

Pre-Answer Security Litigation in Connecticut

By

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I. Introduction

Most states have enacted statutes requiring that an insurer or reinsurer which is unlicensed or otherwise unauthorized to do business in that state to post security before it files an answer in any court action or other proceeding. These statutes often are based on the Unauthorized Insurers Process Model Act developed by the National Association of Insurance Commissioners.¹

Litigation with respect to the Connecticut version of this act has been particularly intense. The purpose of this article is to examine this litigation and the scope of application of the statute as a means of exploring precedent for other states.

II. Connecticut Statute

Conn. Gen. Stat. § 38-27(a) (hereinafter “Security Statute”) provides:

Before any unauthorized person or insurer files or causes to be filed any pleading in any court action or proceeding or in any administrative proceeding before the commissioner instituted against the person or insurer . . . , the person or insurer shall either: (1) Deposit with the clerk of the court in which the action or proceeding is pending, or with the commissioner . . . cash or securities or a bond . . . sufficient to secure the payment of any final judgment which may be rendered in the action or proceeding . . . or (2) procure proper authorization to do an insurance business in this state.

This statute:

[I]s intended to ensure that any insurer, domestic or foreign, selling insurance or reinsurance to a person in this state will have sufficient assets in this state to satisfy any judgment. It is a regulatory requirement targeting a specific subset of insurance companies that do not maintain adequate reserves and surplus in the state to satisfy licensure requirements and are alleged by a policyholder to have defaulted on their obligations under the terms of a policy.²

As indicated by the case law described below, the application of this statute has gone well beyond this explanation.

III. Application to Security Statute to Various Defenses

A. Application to Reinsurers

Sec. Ins. Co. v. Universal Reinsurance Co., 2007 U.S. Dist. Lexis 5694 involved a quota share relationship between a Connecticut cedent and an unlicensed reinsurer. The cedent sued for reinsurance recoverables and then moved to strike the answer of the reinsurer based on the Connecticut Security Statute. The reinsurer argued that it was statutorily exempt from the Security Statute. The court, however, rejected this argument finding that the reinsurer fell within the statutory definition of “insurer”, that the reinsurer was assuming risk from a Connecticut company and that certain statutory exceptions for reinsurers did not apply to the Security Statute.

B. Need to Show Probability of Prevailing on the Merits

The ceding insurer moved for pre-answer security from the reinsurer in *Hartford Accident & Idem. Co. v. ACE Am. Reinsurance Co.*, 2008 Conn. Super. Lexis 2470. The reinsurer resisted arguing that the Security Statute was similar to the Connecticut Pre-Judgment Remedy Statute under which a hearing was required in which the defendant is authorized to raise defenses and the court is required to find that there is probable cause that the plaintiff will prevail. The court rejected this argument noting that the legislature could have included such language in the security statute should it have wished to impose such a requirement. All that the Security Statute

required was “the submission of some proof that the contracts existed, billings were made under the auspices of those contracts, and the bills remain unpaid.”³

C. Licensed at the Inception of the Transaction

In *Travelers Indem. Co. v. Excalibur Reinsurance Corp.*, 2014 U.S. Dist. Lexis 33182, the reinsurer, Excalibur, was licensed in Connecticut at the inception of the transaction but gave up its license before litigation commenced and became an unauthorized insurer. The court found that the prior possession of a license was irrelevant: “It would be contrary to the intent of the law and public policy to allow unauthorized insurers to claim that they are not subject to pre-pleading security obligations, because at some point prior to litigation they were authorized in Connecticut.”⁴ See also, *Select Ins. Co. v. Excalibur Reinsurance Corp.*, 2016 U.S. Dist. Lexis 31264.

D. Contrary Order of An Insurance Department

Also in *Travelers Indem. Co. v. Excalibur Reinsurance Corp.* 2014 U.S. Lexis 33182, Excalibur argued that the Pennsylvania Insurance Department had prohibited it from posting security without the Commissioner’s approval except to the extent required by law. The court rejected this argument noting that security was required by Connecticut law and, in any case, “under the principle of comity and the limits of the Pennsylvania Department of Insurance’s authority, Connecticut’s pre-pleading security statute trumps an order from an out-of-state administrative agency.”⁵ See also, *Travelers Indem. Co. v. Excalibur Reinsurance Corp.*, 2014 U.S. Dist. Lexis 35434; *Select Ins. Co. v. Excalibur Reinsurance Corp.*, 2016 U.S. Dist. Lexis 31264.

E. Cedent Not Authorized in Connecticut

While the decision of the magistrate judge is somewhat confusing in *Select Ins. Co. v. Excalibur Reinsurance Corp.*, 2016 U.S. Dist. Lexis 31264, it appears that the facts involved two unauthorized insurers that issued the policies in question which were reinsured by Select which retroceded to Excalibur. Select was an unauthorized insurer in Connecticut but was an approved surplus lines insurer. Excalibur argued that the Security Statute did apply since Select was

domiciled in Texas and was not authorized in Connecticut. The magistrate judge rejected this argument on the basis that the purpose of the Security Statute was to assure that a party selling insurance or reinsurance to a person in Connecticut has sufficient assets to satisfy any judgment.

“There is nothing in the statute regarding the citizenship of the party initiating the action.”⁶

F. Choice of Different State Law

The treaty in question contained a New York choice of law in *Travelers Indem. Co. v. Excalibur Reinsurance Corp.*, 2014 U.S. Dist. Lexis 33182. Excalibur argued that as a result, the Connecticut pre-answer Security Statute did not apply. Travelers countered that under Federal Rule 64(a) of Civil Procedure, every remedy is available that is allowed by the state in which the court is located and since the district court was in Connecticut, the Connecticut Security Statute was applicable. After extensive review of available authority on point, the court agreed with a plain reading of Rule 64(a) that the Connecticut Security Statute was an available remedy. Under an *Erie Doctrine* analysis, the court found that the Connecticut security statute is procedural rather than substantive so that the cedent was entitled to invoke it in this case. *See also, Select Ins. Co. v. Excalibur Reinsurance Corp.*, 2016 U.S. Dist. Lexis 31264.

G. Policy was not Issued and Delivered in Connecticut

In *Travelers Indem. Co. v. Excalibur Reinsurance Corp.*, 2014, U.S. Dist. Lexis 33182, Excalibur argued that the Security Statute did not apply since the policy in question was not issued and delivered in Connecticut. The court rejected this argument on the basis that the purpose of the Security State was to prevent Connecticut residents from having to litigate their claims in distant forums.

IV. Commentary

As the court noted in *Travelers Indem. Co. v. Excalibur Reinsurance Corp.*, 2014 U.S. Dist. Lexis 33182 *6-7, the Connecticut Security Statute is a mandatory provision requiring the court to order security be posted by any party falling within the ambit of the statute with the consequences of the failure to comply being striking that party's pleading. It appears from

the case law noted above, that scope of the statute is interpreted liberally so as to protect Connecticut consumers from insurers or reinsurers that may not be able to meet their obligations.

ENDNOTES

¹ Robert M. Hall, *Pre-Answer Security and Reinsurance Arbitration*, XII Mealey's Reins. Rpt. No. 18 at 20 (2002), also available at the author's website: robertmhall.com

² *Hartford Accident & Indem. Co. v. ACE Am. Reinsurance Co.* 2008 Conn. Super. Lexis 2470 *4.

³ 2008 Conn. Super. Lexis 2470 *10.

⁴ 2014 U.S. Dist. Lexis 33182 *8.

⁵ *Id.* *30.

⁶ 2016 U.S. Dist. Lexis 31264 *8.