore, Security has paid $13,060,312.39 in claims and associated expenses and is not seeking reimbursement from the Liquidator for that amount.

[7] A cursory analysis of the most recent financial statements made available by the Liquidator strongly suggests that claims with a Priority Class E designation will not be paid.

Certificate were significant. Through May 2001, when Legion filed its Statement of Position in the reinsurance arbitration, Security had paid $9,844,749.95 in claims and expenses with respect to the AIMCO program. And through August 2002, when Legion filed its verified Answer to the Petition to Intervene, claim and expense payments had increased to a staggering $11,407,829.92. In light of these significant amounts, it is no wonder why Legion aggressively and consistently maintained its position that the reinsurance Certificate under which Security had paid those claims was invalid. That is until now, when flipping its position to assert that the Certificate is in fact valid results in the classification of Security's claims as Class E, rendering the claims valueless.

Despite its purported attempt to do so, the Liquidator cannot change the facts to suit its position since he is legally estopped from doing so. Nor can the Liquidator change the shoes into which it has stepped by operation of law. Legion already has taken the position that there was no valid reinsurance contract and, thus, the $5,107,411.83 cannot possibly be an asset of the Legion Liquidation Estate. The Liquidator cannot now disavow the consequences of his prior actions to the detriment of Security merely because it suits his present purpose of refusing to pay back the $5,107,411.83 wrongfully withheld from Security.

III. ARGUMENT

In an insurance insolvency or liquidation proceeding under the Pennsylvania Insurance Department Act of 1921, as amended, the Commonwealth Court acts in a supervisory role to "check" the Liquidator's exercise of discretion in carrying out his statutory duties in order to prevent abuse. Koken v. Legion Ins. Co., 831 A.2d 1196 (Pa. Cmwlth. 2003), adopted by Koken v. Villanova Ins. Co., 878 A.2d 51 (Pa. 2005) ("the Order of the Commonwealth Court is hereby AFFIRMED, on the basis of the Commonwealth Court opinion, Koken v. Legion Ins. Co., 831

A.2d 1196 (Pa. Cmwlth. 2003)); Foster v. Mutual Fire, Marine and Inland Ins. Co., 614 A.2d 1086, 1091 (Pa. 1992).

As this Court has observed, the Liquidator is not a "free agent. [H]e must follow the statutory mandates (as must this Court) and use 'reasonable discretion.'" Koken v. Legion Ins. Co., 831 A.2d at 1232. The Commonwealth Court's task in this proceeding is to insure that the Liquidator's actions are "consistent with equitable principles and serve the interests of policyholders." Id. at 1242.

As more fully discussed above, and below, the Commonwealth Court's supervisory role must be exercised in this case to prevent the abuse that is manifest in the Liquidator's fast and loose handling of Security's POCs. The Liquidator's actions are inconsistent with, and indeed prohibited by, both legal and equitable principles and must not be condoned by the Court.

A. **The Liquidator's Purported Refusal to Address the Merits of Security's Primary Proof of Claim Seeking the Return of the $5,107,411.83 Paid to Legion Fails to Comport with the Liquidation Statutes and the September 23, 2002 Order of this Court.**

Pursuant to Section 221.41 of Title 40, the Liquidator has a mandatory statutory duty to issue a notice of determination with respect to proofs of claim submitted in an insurance company liquidation. 40 P.S. § 221.41 ("When a claim is denied in whole or in part by the liquidator, written notice of the determination shall be given to the claimant and his attorney . . . ."); see also Commonwealth Court Order dated January 11, 2006 ("Procedures for Disposition of Proofs of Claim"). A claimant is entitled to object to a notice of determination object within sixty (60) days. Id.

The basis for the Liquidator's Notice of Determination on Security's primary POC was its acceptance of Security's alternative POC:

> No value has been allowed for your claim because [t]his proof of claim for premium was valued at zero due to the acceptance of the paid loss POC.

See Exhibit "2". The Liquidator, in issuing a Notice of Determination on the basis of a separately submitted alternative POC, has purposely failed to fulfill his statutory duty to provide Security with a substantive Notice of Determination on its primary POC. The Liquidator's stated reason for refusing to accept Security's primary POC has nothing to do with the merits of the underlying claim, and therefore deprives Security of its right to an adjudication under Section 221.41.

In addition, the Liquidator's Notice of Determination fails to comport with this Court's September 23, 2002 Order. In that Order, issued on Security's Application for Relief, the Commonwealth Court provided:

> Security Insurance Company of Hartford's Application for Relief is STAYED in accordance with this Court's order of June 28, 2002, **without prejudice** to file a claim against Legion at a later date, including the claim that funds held by Legion are not an asset of the estate, pursuant to a rehabilitation plan or claims filing procedure ordered by this Court.

See Exhibit "1", Tab G (emphasis supplied). As specifically was contemplated by the Court's Order, Security submitted its primary POC to the Liquidator, asserting as the basis for its claim that the $5,107,411.83 sought is not an asset of the Legion Liquidation Estate. Instead of adjudicating the claim the Commonwealth Court's Order specifically provided Security could assert without prejudice in the proof of claim process, the Liquidator chose to issue its Notice of Determination on the basis of Security's separately submitted alternative POC. In doing so, the Liquidator deprived Security of the very right the Commonwealth Court provided Security could assert – and that Security did assert – as the basis for its primary POC. Therefore, the

Liquidator's Notice of Determination on the instant POC fails to comport with the Court's September 23, 2002 Order.

B. The Purported Refusal of Security's Primary Proof of Claim Seeking the Return of the $5,107,411.83 Paid to Legion Is Based on a Legal Position the Liquidator is Estopped from Taking.

As discussed above, infra Sections II. C and D, Legion consistently, throughout the reinsurance arbitration and Commonwealth Court Rehabilitation intervention proceedings, took the position that there was no valid agreement between the parties. Legion asserted in the arbitration in 2002 that because GMI was unable to bind Legion to the Certificate, and Security knew that GMI has no authority, the Certificate was void. See Exhibit "1", Tab B. In 2003, the Rehabilitator admitted and reaffirmed Legion's position, in its **verified** Answer to Security's Petition to Intervene, that the Certificate was invalid:

> the Certificate of Property Facultative Reinsurance upon which Petitioner relies ("Facultative Reinsurance Certificate") and which upon information and belief is attached as Exhibit A to the Petition, **was entered into without the authority of Legion** with the knowledge of Security and its agents, First Capital Group (hereinafter "First Capital") and The Artis Group (hereinafter "Artis").

Exhibit "5" at ¶ 3 (emphasis supplied).

As the Commonwealth Court has routinely observed, when an insurance company is placed into Liquidation, the Liquidator "steps into the shoes of the insurer" and functions as its successor. TIG Specialty Ins. Co. v. Koken, 855 A.2d 900, 912-913 (Pa. Cmwlth. 2004) (collecting Pennsylvania cases). Indeed, Judge Leavitt specifically has recognized that the Liquidator in this very matter has stepped into the shoes of Legion Insurance Company. Koken v. Legion Ins. Co., 831 A.2d 1196 (Pa. Cmwlth. 2003). Having done so, the Liquidator by operation of law succeeded to the legal position advanced by Legion itself during the reinsurance arbitration, and then by the Rehabilitator in the Commonwealth Court Rehabilitation intervention

proceeding. The Liquidator is estopped from now simply casting aside that position for its own convenience, to the detriment of Security.

Indeed, the Pennsylvania Supreme Court has held that a statutory liquidator is estopped from doing exactly what the Liquidator purports to do in this case, i.e., engage in a 180 degree tactical reversal where its purpose is conveniently served to the detriment of another party. In Commonwealth ex rel. Kelly v. Commonwealth Mut. Ins. Co., our Supreme Court held that the statutory liquidator was estopped from denying the validity of a contractual limitation where the Insurance Commissioner prior to liquidation of the Commonwealth Mutual Insurance Company had approved the very contract containing the limitation at issue. 299 A.2d 604, 606 (Pa. 1973).

The Liquidator's tack in this instance presents the other side of the same coin; here, the Liquidator purports to recognize the validity of an agreement it consistently has maintained is invalid, in two (2) separate proceedings in which this issue was raised. The Supreme Court's holding in Kelly is no less applicable here, and the reasons for not allowing the statutory liquidator to change its position in that case are even more compelling on these facts, where the Liquidator has essentially rendered Security's claims valueless.

In addition, the Liquidator's tactical reversal and calculated effort to avoid payment to Security squarely are prohibited by the doctrines of judicial and equitable estoppel. The Pennsylvania Supreme Court has explained the doctrine of judicial estoppel as follows:

> Judicial estoppel is an equitable, judicially-created doctrine designed to protect the integrity of the courts by preventing litigants from playing 'fast and loose' with the judicial system by adopting whatever position suits the moment. Unlike collateral estoppel or res judicata, it does not depend on relationships between the parties, but rather on the relationship of one party to one or more tribunals. In essence, the doctrine prohibits parties from switching legal positions to suit their own ends.

Sunbeam Corp. v. Lib. Mut. Ins. Co., 781 A.2d 1189, 1192 (Pa. 2001) (internal citations omitted). The Liquidator by accepting Security's alternative POC based on its recognition of the existence of a valid reinsurance contract between the parties is taking a position that is in flat contradiction of – not merely inconsistent with – the position Legion took in the reinsurance arbitration and in the Commonwealth Court Rehabilitation intervention proceeding. The Liquidator's tactic – which as noted all but ensures that Security is paid nothing, on either claim – is exactly what the doctrine of judicial estoppel was designed to prevent, i.e., the switching of a legal position to suit its own ends.

Similarly, the doctrine of equitable estoppel also bars the Liquidator's fast and loose handling of Security's claims. Equitable estoppel "applies to prevent a party from assuming a position or asserting a right to another's disadvantage inconsistent with a position previously taken." Blofsen v. Cutaiar, 333 A.2d 841, 843 (Pa. 1975). There are two elements of equitable estoppel, inducement and reliance. Novelty Knitting Mills, Inc. v. Siskind, 457 A.2d 502 (Pa. 1983). The inducement may be words or conduct, and the acts that are induced may be by commission or forbearance, provided that a change in condition results causing disadvantage to the one induced. Id. at 503-504. Once established, "the person inducing the belief in the existence of a certain state of facts is estopped to deny that the state of facts does in truth exist, aver a different or contrary state of facts as existing at the same time, or deny or repudiate his acts, or statements. In re Estate of Tallarico, 228 A.2d 736, 741 (Pa. 1967).

Based on the Liquidator's denial of the existence of a valid reinsurance contract between the parties, Security was induced to submit its POCs alternatively, leading with its primary POC, the success of which was premised on the absence of a valid reinsurance contract, and following with its alternative POC, the success of which was premised on the presence of a valid

reinsurance contract. Under the circumstances, there can be no doubt that Security's reliance on the Liquidator's prior position was justified, or that the manner in which the Liquidator has sought to dispense with Security's claims has disadvantaged Security.

Accordingly, the Liquidator is estopped from asserting the validity of the Certificate as the basis for refusing Security's primary POC.

C. Since The Liquidator is Estopped from Asserting the Validity of the Certificate as the Basis for Refusing Security's $5,107,411.83 Proof of Claim, It is Unlawfully Refusing to Return and Has Converted Funds Which Are not An Asset of the Legion Estate.

There is no statutory authority for the Liquidator's retention of the approximately $5.1 million in funds sought in Security's primary POC. The Liquidator is empowered only to retain and marshal "general assets" of the estate (see 40 P.S. § 221.15(c) and § 221.20(c)), as defined in 40 P.S. § 221.15(c). The Liquidator has no authority to retain the $5,107,506.49 paid by Security to Legion since those funds do not constitute a general asset of the estate as defined in 40 P.S. § 221.3. These funds, which were paid by Security to Legion pursuant to the terms of an agreement the Liquidator is now estopped from asserting is valid, are not an asset of the Legion estate. See 40 P.S. § 221.3. The Legion Liquidator has no legal or equitable, but rather only a possessory interest (if any), in the $5,107,506.49.

Moreover, the Liquidator cannot retain Security's funds ($5,107,411.83) under the pretense that it will fulfill Legion's legal obligations and thereafter retain those monies, while simultaneously asserting that there never was a valid reinsurance contract. If there never was a valid agreement, then the monies should never have been paid to Legion in the first instance, much less continue to be wrongfully withheld by the Legion Liquidator, who in the absence of a valid agreement never acquired a legal or equitable interest in the $5,107,411.83.

Because the Legion Liquidator is estopped from asserting that there was a valid reinsurance contract, its' interest in the $5,107,411.83, if any, is merely possessory, and a possessory interest alone is an insufficient basis for the monies to flow into the Legion Liquidation Estate. Bankruptcy courts routinely observe that where a debtor has only "bald possession" of an asset at the time of a bankruptcy filing, but no legal or equitable interest, the asset does not become part of the bankruptcy estate. See, e.g., In re Bake-Line Group, LLC, 359 B.R. 566, 570 (Bankr. D. Del. 2007) (granting summary judgment in favor of defendant and against debtor in bankruptcy preference action and holding that because debtor had no legal or equitable interest in $139,208.24, debtor's interest in the money was possessory only and the money therefore never became part of the bankruptcy estate but rather was held in constructive trust for the benefit of the defendant); see also In re Dynamic Technologies Corp., 106 B.R. 994, 1005 (Bankr. D. Minn. 1989); In re Sielaff, 164 B.R. 560, 567 n.7 (Bankr. W.D. Mich 1994).[8]

Since the $5,107,411.83 is not an asset of the Legion Liquidation Estate, there can be no real question that the Liquidator has unlawfully converted Security's property. Under Pennsylvania law, a conversion is "the deprivation of another's right of property in, or use or possession of, a chattel, or other interference therewith, without the owner's consent and without lawful justification." Stevenson v. Economy Bank of Ambridge, 197 A.2d 721, 726 (Pa. 1974). Money of course can be the subject of a claim for unlawful conversion. Shonberger v. Oswell, 530 A.2d 112, 114 (Pa. Super. 1987). A defendant need not have a conscious intent to do wrong, but must merely be shown to have intended to exercise dominion or control over the chattel in a

[8] In the absence of precedent arising under Pennsylvania's rehabilitation/liquidation statutes, this Court can and should look to federal bankruptcy law for guidance. See, e.g., Koken v. Fidelity Mut. Life Ins. Co., 803 A.2d 807, 817 (Pa. Cmwlth. 2002) ("Again, the Policyholders Committee commends us to cases in bankruptcy jurisprudence, and rightly so, because there is little precedent in state rehabilitation proceedings.").

manner which is inconsistent with the rights of the true owner. Norriton East Realty Corp. v. Central-Penn Nat'l Bank, 254 A.2d 637, 638 (Pa. 1969).

If the Liquidator is taken at its word – as he must since he is estopped from asserting otherwise – then there was no valid reinsurance contract between Legion and Security. Therefore, Legion has no legal or equitable right to the $5,107,411.83 paid by Security. Quite obviously, Security never consented to the Liquidator's refusal to return these funds, and its continued withholding of the $5,107,411.83 is no less unlawful today than when it initially declared the reinsurance agreement invalid and void ab initio.

Since Legion never had a legal or equitable interest in the funds, the Liquidator must immediately return the $5,107,411.83 to Security. See, e.g., Northern Bank v. FDIC, 496 N.W.2d 459 (Neb. 1993) (affirming Order imposing constructive trust on funds held by statutory receiver on the basis of its conclusion that the funds never became part of the receivership estate); accord Official Comm. of Unsecured Creditors of the Columbia Gas Transmission Corp. v. Columbia Gas Sys., Inc., 997 F.2d 1039, 1059 (3d Cir. 1993) (holding that property held in constructive trust for another party at time of bankruptcy filing is excluded from the debtor's bankruptcy estate), cert. denied, 510 U.S. 110 (1994). Indeed, those funds should immediately have been returned to Security when Legion initially declared the Certificate invalid.[9]

In addition, the Liquidator's position with respect to the invalidity of the reinsurance contract is tantamount to a rescission, giving rise to a duty on the part of the Liquidator "to restore or tender a return of the property or security which was the subject matter of the contract." Keenheel v. Pennsylvania Securities Comm'n, 579 A.2d 1358, 1361 (Pa. Cmwlth. 1990), citing Fowler v. Meadow Brook Water Co., 57 A. 959 (Pa. 1904). The Liquidator has

[9] On April 26, 2001, Legion asserted that GMI did not have the authority to bind Legion and that Security was fully aware of this fact. See Exhibit "1", Tab B.

wrongfully refused to return Security's property, and indeed has taken affirmative steps to unlawfully and unreasonably withhold from Security the $5,107,411.83 that was paid.[10]

[10] Notwithstanding the fact that Security has paid $13,060,312.39 in property and casualty losses and related expenses under the AIMCO Program (paid losses on the reinsurance Certificate Legion has disavowed), Security has objected to the Liquidator's Notice of Determination accepting its alternative POC. In doing so, Security has opted – as it did when it initially submitted its POCs – to focus its efforts on seeking the return of its $5,107,411.83 from Legion (funds which never have been a part of the Legion estate). Unlike Security, the Liquidator has chosen to maintain entirely inconsistent positions in a calculated effort to have the best of both worlds, i.e., not having to pay Security on either claim.

IV. CONCLUSION

For the foregoing reasons, Security's Objection to the Liquidator's Notice of Determination with respect to its primary POC (POC# 3800201) should be sustained, and Security's claim should be allowed in the full amount of $5,107,411.83, including but not limited to Security's attorneys' fees, costs and expenses associated with this Objection. Given the conduct of Legion and its statutory Rehabilitator and Liquidator as more fully discussed above, the Court also should award Security interest on the $5,107,411.83 wrongfully withheld by Legion.

In the interest of economy and given the obvious interrelatedness of Security's primary and alternative POCs, Security respectfully requests that the proceedings with respect to its POCs be consolidated.

Respectfully submitted,

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