

REINSURANCE SETOFF AND ASSIGNED RIGHTS

by

Robert M. Hall

[Mr. Hall is a former law firm partner, a former insurance and reinsurance executive and acts as an expert witness and insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes. The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright 2008 by the author. Questions or comments may be addressed to the author at bob@robertmhall.com.]

I. Introduction

There is a rich history of case law concerning the application of setoff rights by reinsurers in the receivership proceedings of their cedents.¹ In essence, this case law articulates the rule that to be set off, debits and credits must be mutual in terms of time and capacity. There are a few factual scenarios in which this mutuality rule has not been fully explored. Once such scenario, setoff of assigned rights, is the subject of this article.

II. Recent New Hampshire Case

In the Matter of the Liquidation of the Home Ins. Co., 2008 N.H. Lexis 93 involved a 1995 agreement between Century Indemnity Company ("CIC") and its affiliates by which the affiliates ceded to CIC 100% of their net carried reserves on certain business in exchange for assigning to CIC all reinsurance recoverables. If, however, CIC deemed the reinsurance to be unrecoverable, CIC could return the assigned claims to the affiliates. Some of the reinsurance claims included recoverables from Home which CIC attempted to set off against recoverables which Home had against CIC.

Home resisted the setoff claiming that there was no mutuality of the debits and credits. Home argued that the lack of mutuality resulted from a triangular setoff *i.e.* CIC attempting to set off its payables to Home against payables from Home to the affiliates. CIC's ability to return the assigned claims, Home argued, made the assignment one for collection only in which the assignor (the affiliates) retains the equitable ownership of the claims in the assignor *i.e.* the assignment is not complete and absolute. Finally, Home argued that the setoff ran afoul of a statutory provision which limits a reinsurer's ability to assert a right which it purchased or which was transferred to it for setoff purposes.

The New Hampshire Supreme Court rejected all of these arguments. It found that the assignment was absolute by the terms of the 1995 agreement. Regardless of CIC's ability to return the claims to the affiliates if unrecoverable, CIC had not done so and was asserting them against Home in the form of setoff.² The ability to return unrecoverable claims to the affiliates, in effect, was a guarantee of

payment to CIC.³ The fact that the affiliates were benefited by CIC's assertion of the assigned rights through setoff was incidental and did not negate the absolute nature of the assignment.⁴

The supreme court also rejected the argument that the setoff violated RSA 402-C:34, II(b) which states that: "No setoff shall be allowed in favor of any person where: (b) the obligation of the insurer to the person was purchased by or transferred to the person with a view to its being used as a setoff. . . ." The 1995 agreement between CIC and its affiliates took place years before Home was placed in liquidation so it would have been difficult to have a view toward liquidation before it occurred. Given the unconditional nature of the transfer, the court found untenable Home's argument that the transfer actually took place when CIC decided not to return assigned claims to the affiliates.⁵

III. Other Supportive Case Law

While the assignment of setoff rights may be rare in the insurance company receivership arena, it is less so in bankruptcy. One such case is *Depositors Trust Co. of Augusta v. Frati Enterprises, Inc.*, 590 F.2d 377 (1st Cir. 1979). Two affiliated banks in Augusta and Bangor did business with Frati which eventually went bankrupt. Augusta held funds and Bangor held a promissory note. For administrative purposes, the Bangor bank sold the note to the Augusta bank in consideration of proceeds of the note. When Frati went bankrupt, the Augusta bank set off the funds held against the promissory note. The court rejected the argument of the bankruptcy trustee that this was an attempt at a triangular setoff with the Bangor bank as the true creditor.⁶

In re U.S. Aeroteam, Inc. v. Delphi Automotive Systems, LLC, 327 B.R. 852 also involved setoff through assignment. Delphi owed debts to the bankrupt, USAT, but Delphi had paid USAT debts to its supplier, Texas Foundries and obtained an assignment of the claim against USAT. The court allowed the setoff stating:

[A] "triangular setoff," when A attempts to offset an obligation owed to B against B's debt to C, is prohibited because there is no mutuality of debt between two parties. . . . Another way to establish mutuality in a triangular situation is through assignment. . . .

In this case, upon Delphi's promise to pay USAT's debt to Texas Foundries, Texas Foundries assigned its rights against USAT to Delphi. Through the assignment, Delphi "stepped into the shoes" of Texas Foundries' right to payment from USAT which Delphi wants to set off against amounts it owes to USAT. The assignment of Texas Foundries rights to Delphi creates dual obligations of payment between two parties, USAT and Delphi thereby establishing mutuality for setoff.⁷

IV. Conclusion

While there is little case law on the issue of set off of assigned rights in the insurance company receivership context, a recent decision of the New Hampshire Supreme Court plus some bankruptcy cases provide some context. In essence, an assigned right can be used for setoff if the assignment is: (a)

complete and absolute; (b) not just for collection purposes; and (c) the assignor retains no equitable interest in the proceeds from the assigned right.

ENDNOTES

¹ See e.g. Robert M. Hall, *Direct Actions and Setoff: The Next Generation*, VIII Mealey's Reins. Rpt. No. 7 at 15 (1997); T. Darrington Semple, Jr. and Robert M. Hall, *The Reinsurer's Liability in the Event of the Insolvency of a Ceding Property and Casualty Insurer*, Tort & Ins. L.J. No.3 (1986) at 407.

² 2008 Lexis N.H. Lexis 93 *13-4.

³ *Id.* *16.

⁴ *Id.* *17.

⁵ *Id.* *20.

⁶ 590 F.2d 377 at 379.

⁷ 327 B.R. 852 at 864-5 (internal citations omitted).