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Recommended Citation
Davis J. Howard Standing to Sue a Carrier's Killers, 17 Pepp. L. Rev. 2 (1990)
Available at: http://digitalcommons.pepperdine.edu/plr/vol17/iss2/1

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Standing to Sue a Carrier’s Killers

Davis J. Howard*

I. INTRODUCTION

Those who frequent latter-day Lloyd’s of London coffee houses have known for some time that insurance companies are dropping like flies. However, this news became public knowledge only on April 5, 1989, when the New York Times ran a front-page article entitled, As More Insurance Companies Fail, Fears Mount of an Industry Crisis. The casual reader, after glancing at this article, may well have proceeded to peruse the sports, the weather, or the obituary section of the newspaper. However, those bound by statute and court order to liquidate insolvent insurance companies cannot afford to be as cavalier. Instead, they must scour the planet in search of assets to compensate unfortunate policyholders and creditors of the defunct insurance carrier; the victims may decide to conduct searches as well. One method frequently used to obtain funds is to sue those allegedly responsible for the carrier’s demise. Typical targets include the insurance company’s former directors and officers, corporate parents

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2. Nash, As More Insurance Companies Fail, Fears Mount of an Industry Crisis, N.Y. Times, Apr. 5, 1989, at A1, col. 1. In recent years, the problem of insurance company insolvencies has dramatically increased not only in number, but in severity as well. For example, more than half of the insolvencies occurring from 1975 to 1988 occurred between 1985 and 1988. See Anderson & Keenan, Choosing a Target—Policyholders Explore Suing Those Responsible for Insurer Insolvency, BUS. INS., Feb. 22, 1988, at 23. In addition, four of the most recent insolvencies—Mission, Transit, American Mutual, and Integrity—are believed to be the four largest insurance company insolvencies to date. See Massachusetts Seeks to Liquidate Two American Mutual Affiliates, BUS. INS., Feb. 20, 1989, at 1-2.
and their managers, and independent auditors and actuaries. The purpose of this article is to determine who has standing to sue and, assuming the lawsuit is successful, the method to distribute the recovery among those injured by the insolvency.

Part II of this article briefly describes state statutory procedures for liquidating an insolvent insurance company. Part III sets forth several conventional approaches to resolve the issue of standing. Part IV identifies the cast of characters and the arguments and motives used to support the right to sue those responsible for the carrier's financial failure. Part V examines state laws on standing, and concludes that application of traditional rules of statutory construction would often authorize victims of insolvency to prosecute independent actions. Part VI explores the public policies that insurance company insolvency laws seek to achieve, and concludes that such objectives may be realized only if the liquidator is afforded the exclusive right to sue. Parts V and VI reveal an apparent irconcilable conflict between legislative intent and the statutes designed to achieve that intent. Part VII describes the untenable problems that may arise if courts, in deference to the letter of the law but in derogation of its spirit, allow multiple parties to simultaneously sue the same defendants. Part VIII provides an alternative method of statutory construction designed to neutralize the conflict between the letter and the spirit of the liquidation laws. Part IX concludes by advocating emendation of state laws to harmonize statutory language with legislative intent, to ensure that only liquidators of insolvent insurance companies have standing to sue a carrier's "killers."

II. STATE REGULATION OF FINANCIALLY IMPAIRED INSURANCE COMPANIES

A. Liquidation Proceedings

Each state has a statute that governs insurance company delin-
quency proceedings. The statute is part of the state's insurance code and provides that if a carrier becomes financially impaired or otherwise poses a hazard to the public, the state's insurance commissioner may commence a judicial proceeding to place the insurance company in rehabilitation, reorganization, conservatorship, or liquidation. If the carrier is placed in liquidation, the commissioner of insurance is appointed to serve as liquidator. The commissioner's primary responsibilities are: (1) to marshal assets into the estate; (2) to determine the validity and the amount of each creditor's claim against the estate; and (3) to distribute the marshaled assets to covered claimants pursuant to the statute's priority provision.

The priority provision enumerates categories of claims and claimants in descending order of preference. Claims at each level must be satisfied in full before claims at the next level are paid. Although priority provisions vary from state to state, administrative expenses of liquidation usually receive first priority, followed by unpaid wage claims of the company's former employees. The next preference is often afforded to those with liens or security interests against the company's assets, provided they were perfected before the carrier was placed in liquidation. The next (and largest) preference level consists of policyholders, insureds, beneficiaries, guaranty associations, and third-party claimants (i.e., those injured by the covered conduct of policyholders). The final level consists of "all other claims," or is divided into a penultimate group of general creditors, followed by those with ownership interests in the defunct company, such as shareholders of an insurance company that was organized as a stock corporation.

In practice, policyholders and third-party claimants—victims most likely to be devastated by the insolvency—are unlikely to receive full reimbursement from the estate. Moreover, to the extent they are reimbursed for their losses, payments may not be made until years af-


For the evidentiary threshold establishing insolvency, see Porter v. Yukon Nat'l Bank, 866 F.2d 335, 356-59 (10th Cir. 1989).
fter the company is placed in liquidation. The plight of these claimants is ameliorated by state guaranty funds.

B. Guaranty Funds

Guaranty associations are nonprofit organizations created by state statutes to rapidly pay the claims of policyholders and third-party claimants.14 The associations are composed of and funded by solvent insurance companies licensed to conduct business in the forum; their obligations are triggered by insolvencies that occur after the statutes which created the associations have become effective.15 Guaranty associations pay only certain types of claims made by particular types of claimants and payment is limited by a maximum dollar amount (cap) that varies from state to state.16 If the loss sustained by a covered claimant exceeds the association’s cap, the claimant may recover the difference from the insolvent carrier’s estate.

After a guaranty association has paid a covered claim, it becomes subrogated to the claimant’s rights against the insolvent carrier’s estate and occupies the same distributive priority level as the policyholder or third-party claimant that it reimbursed.17 It is therefore


16. See Lasley, Winters & Puebla, Insurance Guaranty Funds: The New ‘Money Pit’, in 1987 A.B.A. Sec. Tort & Ins. Prac., Insolvency and Solidity of Insurance Companies 113, 126 (“Caps on covered claims vary from state to state; three have only $50,000 limits, while there are approximately twelve in the $100,000 to $150,000 range, one with a $1,000,000 “cap,” and one with no maximum at all. . . . [T]he majority have adopted the $300,000 limit proposed in the Model Act.”). The Model Act referred to is the Post-Assessment Property and Liability Insurance Guaranty Association Model Act, promulgated in 1969 (revised in 1985) by the National Association of Insurance Commissioners (NAIC). Both versions of this Model Act are reprinted in the Reference Handbook on Insurance Company Insolvency, 1986 A.B.A. Sec. Tort & Ins. Prac. 2-23. Future guaranty fund protection for the nation’s largest insureds is likely to diminish because the NAIC has proposed that insureds with a net worth of $50 million or more be excluded entirely from coverage by guaranty associations. See Duncan, The NAIC Model Property and Casualty Post-Assessment Guaranty Funds, in 1986 A.B.A. Sec. Tort & Ins. Prac., Law and Practice of Insurance Company Insolvency 459, 472-73. Such provisions already have been adopted in Colorado, Connecticut, Hawaii, Illinois, Oklahoma, Rhode Island, and Vermont. See Bus. Ins., July 17, 1989, at 13. However, a federal court in Michigan recently invalidated, on equal protection grounds, a guaranty fund law excluding policyholders whose net worth was greater than 0.1% of the aggregate premiums written by member insurers during the preceding calendar year. Borman’s Inc. v. Michigan Property & Casualty Guar. Ass’n, 717 F. Supp. 468 (E.D. Mich. 1989).

17. A single exception arises for the guaranty association’s expenses and costs of administration, which receive top distributive priority along with the estate’s costs of
unlikely that a guaranty association will receive full reimbursement from the estate. The association may recover the deficit by imposing a surcharge (or charging higher premiums) on policies issued in the future. Thus, the public ultimately pays for much of the protection afforded by statute to victims of insurance company failures.\footnote{18}

\textbf{III. Common Approaches for Resolving the Standing Issue}

Standing is not a monolithic concept. To determine legal rights, it is necessary to examine the nature of the loss and the type of misconduct that caused it. It is universally acknowledged that the liquidator, the statutory successor of the insolvent insurer, has the exclusive right to bring suit to recover the insurer's assets. The liquidator also may bring any action that could have been brought by or on behalf of the carrier had it not become insolvent. However, less agreement exists as to what constitutes an "asset of the insurer's estate,"\footnote{19} and whether misconduct injured the company rather than its policyholders.


ers and creditors. There are three conventional ways to resolve these issues.

A. Did the Funds that the Plaintiff Seeks to Recover Belong to the Carrier Before It was Liquidated?

The first and simplest approach is to determine if the money sought to be recovered ever belonged to the insurance company. If it did, it is an asset of the company and becomes an asset of the company's estate. Because the loss of this money injured the company, an action to compel its return would belong solely to the liquidator. If the liquidator is successful, any recovery will be treated as a general asset of the estate and distributed according to the insurance code's priority provision. Examples of such assets include improperly declared dividends; underwriting losses; wasted assets; funds illegally diverted to the insurer's affiliates, managers, owners, or third parties; overpayment of corporate taxes; uncollected premiums; and reinsurance receivables.

In contrast, loss payments owed to policyholders and debts due general creditors represent funds that never "belonged to" the insurance company. Its inability to fulfill these obligations caused injury to policyholders and creditors rather than to the company or its estate. Each policyholder or creditor should therefore be allowed to commence and prosecute an action to redress his injury and to retain recovery.

In practice, the liquidator, as the company's statutory successor, could bring suit against management for mismanagement of the company or fraudulent diversion or wasting of assets, and also an action against the company's auditors and actuaries for aiding and abetting such misconduct. The same defendants can be sued to recover the same loss in an action by or on behalf of a solvent company. In contrast, each claimant has his own cause of action against management for continuing to write insurance policies after the company became insolvent. In addition, each claimant may bring suit against management as well as the auditors and actuaries for concealment of the insolvency resulting in the inducement of policyholders and claimants to continue doing business with the insurer notwithstanding its pre-

20. The distinction is not as simple as it appears because the insurer's inability to satisfy covered claims and other debts arises only when its assets have been so diminished that it becomes insolvent. Because injury to the corporation and damage to its policyholders and other creditors are inseparable, the distinction based on whether the assets ever belonged to the insurer is somewhat heuristic. However, it can be modified and legitimized by conversion into a proximate cause analysis. The operative question then becomes whether the injury was caused directly or indirectly by dissipation of assets that at one time "belonged to" the now-insolvent insurer. The liquidator would be the proper party plaintiff only if the corporation's injury was caused directly by diversion of its assets.
carious financial condition. However, such an action could not be brought by or on behalf of the company if it were rehabilitated or reorganized.  \(^{21}\)

**B. Was the Loss Sustained Before or After the Insurance Company Became Insolvent?**

The second approach is a temporal concept based on the assumption that no injury may be sustained by a company after it becomes insolvent. Stated more simply, once a company is financially deceased, it cannot suffer further injury merely because its debts continue to increase.  \(^{22}\) Under this construct, the distinctions created by the first approach apply prior to insolvency. However, after insolvency all losses are sustained solely by the claimants, and they alone have standing to seek redress regardless of the nature of the loss-producing conduct or the subsequent causes of action. The adoption of this approach is significant because failing insurance companies typically continue to do business for a substantial period of time after becoming statutorily insolvent but before being placed in liquidation.

**C. Did the Alleged Misconduct Cause Discrete Injury to Each Claimant or Common Injuries to All Claimants?**

The third approach is less an independent principle than an imprecise statement of the results usually achieved by applying the first approach. It provides that:

[A] creditor of a corporation may maintain an action against the corporation’s directors for fraud or mismanagement if the creditor sustained an identifiable loss peculiar and personal to itself. But where the misconduct results in loss to the corporation and its creditors generally, the right of action belongs to the corporation and must be maintained by it or by its receiver.  \(^{23}\)

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This approach is of limited value because it is often impossible to distinguish a loss peculiar and personal to an individual creditor from a loss common to all creditors.

Consider a sophisticated policyholder who requested, received, and examined the audited financial statements of an insurance company from whom he contemplated purchasing an insurance policy. The financial statements revealed that the company was profitable and viable and likely to remain so in the future in the event the prospective insured sustained a covered loss. On the basis of this information, which turned out to be false, the prudent consumer purchased the insurance policy. The company then became insolvent and was placed in liquidation soon after he sustained a covered loss. The policyholder will assert that his loss, consisting of unpaid insurance proceeds, is personal and peculiar to him and that he alone may sue those responsible for preparing and auditing the financial statements on which he relied. The policyholder also will argue that he is entitled to retain any recovery. The third approach will support both positions asserted by the policyholder.

Adopting a broader view of the same scenario, assume that the same false financial statements were provided by the insurance company to the insurance department in its state of incorporation. Relying on the information contained in the statements, the department gave the company a clean bill of health and refrained from initiating any form of corrective intervention. Those who subsequently purchased insurance from the company actually or constructively relied on the department’s response; nevertheless, the company became insolvent and was placed in liquidation. The liquidator will argue that he has the exclusive right to sue those who prepared and audited the financial statements because their misconduct resulted in a common loss to the policyholders in general. The liquidator also will contend that any recovery should be treated as a general asset of the estate and distributed according to the applicable priority provision. The third approach will provide as much support for the liquidator’s position as it did for the policyholder’s.

IV. THE COMPETING PLAYERS AND THEIR RESPECTIVE POSITIONS

Liquidators, claimants, and guaranty associations compete for standing to sue those responsible for the insurer's insolvency. This competition arises because of the mechanics of the distributive priority provisions in the state insurance codes. If the liquidator is the plaintiff, any recovery will be treated as a general asset of the estate and distributed according to the insurance code's priority provision; however, if the claimants or subrogated guaranty associations are the plaintiffs, the recovery will bypass the priority provision and they will be permitted to retain the recovery.24 The positions advanced by claimants and guaranty associations are derived from self-interest.25

24. This assumption is not necessarily correct, because the concept of standing is conceptually distinct from the identity of those who have been damaged and should be compensated. It would be perfectly natural to assume that if the liquidator was granted standing to represent policyholders and creditors, any recovery would simply pass through the liquidator and inure to their benefit. Similarly, creditors and policyholders often find themselves representing the insolvent insurer's estate, where any recovery is treated as a general asset of the estate and distributed according to the applicable priority provision. This is similar to a shareholder prosecuting a derivative suit on behalf of the corporation in which he owns stock. It typically occurs when the statutorily appointed receiver improperly chooses not to sue and the court then permits a committee of claimants to sue on the estate's behalf. See, e.g., Gochenour v. George & Francis Ball Found., 35 F. Supp. 508, 517 (S.D. Ind. 1940), aff'd, 117 F.2d 259 (7th Cir.), cert. denied, 313 U.S. 566 (1941); National Bondholders Corp. v. Joyce, 276 N.Y. 92, 11 N.E.2d 552 (1937); Isaac v. Marcus, 258 N.Y. 257, 265-69, 179 N.E. 487, 490-91 (1932); Annotation, Right of Creditors or Stockholders of Insolvent Bank in Charge of Liquidating Officer Who Refuses or Fails to Enforce Liability of Third Persons to Bank, To Maintain Action for That Purpose, and Conditions of Such Right, 97 A.L.R. 169 (1935).

25. Another reason why claimants seek to prosecute their own actions is because they fear that if the liquidator acts as plaintiff, he may be subject to certain defenses that could be raised against the company but not against its policyholders and creditors. Such defenses include in pari delicto, unclean hands, equitable estoppel, the statute of limitations, and the insurance regulator's negligence. However, the policyholders' concern is unfounded. To the extent that the liquidator represents them, the policyholders' claims should not be subject to any defenses that could be raised against the liquidator acting in his capacity as statutory successor to the insolvent insurer. Even when such defenses have been interposed against the proper party, they generally have failed. Defenses based on in pari delicto or equitable estoppel are based on the principle of imputation; i.e., the wrongful acts and knowledge of the corporate agents are imputed to the corporation. Thus, in theory, the wrongful acts of the insider defendants are imputed to the insolvent insurer, and through the insurer, to the liquidator. Pursuant to the "adverse interest exception," however, such imputation does not occur when the agents act against the interests of the corporation they serve. Because of this exception, imputation defenses have failed when they have been raised by defendants sued by receivers for allegedly causing the company to fail. See, e.g., Schacht v. Brown, 711 F.2d 1343, 1346-50 (7th Cir.), cert. denied, 464 U.S. 1002 (1983); Meyers v. Moody, 693 F.2d 1196, 1207-08 (5th Cir. 1982), cert. denied, 464 U.S. 920 (1983); United States Fiduciary & Guar. Co. v. Oklahoma, 383 F.2d 417, 419-20 (10th
Conversely, the position of the liquidator, who functions similar to a stakeholder, is derived from his view as to which procedure is the most efficient way to liquidate an insurer for the common benefit of all claimants entitled to compensation.

A. The Liquidators

Liquidators act for the common benefit of those who assert legitimate claims against the insolvent insurer's estate. They seek exclusive standing to bring lawsuits against those allegedly responsible for causing the company to fail. They also argue that all recoveries should be treated as general assets of the estate and distributed according to applicable priority provisions. The typical liquidator asserts that all losses caused by such defendants injured the insurance


A statute of limitations defense fails as well because the liquidator will assert that the defendants concealed the company's true economic condition from the regulators as well as the public. By employing the discovery rule alone, or coupled with the equitable tolling doctrine, the court should hold that the liquidator's cause of action does not accrue until the date of his appointment. Meyers, 693 F.2d at 1206; see also Washburn v. Brown, No. 81-C-1476, slip op. at 3 (N.D. Ill. July 27, 1987); Investors Funding Corp., 523 F. Supp. at 548.

Finally, even assuming the regulators are negligent in failing to discover and correct the insurer's financial difficulties, this should not serve as a defense because the plaintiff will be the liquidator rather than the department or commissioner of insurance. See Corcoran v. Hall, No. 36955, slip op. at 11 (N.Y. App. Div. Aug. 17, 1989) ("[t]he law is clear that the Superintendent as Regulator and the Superintendent as Liquidator are distinct and separate legal entities"); Corcoran v. National Union Fire Ins. Co., 143 A.D.2d 309, 311, 532 N.Y.S.2d 376, 378 (1988).

This does not mean that the regulators' acts may not have a significant impact on the defendants' liability. If the insurance department's behavior is deemed a superimposing cause of the insurer's insolvency, the causal connection between the defendants' misconduct and the plaintiff's injury would be severed. Id. A related line of cases suggests that when a plaintiff is directly injured by the discretionary acts of a public agency, whose acts are based on reliance upon false information provided by the defendant, there cannot be, as a matter of law, any proximate causal connection between the defendant's statements and the plaintiff's injury. See, e.g., Matossian v. Fahmie, 101 Cal. App. 3d 128, 137-38, 161 Cal. Rptr. 532, 537 (1980); Carr v. Brown, 395 A.2d 79, 84-85 (D.C. 1978); Gordon v. Noel, 356 N.W.2d 559, 563 (Iowa 1984); Hohl v. Mettler, 62 N.J. Super. 62, 63-64, 162 A.2d 128, 130-32 (1960). But see Hoyt v. Hampe, 206 Iowa 206, 210, 214 N.W. 718, 724 (1927); Globe Woolen Co. v. Utica Gas & Elec. Co., 224 N.Y. 483, 489-90, 121 N.E. 378, 380 (1918).

Assuming the defendants are not entirely exonerated by the regulators' negligence, they will be unable to shift any part of their liability onto the government. Under the "discretionary function exception," an insurance department is immune from liability for negligently failing to uncover or correct an insurer's insolvency. Hager v. Durham, No. CL 64-37701, slip op. at 4 (D. Iowa May 5, 1989); Nordbrock v. Iowa, 395 N.W.2d 872, 876 (Iowa 1986); Gilford & Medalie, Suits Against State Insurance Commissioners for Misconduct in the Regulation and Liquidation of Insurance Companies, in 1986 A.B.A. SEC. TORT & INS. PRAC., LAW AND PRACTICE OF INSURANCE COMPANY INSOLVENCY.
company; therefore, the liquidator should have exclusive standing. Whether he sues on behalf of some or all claimants is a question that need not be addressed. 26 Regarding the approaches described above, the liquidator will ignore the first approach, reject the temporal distinction of the second approach, and adopt the broadest construction of the third approach.

If the liquidator is forced to address the first approach, he will not merely reject it as a matter of law, but also will denounce it as unrealistically hypertechnical. He will point out that, if he is not afforded the exclusive right to sue on behalf of all claimants, the public policies sought to be achieved by the liquidation laws will be defeated and the liquidation proceeding will be transformed into an administrative nightmare. 27 The liquidator, in essence, will adopt the position that the only way to truly protect policyholders and creditors is to divest them of any individual claims they might otherwise have against the defendants. He may acknowledge, as did Winston Churchill on democracy, that this is the worst way of liquidating an insolvent insurance company—except for all the others.

B. The Claimants

Policyholders, general creditors, and guaranty associations seek to broaden the scope of permissible standing in order to avoid the diminished reimbursement that occurs when a recovery by the liquidator is filtered through a priority provision. Referring to the approaches described above, they will adopt the first and second approaches and the narrowest construction of the third approach. Although their motives and arguments are essentially the same, claimants will pursue their interests with different degrees of enthusiasm, depending upon the degree to which their reimbursement will be diminished by the priority provisions, their economic wherewithal to litigate the standing dispute. If successful, they will bring separate claims against those responsible for the insurer’s demise. 28

26. This approach has succeeded in bankruptcy proceedings when the issue of standing is interposed as a defense by third parties sued by a trustee. See In re Leedy Mortgage Co., 76 Bankr. 440, 450-51, (Bankr. E.D. Pa. 1987).
27. See infra notes 97-114 and accompanying text.
One hundred and thirty-five thousand policyholders have an interest in the outcome of this litigation. Probably few, if any, of them have enough involved to warrant the expense of litigation and payment of their own counsel. They
1. Large Policyholders With Large Claims

The largest policyholders with the largest claims have the greatest incentive and financial ability to challenge the liquidator's assertion of exclusive standing. These policyholders will be more prejudiced by application of the priority provisions because they will receive less protection from the guaranty funds. It is quite possible that none of their claims will be covered by guaranty associations. Guaranty associations typically exclude coverage for losses arising under the types of insurance generally issued to well-endowed institutional policyholders: mortgage guaranty, financial guaranty, or other forms of insurance offering protection against investment risks; fidelity or surety bonds or any other bonding obligations; credit insurance; title insurance; and ocean marine insurance. Their exclusion from coverage reflects a legislative policy decision that guaranty funds are designed principally to bail out small individual and commercial policyholders and third-party claimants who may be personally and financially devastated by unreimbursed catastrophic losses. If a large policyholder with a substantial claim does not receive protection from a guaranty association, his only recourse, other than commencing a separate lawsuit, is to submit his entire claim to the insolvent insurer's estate. However, looking to the estate for reimbursement means that his recovery will be diminished by the priority provision, and he will have to wait years before receiving even partial compensation for his covered claim.

Even assuming that guaranty fund protection exists, recovery will be limited by the association's cap. The largest claims will exceed these caps, compelling the policyholder to resort to the insolvent insurer's estate to recover the deficit, and this deficiency may well represent the major portion of his claim. A policyholder with such a claim has a strong incentive to circumvent the priority provision by bringing a separate lawsuit against the defendants. In his view, to proceed under the priority provision is to needlessly subsidize the administrative expenses of liquidation, the claims of the insurer's former employees, claimants with perfected security interests, and the claims of other policyholders or subrogated guaranty associations.

are entitled to the best legal representation available, and it is the duty of the lower court to see that their interests are protected.

Id. at 619, 244 S.E.2d at 299. Thus, in an adversary proceeding in an insurance company liquidation, part of the court's function is to be an advocate on behalf of the claimants as a group. See also North Carolina ex rel. Ingram v. All Am. Assurance Co., 34 N.C. App. 517, 519, 239 S.E.2d 474, 477 (1977).

29. NAIC Model Act, supra note 16, § 3.
29. Uncle Sam, supra note 12, at 14.
30. See supra note 16 and accompanying text.
31. See supra note 16 and accompanying text.
2. Insurance Company Claimants

Many claimants will be other insurance companies as cedents or reinsurers of the insolvent company,\(^3\) or as excess insurers of the policyholders.\(^3\) Such claimants do not receive protection from guaranty associations\(^3\) and fare little better asserting claims directly against the insolvent insurer's estate. Some priority provisions expressly relegate insurance company claimants to a lower level than that reserved for policyholders, insureds, beneficiaries, third-party claimants, and guaranty associations.\(^3\) However, even when statutes are ambiguous about the priority afforded to insurance company claimants, every court that has addressed the issue has held that they shall be treated like general creditors even though their claims arise under contracts of insurance.\(^3\) Therefore, as a practical matter, in-

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\(^{32}\) The Reinsurance Association of America has described the concept of “reinsurance” in the following manner:

- If an insurer decides that it has, or may soon have, in its portfolio, more insurance risks than it wishes to retain, or than the law will allow it to retain, the insurer may seek to spread all or part of its risks to other insurers. An insurer seeking to spread all or part of its risks is known as a ceding company.
- An insurer that agrees to indemnify the ceding company against all or part of its risks is known as a reinsurer.

REINSURANCE ASS'N OF AMERICA, GLOSSARY OF REINSURANCE TERMS (1983); see also R. KILN, REINSURANCE IN PRACTICE 1-6 (2d ed. 1986).

\(^{33}\) In the event of a primary carrier's insolvency, the excess carrier may be required to “drop down” and reimburse the policyholder for that portion of his loss falling below the excess threshold, which would lead to a claim by the excess carrier against the insolvent primary insurer's estate. See P. MAGARICK, EXCESS LIABILITY: THE LAW OF EXCESS CONTRACTUAL LIABILITY OF INSURERS § 17.12 (3d ed. 1989); B. OS-TRAGER & T. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 11.03 (1988); Brady & Grogan, The Excess Drop Down Issue: When is the Excess Carrier Responsible for the Insolvency of a Primary Carrier?, 39 FED'N INS. & CORP. COUNS. Q. 63 (1988); Lanzone & Burke, The Drop-Down Liability of Excess Insurers, 18 THE BRIEF 36 (Spring 1989).

\(^{34}\) NAIC Model Act, supra note 16, § 5(6)(4) (“'Covered claim' shall not include any amount . . . due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise.”). The official comment provides, in pertinent part: “The subcommittee does not feel that coverage should be extended to elements of the insurance industry which know or reasonably can be expected to know the financial condition of various companies.” Id.

\(^{35}\) See, e.g., N.C. GEN. STAT. § 58-155.15(a)(3) (1987), which expressly exempts from level three priority “claims of insurance pools, underwriting associations, or those arising out of reinsurance agreements, claims of other insurers for subrogation, and claims of insurers for payments and settlements under uninsured and underinsured motorist coverages.” Id. This section expressly includes such excluded claims in level five, the lowest priority in the North Carolina provision. Id.

surance company claimants cannot expect to receive any reimburse-
ment from the insolvent insurer’s estate. Because they are
financially capable of litigating the standing issue and prosecuting
their own claims, it is not surprising that insurance company claim-
ants prefer to prosecute separate actions against those allegedly re-
sponsible for the insolvent carrier’s demise.

3. General Creditors

Like insurance company claimants, general creditors receive no
protection from guaranty associations and a low preference in prior-
ity provisions. Unless they have standing to prosecute their own ac-
tions, they are unlikely to receive any reimbursement for their
covered losses. Therefore, only the largest creditors with the most
substantial losses will have the financial ability to litigate the stand-
ing issue and, if successful, assert claims against third parties.

4. Guaranty Associations

Guaranty associations may recoup their losses from the insolvent
insurer’s estate. They receive the same preference level as their sub-
rogors; i.e., policyholders, insureds, beneficiaries, and third-party
claimants. However, because their constituents are insurance compa-
nies, they possess the financial ability to litigate the standing issue
and to bring separate actions against those responsible for the insur-
ance company’s insolvency. In terms of competition within the insur-
ance industry itself, this is preferable to recouping a deficit by
surcharging policyholders or increasing premiums on policies sold in
the future.

V. THE STATE STATUTES AND THEIR CONSTRUCTION

Most insurance company insolvency laws are based on one of two
model acts: (1) the Uniform Insurers Liquidation Act (UILA),37
promulgated in 1939 by the National Conference of Commissioners
on Uniform State Laws and the American Bar Association; or (2) the
Insurer’s Supervision, Rehabilitation, and Liquidation Model Act
(NAIC Model Act),38 originally promulgated in 1969 by the National
Association of Insurance Commissioners (NAIC). Both model acts
empower the liquidator to sue on behalf of the insolvent insurer.39
However, they address differently the question of whether the liqui-

1988).
38. The NAIC Insurer’s Supervision, Rehabilitation and Liquidation Model Act is
TORT & INS. PRAC. 151-84 [hereinafter NAIC Insurer’s Model Act].
ator has standing to sue third parties on behalf of the insolvent insurer's policyholders and general creditors.\textsuperscript{40} The UILA empowers the liquidator to avoid preferential transfers of the insurer's assets on behalf of its policyholders and creditors.\textsuperscript{41} Beyond this single exception, the UILA is silent on the liquidator's right to litigate on behalf of such claimants. In contrast, the NAIC Model Act provides that "[t]he liquidator shall have the power . . . [t]o prosecute any action which may exist on behalf of the creditors, members, policyholders or shareholders of the insurer against any officer of the insurer, or any other person."\textsuperscript{42}

The dichotomy inherent in the model acts regarding the liquidator's standing is reflected in the state statutes based on these models. Thus, the liquidation statutes in New Jersey and New York, modeled on the UILA, are silent as to third-party standing except for empowering the liquidator to avoid fraudulent transfers of the company's assets on behalf of its policyholders and creditors.\textsuperscript{43} In contrast, liquidation laws based on the NAIC Model Act, such as those in Indiana, Iowa, and Wisconsin, expressly empower the liquidator to prosecute all actions on behalf of creditors and policyholders of the defunct insurer.\textsuperscript{44}

The UILA has been adopted in thirty states and territories; ten states have adopted the NAIC Model Act.\textsuperscript{45} The most likely reason for the discrepancy is that the UILA existed for thirty years prior to

\begin{itemize}
\item 40. For history of the model legislation, see Veach, \textit{Delinquency, Rehabilitation and Liquidation Proceedings under the NAIC Model Act and State Statutes}, in \textit{RIGHTS AND STRATEGIES IN INSURANCE/REINSURANCE INSOLVENCIES} (Executive Enterprises, Inc., Seminar Materials, May 4-5, 1989).
\item 42. NAIC Insurer's Model Act, supra note 38, § 21(A)(13).
\item 43. N.J. STAT. ANN. § 17:30C-25 (West 1985); N.Y. INS. LAW § 7425(c) (McKinney 1985).
\end{itemize}
the original formulation of the NAIC model. As a result, in the majority of jurisdictions, statutes are silent about the liquidator's authority to pursue claims on behalf of the insolvent insurer's policyholders and creditors. Moreover, when traditional rules of statutory construction are applied to these "silent" statutes, it appears that claimants should be afforded the right to sue those responsible for the insurer's insolvency unless the cause of action involves retrieval of diverted assets of the estate.

The rules of statutory construction are few and simple. First, it should be presumed that if a legislature is intent on accomplishing a particular result, it will do so in clear and unmistakable language. If a legislature in a UILA state wished to empower the liquidator to pursue all claims belonging to policyholders and creditors, accomplishing this objective would be relatively easy. The ease should have considerably increased after 1969, when the NAIC Model Act demonstrated precisely how simple it was to accomplish this goal. Therefore, the silence of the UILA statutes indicates they were not intended to broaden the scope of the liquidator's standing. This argument becomes even stronger when it is noted that the UILA carves out a single exception (i.e., preferential transfers) in which the liquidator may act on behalf of the insolvent insurance company's claimants. Common sense suggests that the inclusion of one exception implies the exclusion of all others. This notion is virtually enshrined in the law of statutory construction through the doctrine of expressio unius est exclusio alterius.

Second, when an area of the law is imbued with public interest

46. Howard, supra note 3, at 15.


However, an alternative explanation exists for carving out a single exception for voidable transfers. Under normal circumstances, creditors have the right to recover such transfers on behalf of the corporate entity. The corporation is not expected to recover its own fraudulently transferred assets because its own managers usually have been responsible for the decision to improperly deplete the corporate assets. Under this context, the exception for voidable transfers merely harmonizes the liquidation law by clarifying that the liquidator of an insolvent insurance company has exclusive standing to prosecute all actions that seek to recover assets of the estate, including voidable transfers.

49. Insurance is undoubtedly such an area of the law. See California State Auto. Ass'n Inter-Ins. Bureau v. Maloney, 341 U.S. 105 (1951); United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944); German Alliance Ins. Co. v. Lewis, 233 U.S. 369 (1914); see also infra notes 97-103 and accompanying text.
and subject to intense and comprehensive regulation, courts should be more reserved in contracting or expanding the language of the statute. To deviate from the statutory language may result in proscribed judicial legislation. A related principle is that legislative intent should not be considered unless the statutory language is facially ambiguous.

These statutory construction rules imply that a claimant seeking to assert his own lawsuit against a carrier's "killers" would obtain standing in a UILA state. However, this assumption is not correct. Although such arguments have prevailed on numerous occasions in the past, they have failed an equal number of times. The deci-

50. Dunkin' Donuts of Am. v. Middletown Donut Corp., 100 N.J. 166, 183, 495 A.2d 66 (1985); Fail at Liquidating, supra note 12, at 45-51. The pejorative term "judicial legislation" is especially prone to be leveled against liquidation courts because many insurance company liquidation laws expressly provide for their own exclusivity. See, e.g., N.J. STAT. ANN. § 17:30C-3 (West 1985) ("Delinquency proceedings pursuant to this act shall constitute the sole and exclusive method of liquidating ... an insurer ... ").


Plaintiffs contend that if the legislature had intended to make the remedy under [the statute] exclusive, it should and would have said so specifically and expressly. . . . However, we are aware of no rule which requires the legislature to signify its intent in only one way. While we must decide the case on the basis of what the legislature did say in the relevant statutes, rather than what it should or might have said, we are also obligated, whatever the form of the statutes, to consider their subject matter, reason, consequence, and spirit in order to identify and give effect to the legislative purpose.

Id. at 389; see also Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("The starting point in every case involving construction of a statute is the language itself."); United States v. Demko, 385 U.S. 149, 151-52 (1966); Aubrey v. United States, 254 F.2d 768, 772 (D.C. Cir. 1958).


sions are of limited value because, until quite recently, opposing arguments did not focus on the express grants of authority in the applicable statutes. Parties preferred to argue on the basis of broad, vague concepts such as public policy and administrative feasibility, or to opine as to legislative intent without reference to statutes or legislative history. Liquidators, in particular, adopted the habit of citing to a litany of cases in which the decisions would, in dicta, advocate the liquidator's exclusive right to prosecute lawsuits on behalf of all interested parties. However, a close examination revealed that most of these cases involved efforts by liquidators to recover diverted assets of the insolvent insurer's estate. Thus, even if courts had focused on, and strictly construed, the applicable statutes, they would have ruled in favor of the liquidators, given the nature of the causes of action being pursued.

Recently, statutory construction has advanced to the forefront of the dispute on motions to dismiss liquidators' lawsuits by both defendants and claimants who are seeking leave to prosecute their own lawsuits. The movants' main arguments consist of a detailed examination of the applicable liquidation law, followed by the invocation of traditional principles of statutory construction. Such arguments were recently advanced in two lawsuits involving liquidations under state laws modeled on the UILA: Merin v. Yegen Holdings Corp. and


In addition to the issues raised in the moving papers, the parties should brief the issues of whether the Chancery Division should be directed alternatively to determine whether a class action should be certified or other case management techniques utilized on behalf of all policyholders, and prosecuted by one other than the liquidator. (The recovery against Touche Ross in such a class action would be subject to the condition that each claimant prove his, her or its reliance upon any financial statement shown in such action to have been improperly or negligently prepared by Touche Ross).

The granting of this motion shall not deprive the trial court of jurisdiction to consider alternative management techniques, and to supplement the record if necessary with any amended orders and the reasons therefor.

Id.; see Integrity Liquidator Asks Court to Deny Touche Ross Appeal, 1 MEALEY'S LITIG. REP.: INS. INSOLVENCY, July 19, 1989, at 19-21; Touche Ross Petitions for Appeal in Integrity RICO Suit, 1 MEALEY'S LITIG. REP.: INS. INSOLVENCY, July 5, 1989, at, 7-9. Appellate oral argument took place on January 18, 1990; a decision has yet to be rendered.
Corcoran v. Hall. In both cases, the liquidators prevailed. Although the trial courts relied partially on considerations of public policy and administrative efficiency, the briefs submitted by the parties compelled them to address the applicable statutes and their interpretation.

Merin arose as a result of the 1987 liquidation of Integrity Insurance Company (Integrity), a stock insurance company organized under the laws of New Jersey. New Jersey's Commissioner of Insurance, in his capacity as Integrity's liquidator, commenced an action against the company's former directors and officers, its parent holding companies and their directors, and its independent auditor, Touche Ross & Co. He asserted that all defendants were jointly and severally liable for causing the insurance company to fail. The amended complaint alleged negligence, negligent misrepresentation, breach of fiduciary duty, fraud, waste, diversion of corporate assets, illegal declarations of dividends, violation of the state's anti-racketeering law, and consumer fraud against the insider defendants. The awarded complaint also alleged breach of contract, negligence, negligent misrepresentation, fraud, violation of the state's anti-racketeering law, and consumer fraud against the independent auditor.

The claims were easily susceptible to bifurcation under the first approach described above. The charges of negligent mismanagement, waste, diversion, and illegal declarations of dividends asserted that the insider defendants had devalued the company by improperly depriving it of assets. The claims against the insider defendants for fraud and negligent misrepresentation (and all claims against the auditor except for breach of contract) were based on the common assertion that the defendants prepared, approved, and disseminated false financial statements and reports which concealed the insurer's true financial condition, and allowed it to continue writing insurance policies from the time it became insolvent until it was placed in liquidation. This misconduct did not deprive the company of its own property, but rendered it incapable of paying covered claims and satisfying commercial debts.

59. Id.
60. Id.
61. Id.
The claims could also be bifurcated under the second approach depending on whether the alleged misconduct and resulting loss occurred before or after the company became insolvent. The liquidator alleged that Integrity was statutorily insolvent at least five years before being placed in liquidation.

The insider defendants moved to dismiss all claims based on equitable and actual fraud, and the auditor moved to dismiss all but the breach of contract claim. They asserted that such claims belonged exclusively to the policyholders and creditors, and that they had the exclusive right to assert these claims. In support of their motions to dismiss, the defendants engaged in a detailed examination of New Jersey's liquidation law, based on the UILA model. They noted that the statute empowers the liquidator to prosecute actions on behalf of the insurer to recover its property, and to recover fraudulent transfers of the carrier's assets even if the law would otherwise allow the creditors to litigate such claims. However, the statute was significantly silent on any other form of third-party standing. Thus, the defendants contended that, pursuant to traditional rules of statutory construction, the liquidator had no standing to prosecute claims based on the preparation and dissemination of false financial statements.

The trial court rejected this position by coupling alternative statutory provisions with concepts of public policy and administrative feasibility. It placed particular emphasis on the statutory provision empowering it to grant "such other relief as the nature of the case and the interests of the policyholders, creditors, stockholders, members, subscribers, or the public may require."62 This provision was treated as a broad grant of power, similar to the wide, flexible powers traditionally reposed in a court of equity to accomplish what is fair under any circumstance. Because the trial court believed that the interests of the policyholders and creditors would be promoted by granting the liquidator standing to sue on behalf of Integrity's policyholders and creditors, it concluded that it was statutorily empowered and obligated by this provision to vest third-party standing in the liquidator.63

The trial court also relied on another provision in the statute which empowered it to issue injunctions and any other orders necessary to prevent interference with the liquidation proceeding or the creation of preferences among claimants.64 If each claimant could

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64. N.J. STAT. ANN. § 17:30C-5b (West 1985). This subsection provides:

The court may, at any time during a proceeding under this act, issue such other injunctions or orders as may be deemed necessary to prevent interference with the commissioner or the proceeding, or waste of the assets of the insurer, or the commencement or prosecution of any actions, or the obtaining
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commence a separate lawsuit against the same parties being sued by
the liquidator, this would certainly interfere with the liquidation.
Moreover, because claimants who proceeded separately might obtain
a full recovery on their losses, whereas those who proceeded through
the estate would at best receive a diminished pro rata share, the for-
mer would obtain preferential treatment as compared to the latter.
Therefore, the court concluded that it was expressly authorized to
stay such separate actions.65

However, to merely stay parallel proceedings, while allowing
the liquidator to proceed on behalf of the estate, would delay liquidation
by creating the potential for piecemeal recovery and a second wave of
litigation. Moreover, if the second wave was precluded by the results
in the initial litigation (based on res judicata or collateral estoppel),
the ultimate result might be a windfall for the defendants at the in-
solvent victims' expense. Therefore, the trial court construed its
powers to enjoin individual lawsuits, and to act in the best interests
of all claimants, as justification for allowing the liquidator to prose-
cute all claims against the defendants, regardless of whether the
claims belonged to the insurance company or its creditors.66

New Jersey's Chancery Division countered by interposing certain
statutory provisions against those invoked by the defendants. The
provisions accentuated by the chancery court were those which pro-
vided the greatest degree of discretion in resolving disputes that
might arise during a liquidation proceeding. By emphasizing these
provisions and ignoring others, the court was able to treat the entire
liquidation statute as a suggested format rather than a detailed
formula. It advocated varying the formula's components, provided

65. An analogous case, in the bankruptcy context, is In re S.I. Acquisitions, Inc.,
817 F.2d 1142, 1150-52 (5th Cir. 1987), in which the court enjoined creditors from suing
the debtor's nonbankrupt principals because the cause of action involved property of
the debtor's estate and thus was only assertable by the trustee. See Annotation, Stay
by Bankruptcy Court of Action Against Debtor's Liability Insurer, 93 A.L.R. FED. 102
(1989).

66. Other courts have dealt with the "second wave" concept differently. For ex-
ample, in Hartford Casualty Ins. Co. v. Borg-Warner Corp., No. 88-C-0783, slip op. at 3-
6 (N.D. Ill. Apr. 18, 1989), the court dismissed a separate action by an insolvent in-
surer's creditor on ripeness grounds, ruling that the amount of its claim could not be
determined until its distribution from the insolvent's estate was deducted from its total
loss.
such variations were neither *expressly* prohibited by law nor contrary to the underlying legislative intent. The chancery court's object was to creatively achieve equitable results on a case-by-case basis, rather than to stringently adhere to the same formula in each liquidation proceeding. Thus, the *Merin* decision may be limited to the liquidation of Integrity Insurance Company and may even be further limited to the scenario that existed when the decision was rendered. For if the chancery court was truly endowed with as much power and discretion as suggested by its decision, it also would have the power to vacate that decision in the future, based on new or altered circumstances, and allow all or some policyholders and creditors to prosecute lawsuits on their own behalf.

67. Perhaps the most comprehensive and eloquent statement of the breadth of a court's powers in an insurance company delinquency proceeding was provided by the decision in North Carolina *ex rel.* Ingram v. All Am. Assurance Co., 34 N.C. App. 517, 239 S.E.2d 474 (1977):

> The applicable statutes are clear as to purpose, nebulous as to procedure and generally silent as to powers of the court in accomplishing the purpose of the rehabilitation. The control of the insurer company is transferred to the Commissioner as rehabilitator, but if the power of the court in rehabilitation is narrowly limited by a literal interpretation of the statutes, the objective of receiving and protecting the insurer, its creditors, the insured and the public could not be accomplished. The court must have broad supervisory power in order to deal effectively with the many and varied situations that are likely to arise in rehabilitation proceedings. The statutory language reflects this purpose and the need for judicial supervision over the rehabilitation proceedings, and guides us in determining the authority of the court... Under the statute the Commissioner as rehabilitator has discretionary as well as ministerial powers. Clearly also the court has broad supervisory powers and must also be held to have broad initiative powers as well so as to effect the mandate of such provisions as [the one directing] the court after full hearing to deny or grant the application for rehabilitation 'together with such other relief as the nature of the case and the interests of policyholders, creditors, stockholders, members, subscribers or the public may require.' The court is the final protector of those interests most jeopardized by an insurance company's financial instability, and we see no reason to assume that the broad mandate above quoted does not cover the court's actions in the instant case. [*Id.* at 520-21, 239 S.E.2d at 476-77 (citation omitted).]

68. The court subsequently vacated a portion of its decision by granting limited rights of intervention to a policyholder-claimant. However, this decision was made before the court memorialized its opinion on standing in a formal order. Thus, when the court signed an order on the standing issue, it provided the liquidator with "nonexclusive" standing to represent Integrity's policyholders and general creditors. Nonetheless, the court's partial retreat from exclusivity should not be overestimated because the intervenor's rights were quite limited. The intervenor could attend depositions but could not propound questions; the intervenor could not be interrogated by any defendant about its claims; the intervenor was not granted the right to attend settlement conferences, although it could obtain copies of all filed documents at its own expense; and if the liquidator asked the court to approve a settlement with one or more of the defendants, the intervenor must receive notice and have an opportunity to be heard about the settlement. It is questionable whether such limited intervention rights provide the policyholder with any opportunities it would not otherwise be entitled to even if it was not an "intervenor-plaintiff." *See, e.g., A. APPLEMAN, supra* note 17, § 10654. A more interesting question is whether the intervenor would be deemed a "party" for res judicata purposes regarding any settlement or judgment obtained by
The opinion in Merin is undoubtedly subject to criticism. The court evidently ignored many conventional principles of statutory construction and, by focusing on only two discrete sections of the statute, breached the time-honored rule that statutes should be construed so that each and every provision is given effect.\textsuperscript{69} In addition, the court's broad construction of its power to act for the benefit of policyholders and creditors renders the statute's exclusivity provision superfluous.\textsuperscript{70}

Finally, the court's transformation of the power to enjoin parallel proceedings into the power to alter the rules of standing may be characterized as overreaching. Although the consequence of an injunction may often be more devastating to a plaintiff than divestiture of his claim, an injunction merely maintains the status quo. However, true divestiture could be accomplished only if the liquidator was not merely afforded the right to proceed on behalf of the claimants, but could also treat recoveries as general assets of the estate to be distributed pursuant to the statute's priority provision. The court was sensitive to this distinction and expressly refused to decide the procedure to distribute recovery:

\begin{quote}
the liquidator from (or against) any of the defendant parties. New Jersey's Appellate Division evidently doubted the propriety of this compromise resolution when granting the defendants' motion for leave to appeal from the trial court's dispositions on standing and intervention, as it suggested that alternative case management techniques be utilized.


\textsuperscript{70} "Delinquency proceedings pursuant to this Act shall constitute the sole and exclusive method of liquidating . . . an insurer . . . ." N.Y. STAT. ANN. § 17:30C-4a (West 1985). The Bankruptcy Code also contains a provision empowering the court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a) (1982). Notwithstanding this seemingly open-ended grant of discretionary power, bankruptcy courts have not been allowed to use the provision as a basis for creating procedures proscribed by other sections of the Code, or even where the Code is silent. See Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987), cert. denied, 108 S. Ct. 1228 (1988). The Mabey court noted:

While the equitable powers emanating from § 105(a) are quite important in the general bankruptcy scheme, and while such powers may encourage courts to be innovative, and even original, these equitable powers are not a license for a court to disregard the clear language and meaning of the bankruptcy statute and rules.

The other benefit of [granting exclusive standing to the liquidator] is that the Liquidator bringing the action, if successful, will increase the estate available for distribution, whether it be by the direct payment of some individual policy or claimant, or as payment into the general estate. . . . This decision does not deal with who or where the proceeds of any recovery would go, that is directly to some creditor, policyholder or claimant or to the general estate. That issue can wait to be resolved at the appropriate time.71

Based on the court’s comments,72 as well as from a practical viewpoint, granting exclusive standing to the liquidator probably means that any recovery will be treated as a general asset of the estate to be distributed pursuant to the statute’s priority provision. However, from a theoretical perspective, the court correctly distinguished between two entirely separate concepts: (1) standing, which addresses only the identity of the proper party plaintiff; and (2) asset recovery and distribution, which analyzes who has been damaged and who owns the claim. Therefore, Merin stands for the limited proposition that the liquidator has standing to prosecute claims on behalf of the insolvent insurance company’s policyholders and creditors. To extract more from the decision would be to misread the opinion and to do a disservice to the court.

The trial court opinion in Corcoran v. Hall73 may well exemplify the least satisfactory method of achieving essentially the same result. In Hall, New York’s Superintendent of Insurance, as liquidator of Union Indemnity Insurance Company (Union Indemnity), sued the insurer’s directors, officers, parent corporations, affiliates, and independent auditor, alleging joint and several liability for causing the insurer to fail. The causes of action asserted in the liquidator’s complaint were essentially the same as those asserted by Integrity’s liquidator in Merin. Soon after the action was commenced, a group of guaranty associations and a group of cedents brought actions against the same defendants, asserting essentially the same claims and seeking virtually identical relief.74 The three actions were consolidated,

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72. See supra notes 62-71 and accompanying text.


74. Conspicuously absent from these types of actions are claims based on consumer fraud statutes, which typically allow for private causes of action against those who make material misrepresentations in connection with the advertisement or sale of merchandise or services. Since many courts have held that insurance policies are covered by these laws, they should afford an excellent basis for claims based on misrepresentations of the insurance companies’ financial condition. See Doyle v. St. Paul Fire & Marine Ins. Co., 583 F. Supp. 554 (D. Conn. 1984); McCarter v. State Farm Mut. Auto. Ins. Co., 130 Ill. App. 3d 97, 473 N.E.2d 1015 (1985); Stevens v. Motorists Mut. Ins. Co., 759 S.W.2d 819 (Ky. 1988); Dodd v. Commercial Union Ins. Co., 373 Mass. 72, 365
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WHEREUPON the defendants moved to dismiss portions of the liquidator's action for lack of standing; the liquidator moved to dismiss or stay the other two lawsuits on the ground that he possessed paramount and exclusive standing to sue the defendants.

New York's rehabilitation and liquidation law, based on the UILA model, contains essentially the same provisions as the parallel New Jersey statute. Among other things, the New York statute empowers the court to grant "such other relief as the nature of the case and the interests of policyholders, creditors, shareholders, members, or the public may require," and to issue injunctions and other orders to prevent interference with the liquidation proceeding or the obtaining of preferences. The trial court held that the liquidator possessed exclusive standing to prosecute claims on behalf of Union Indemnity's policyholders and creditors. Therefore, it denied the defendants' motion to dismiss the liquidator's lawsuit and stayed prosecution of the actions commenced by the guaranty associations and cedents. However, the court made no effort to overcome the statutory arguments advanced by those opposing the liquidator's standing, even though the New York statute provided the same ammunition used by the Merin court.

Rather than attempting to use portions of the statute to achieve its result, the Hall court merely noted that the insolvency law empowers the liquidator to act on behalf of claimants in recovering fraudulent transfers of the insurer's assets, and this alone supports the proposition that the legislature intended to grant exclusive standing to the liquidator to seek redress on behalf of all who had been injured by the defendants. If carving out this single exception was an indication of anything, it demonstrated that the legislature did not intend to interfere with the claimants' rights to prosecute claims (i.e., those


75. N.Y. INS. LAW § 7417 (McKinney 1985).
76. Id. § 7419(b).
77. Hall, No. 5273-87, slip op. at 2.
78. Id. at 6-11.
not involving diversion of the corporate assets) on their own behalf. Although the *Hall* court did refer to case law, virtually every case either upheld the liquidator's right to prosecute actions for the recovery of *estate assets* or simply articulated broad principles involving public policy, administrative efficiency, and general functions of liquidation statutes separate from statutory construction.

The trial court impermissibly equated the liquidator's undisputed function of acting for the benefit of claimants with his purported statutory right to sue on their behalf. The court drew this conclusion without providing the necessary link: that exclusive standing was essential to maximize the benefits ultimately received by such claimants. It is significant that the court devoted comparatively little attention to the standing issue, even though it was acknowledged to be the principal question involved in the consolidated motion. Moreover, the attention devoted to standing consisted of lengthy quotations from the court's own liquidation order, which, like the comparable order in *Merin*, had evidently co-opted NAIC Model Act language by granting the liquidator standing to sue on behalf of all policyholders and creditors. This is inexplicable as in each case the movants sought to rescind these portions of the liquidation order on the ground that they exceeded the court's statutory authority. Using its own liquidation order as an authoritative source for the powers being challenged is unjustified.

It is difficult to explain the motivation behind the New York Supreme Court's adoption of the approach in *Hall*. Perhaps the court knew the decision it wished to reach, but at the same time felt that such a disposition could not be justified by properly construing the applicable statute. Rather than using specific statutory provisions to achieve its results, thereby abandoning well-established principles of statutory construction, the court rendered what it believed to be the correct decision, and then turned the case over to the New York Appellate Division. If the trial court reached the correct result, it undoubtedly did so for the wrong reasons. Nevertheless, in refusing to manipulate the statute, the New York trial court may have been somewhat less disingenuous than its New Jersey counterpart.

*Hall* was affirmed by the New York Appellate Division on August 17, 1989. In essence, the appellate court rewrote the trial court's de-

79. *See supra* notes 47-48 and accompanying text.


cision, eliminating the problems it contained. Regrettably, the court did not treat the issue of standing as the linchpin of its affirmance. In holding that mounting debts that arise after insolvency injure the insurance company itself, the court ruled that creditor standing was not the fundamental issue on appeal:

The [trial] court’s finding that the Superintendent has standing to pursue even claims of creditors and policyholders exclusively is not necessary to our affirmance since, even if the Superintendent did not have such comprehensive standing in this case, all the causes of action in the Superintendent’s complaint belong to Union. Therefore, the Superintendent, standing in Union’s shoes, can assert these causes of action.

The court was judicious in shifting the focus away from the standing issue, leaving for another day a dispositive answer as to whether an insurance company’s liquidator may sue third parties on behalf of the insolvent’s policyholders and creditors. Thus, the New York civil practice rules create a negative impact on further proceedings concerning the company’s estate. New York law provides that a final order of the appellate division is appealable as a matter of right to the court of appeals if the appellate disposition directly impacts on rights granted by either the United States or New York State Constitutions. In the absence of a direct impact on any constitutional rights, an appellate disposition is appealable as a matter of right only if at least two justices dissent from the decision. Because the appellate disposition in Hall was unanimous, in the absence of constitutional issues, the standing issue cannot reach New York’s highest court unless leave to appeal is granted, which is a highly unlikely prospect.

Assuming leave to appeal were sought and denied, an appeal as a matter of right to the United States Supreme Court would lie only if the state court’s decision rested on constitutional grounds, invalidated

82. Id., slip op. at 14-15.
83. Id., slip op. at 12. The appellate court also shifted the focus away from creditor standing by defining the issue to be adjudicated on appeal:

The main issue on this appeal is whether the Superintendent of Insurance as Liquidator has standing to maintain his action on behalf of Union as against the third parties. An ancillary issue is whether the Superintendent as Liquidator also has exclusive authority to bring actions “belonging” to the creditors of the insolvent third parties.

Id., slip op. at 5 (emphasis in original). In fact, there had never been a dispute about whether the liquidator was empowered to litigate on behalf of the insolvent insurance company. On the contrary, his right to sue on behalf of Union Indemnity’s creditors was always the main issue.

85. Id. § 5601(a).
86. Id. § 5602.
a statute, or both. Otherwise, the only way to reach the highest court in the land would be by petition for writ of certiorari. The likelihood that such a petition would be granted is remote. Given that a liquidator's standing to sue third parties on behalf of creditors implicates constitutional rights, New York's appellate court evidently equivocated in order to ensure that its decision would be the final disposition. Thus, the appellate court's opinion most likely will be the last words spoken on the standing issue, at least in the Hall case.

Although it refused to base its affirmance on a determination of whether the New York statute empowered the liquidator to sue on behalf of Union Indemnity's policyholders and creditors, the New York Appellate Division was not silent on this issue, although its lengthy comments may be viewed as dicta. The court expressly stated that "the Superintendent ha[s] paramount and exclusive standing to assert claims not only on behalf of Union, but also on behalf of its policyholders and creditors." It arrived at this conclusion by examining state insurance company insolvency laws and case law, and finding that their preeminent purposes—equity and efficiency—could not be achieved if each claimant were allowed to bring his own action against those allegedly responsible for causing the insurer's demise. Appellants' expressio unius argument was quickly disposed of on the grounds that: (1) the narrow construction of the statute would "impermissibly narrow[] the intent and scope of the Insurance Law"; and (2) the statute did not expressly provide that the liquidator could not sue on behalf of policyholders and creditors. Concerning statutory construction in general, the court noted that it is necessary to "look to the enactment as a whole, to discern 'the purpose and policy underlying the statute, and [give] the words meaning which serves, rather than defeats, the ends intended by the legislature.'"

The court also relied on the statutory provisions empowering the liquidation court to grant the relief necessary to protect creditors and to issue injunctions or other orders necessary to prevent interference with the liquidation proceeding or preferential treatment by one or more claimants. Finally, the court noted that the liquidator was asserting "general creditor claims possessed by all of Union's creditors and policyholders" rather than claims personal and peculiar to individual claimants. In sum, the dicta by New York's Appellate Divi-

88. Id. § 1254(1).
90. Id. at 7-11.
91. Id. at 9.
92. Id. at 9-10.
93. Id. at 10 (citations omitted).
94. Id. at 10, 18.
95. Id. at 8. The court subsequently retreated somewhat from this position, noting
sion in Hall is very similar, if not functionally identical, to the opinion rendered by New Jersey's Chancery Division in Merin.

In retrospect, Merin and Hall may be viewed as good decisions when considered in a broader context. The jurists responsible for the decisions will be viewed as courageous. The easiest and safest approach would have been to apply conventional rules of statutory construction to divest the liquidator of his role as party plaintiff. However, given the legislative intent behind the liquidation laws, the public policies the laws sought to achieve, and the realistic ramifications of multi-plaintiff standing, such a disposition would have spelled disaster for liquidation proceedings and policyholders.

VI. LEGISLATIVE INTENT: PUBLIC POLICY AND ADMINISTRATIVE EFFICIENCY

A. Public Policy

The insurance industry is one of the most highly regulated industries in history: "The state's regulatory scheme relates to the entire life of the particular insurance business, from the birth of a new insurance business through its activities and productive years and through the business's dissolution and death."97 The government's "cradle to the grave" involvement in every aspect directly or indirectly related to insurance is understandable, as nearly every human

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that "[e]ven though the conduct of the defendants might have constituted independent wrongs both against Union and also against the plaintiffs in Actions Nos. 2 and 3 [i.e., the lawsuits by the guaranty associations and cedents], all of the claims are, nevertheless, inextricably interwoven with the allegations . . . of . . . ongoing fraud." Id. at 17-18. Rather than dismissing the actions by the guaranty funds and cedents, the appellate court affirmed the trial court's stay of the lawsuits pending disposition of the liquidator's action. Id. It is speculation as to whether the court was inviting the claimants to subsequently sue the same defendants for those losses that were not recovered from the insolvent insurer's estate.

In defining "assets of the estate," the court essentially dismissed the analytic conundrum as specious:

Defendants, in effect, are asserting that the Superintendent may bring creditor claims involving assets improperly diverted from Union, but not creditor claims for liabilities improperly imposed upon Union. However, the liabilities imposed by defendants, as alleged by the plaintiff Superintendent, did as much harm to Union, its creditors, and policyholders as would an embezzlement of its assets.

Id. at 9.

96. See infra notes 104-14 and accompanying text.

being and every transaction between or among humans in this culture has insurance implications. Transferring and spreading risk by purchasing insurance avoids catastrophic losses and prevents people from becoming economically devastated as a result of direct loss or liability to others.\textsuperscript{98}

Because insurance and promotion of the public welfare are inextricably intertwined, the failure of an insurance company is a disaster of the highest magnitude. It threatens to disrupt the very fabric of our society. Although many laws are designed to prevent such failure, insolvency continues to occur. When insolvency occurs, state guaranty associations and liquidation laws are the only methods to shield policyholders from the total vulnerability which occurs in the absence of insurance protection. State laws relating to insurance company insolvency are designed as substitutes for the protection otherwise afforded by insurance.

Few would dispute that insurance laws are designed to protect the public. The question is whether certain segments of the public deserve or need greater protection than others. Courts and legislatures have long held that policyholders and third-party claimants need the most protection, with the “average” policyholder deserving and requiring the greatest protection.\textsuperscript{99} This view is supported by several reasons, although some would deem it paternalistic.

First, small policyholders and third-party claimants are much more likely than their institutional counterparts to be devastated by an uncompensated loss. Second, large policyholders are better equipped to avoid insolvency-related losses because at the time they purchase insurance they have the resources necessary to evaluate the future economic viability of the carriers they select.\textsuperscript{100} Third, large commercial

\textsuperscript{98} Oklahoma Benefit Life Ass’n v. Bird, 192 Okla. 288, 292, 135 P.2d 994, 997 (1943) ("Insurance companies have come to be looked upon as at least quasi-public in nature, subject to state control for the general benefit of not only the policyholders but of the public."); R. Keeton & A. Widiss, supra note 97, at 1-3, 8-13; Howard, The Swan Song of Dishonest Duck: A Prototype for Analyzing Cover Under the Bankers Blanket Bond, 20 Loy. U. Chi. L.J. 81 (1988).

\textsuperscript{99} See Foremost Life Ins. Co. v. Dep’t of Ins., 274 Ind. 181, 188, 409 N.E.2d 1092, 1096 (1980) ("[I]t was clearly the intention of the legislature to protect the ordinary insurance consumer."); Aetna Casualty & Sur. Co. v. Int’l Reinsurance Corp., 117 N.J. Eq. 190, 203, 175 A. 114, 123 (1934) ("[T]he reasonable presumption [is] that the purpose of the legislature was to protect the general public—the ordinary citizens who bought 'policies' and who would have little or no opportunity to have or obtain knowledge as to the solvency or financial responsibility of insurance companies ... "); North Carolina ex rel. Long v. Beacon Ins. Co., 87 N.C. App. 72, 77, 359 S.E.2d 508, 511 (1987) ("[T]he primary purpose of such regulatory laws is protection of the insuring public ... [which] clearly does not have equal knowledge or resources at [its] disposal in [its] dealings with the business of insurance."); Neff v. Cherokee Ins. Co., 704 S.W.2d 1, 5 (Tenn. 1986) (noting that the “ability to fend for themselves is not ordinarily within the grasp of direct policyholders”).

\textsuperscript{100} In addition, creditors, as opposed to policyholders, can “avoid the eventual consequences of the insurer’s insolvency by refusing to extend credit, or they can mini-
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insureds, including insurance companies, can spread their losses by passing them onto the public in the form of higher prices for goods and services, or higher premiums for insurance policies. Even if they sustain substantial losses, they are diluted into virtual invisibility by being spread throughout society at large. In contrast, the family whose house is destroyed in a tornado, or the pedestrian crippled for life after being struck by an automobile, has no ability to deflect his personal loss onto others.

Solicitude for the small policyholder is the reason why the aforementioned statutory provisions provide a comparative disadvantage to well-endowed insureds and nonpolicyholder claimants. It also explains why guaranty associations do not cover the claims of general creditors or insurance company claimants; why they impose relatively modest caps on covered claims; why they do not provide coverage for claims arising under the types of insurance policies purchased by well-endowed institutions or individual investors with risk capital to spare; and why priority provisions give general creditor claimants and insurance company claimants comparatively unfavorable preferences.

Cases that construe insurance company insolvency laws emphasize that all policyholders occupying the same statutorily-defined category should be treated alike, and that preferences and races to the courthouse should be avoided because they are inevitably obtained or won by the swiftest, which in this context means the richest. Courts implicitly adopt the position that when a policyholder files a proof of claim with an insolvent insurer’s estate, he has submitted himself to the jurisdiction of the liquidation court and the procedures contained in the applicable statute, including the priority provision.101 Separate


This is very specific legislation which should be deemed to take precedence over general legislation or court rules as to standing to bring a suit. Taken together these procedural provisions, together with the general intendment of the act that the liquidator be in charge of the entire liquidation proceedings, indicate a clear legislative intent that the liquidator have exclusive jurisdiction to consider all claims for any moneys under his control before claimants have access to the court.

actions by well-endowed policyholders threaten to create impermissible preferences because such claimants may obtain full reimbursement for their losses while their fellow claimants are relegated to partial distributions from the assets of the estate. Not only would this defeat the principal purpose of the insolvency laws (i.e., to elevate the degree of protection afforded to average policyholders and third-party claimants), but it also would compel the most needy claimants to bear the full brunt of subsidizing claims that receive more favorable treatment under the statutory formulations (i.e., administrative expenses, wage claims, and secured claims perfected prior to liquidation).

Courts view the initiative in favor of separate and independent actions as selfish attempts to defeat or short-circuit the public policies sought to be achieved by state legislatures through liquidation laws, especially their priority provisions. Priority provisions do not envision equal treatment for all claimants. Using the egalitarian language of equal treatment for all, courts have mostly succeeded in preventing individual claimants, or groups of similarly situated claimants, from separately prosecuting claims against those allegedly responsible for causing the insurer's insolvency. Thus, they have

well established that in filing a proof of claim in liquidation, a claimant submits itself to the jurisdiction of the liquidation court’’); In re Emmet, 164 A.D. 586, 150 N.Y.S. 398 (1914); A. Appleman, supra note 17, § 10725.

102. “It is axiomatic [that] when a creditor is the beneficiary of a transfer that would result in full payment of its obligation, and no other creditor in its class would be similarly treated on liquidation, that creditor has been preferred.” Porter v. Yukon Nat’l Bank, 866 F.2d 355, 359 (10th Cir. 1989) (citing Barash v. Public Fin. Corp., 658 F.2d 504, 508-09 (7th Cir. 1981)); see also Hartford Casualty Ins. Co. v. Borg-Warner Corp., No. 88-C-0783, slip op. at 6 (N.D. Ill. Apr. 18, 1989). The Borg-Warner court observed:

[W]e are also concerned by the fact that Hartford is only one of Centaur’s many creditors. If Hartford’s claim is meritorious . . . . then all creditors of Centaur should have access to Borg-Warner’s funds . . . . [I]ndividual assertion of claims common to all creditors before the Director has completed the marshalling and distribution of Centaur’s assets yields a high potential for conflict and disparate results.

Id. The same sentiments are expressed in an analogous body of law construing the National Bank Act, which requires the receiver of an insolvent financial institution to distribute its assets pro rata to depositors. In the paradigmatic case, an individual depositor seeks to impose a constructive trust on that portion of the estate’s assets that is equivalent to the amount of his deposit. Courts unanimously reject such efforts as they perpetrate an inequity upon the remaining depositors. See, e.g., Downriver Community Fed. Credit Union v. Penn. Square Bank, 879 F.2d 754, 762 (10th Cir. 1989). In Downriver Community Federal Credit Union, the court noted:

A national bank’s fraudulent conduct may give rise to a constructive trust only when the plaintiff can show that the bank’s fraud caused a particular harm that is not shared by substantially all other depositors, and that granting relief to the plaintiff does not disrupt the orderly administration of the receiver’s estate.

Id.; see also Leonard v. Gage, 94 F.2d 19, 24 (4th Cir. 1938) (“To permit the receivers of the failed national bank to thus apply their assets on unsecured claims would be to sanction the violation of the statutes forbidding preferences and requiring the equal
achieved their real objective: to prevent the most well-endowed claimants from gaining what the courts perceive to be an unfair advantage over their less well-endowed co-claimants, otherwise known as ordinary policyholders. Whether this is a form of judicially mandated socialism or merely judicial adherence to a legislative mandate remains an open question.

B. Administrative Efficiency

To achieve the aforementioned objectives, the liquidation proceeding must accomplish its principal functions without being derailed by collateral concerns. Therefore, administrative feasibility is of paramount importance. To ensure efficiency, liquidation courts endeavor to keep all aspects of the proceeding before the domiciliary court under the control of the liquidator. This is especially important and ratable distribution of the assets.

103. From a purely arithmetic point of view, it is not entirely clear that permitting independent actions by certain claimants would unduly disadvantage their co-claimants. Assuming the claimant alone withdraws (or is forced to withdraw) his proof of claim against the estate, the remaining claimants will ultimately receive a greater pro rata share of the available assets. However, if the defendants have finite assets, and the independent claimants are first to execute on the judgments (or conclude settlements), then any similar victory by the liquidator may be Pyrrhic and claimants represented by the liquidator would be prejudiced. See, e.g., Crist v. Sharp Elec., Inc., 876 F.2d 379, 383 (5th Cir. 1989) ("If we applied ordinary contract law would have given these two creditors an unjustified preference over other creditors with perhaps equally justifiable claims. The rights of these insureds can best be determined when judged against the rights of the other creditors and insureds."); Hartford Casualty Ins. Co. v. Borg-Warner Corp., No. 88-C-0783, slip op. at 6 (N.D. Ill. Apr. 12, 1989).


tant today because many insurance companies transact business na-
nationally and internationally. It impacts on standing because if each
claimant could assert a lawsuit in the forum of his choice, virtually
identical lawsuits would be pending simultaneously throughout the
entire nation, if not the entire world.

More often than not, reported decisions rely on the following lan-
guage from Metropolitan Life Insurance Co. v. Board of Directors:106

Experience has demonstrated that in order to secure an economical, efficient,
and orderly liquidation and distribution of the assets of an insolvent corpora-
tion for the benefit of all creditors and stockholders, it is essential that the
title, custody and control of the assets be entrusted to a single management
under the supervision of one court. ... This should be particularly true as to
proceedings for the liquidation of insolvent insurance companies.107

107. Id. at 470 (citing Motlow v. Southern Holding & Sec. Corp., 95 F.2d 721, 725-26
(8th Cir.), cert. denied, 305 U.S. 609 (1938)); see, e.g., Clark v. Willard, 292 U.S. 112
(1934). The court in Clark noted:

Nothing in those provisions declares the existence of a policy to allow the as-
sets of an insolvent corporation to be torn to pieces at the suit of rival credi-
tors when they could be distributed equally and without sacrifice at the hands
of a receiver.

... .

Inequality and waste are to be avoided in special measure when banks or in-
surance companies, unable, as we have seen, to have the protection of courts
of bankruptcy, are in course of liquidation. The Supreme Court of Montana
has been mindful of this need, at all events in respect of banks, and has stated
it with full force and clarity. Thus, in Rohr v Stanton Trust & Sav. Bank, ... a creditor brought suit in the hope of gaining a preference for his deposit out
of the assets of a bank in the hands of a receiver. The court said '... the gen-
eral principal of equity that the assets of an insolvent are to be distributed rat-
ably among general creditors applies with full force to the distribution of the
assets of a bank' and again ... The available assets [are to be] so conserved
that each depositor or other creditor shall receive payment or dividend ac-
cording to the amount of his debt, and that none of equal class shall receive
any advantage or preference over another.' It would seem that conservation
of assets and equality of distribution are goods no less important in the wind-
ing up of insurance companies and of other moneied corporations than in the
winding up of banks.

Id. at 123, 127-28 (citation omitted); see Mortgage Am. Corp. v. Mortgage Am. Corp.,
714 F.2d 1266, 1276 (5th Cir. 1983) ("Actions for the recovery of the debtor's property
by individual creditors ... would interfere with this estate and with the equitable dis-
tribution scheme dependent upon it. ... Any other result would produce near anarchy
where the only discernible organizing principle would be first-come-first-served.");
Craig v. Stacy, 50 S.W.2d 104, 106-07 (Mo. 1932). The Craig court stated:

Creditors shall share equally in proportion to their claims from any funds it is
possible to collect from the assets of the bank [and] the liability of the officers
and directors to the bank for losses caused by negligence or mismanage-
ment. ... Any other interpretation would make equality among depositors
and other creditors impossible.

Id.; see also In re Allcity Ins. Co., 66 A.D.2d 531, 413 N.Y.S.2d 929 (1979); Knicker-
bocker Agency v. Holz, 4 A.D.2d 71, 73, 162 N.Y.S.2d 82, 83, aff'd, 4 N.Y.2d 245 (1958)
("[The] pre-eminent purpose of Article XVII is to 'insure equitable treatment for its
creditors and to avoid preferences' upon the liquidation of an insurer by providing that
any matter affecting the assets available for distribution be the subject of a single, inte-
grated administration.'").

For similar reasons, many federal courts have abstained from deciding insolvency-
Although the Metropolitan Life court was referring to the marshaling and distribution of assets of the insolvent company, jurists have no qualms about applying it to lawsuits by claimants against third parties to recover funds that are not, and never were, assets of the estate. The application is admittedly circular, because defining "assets of the estate" is a threshold exercise that must be engaged in before a logically consistent position may be taken on the issue of standing. However, concerns such as these are not disturbing to a court engaged in a mission of mercy in a jurisprudential milieu in which practical realities are at least as compelling, if not more so, than jurisprudence. This becomes evident upon examination of those portions of the Merin v. Yegen Holdings Corp.\textsuperscript{108} and Corcoran v. Hall\textsuperscript{109} trial court opinions that treat public policy and administrative efficiency as dual objectives of the legislatures' intent.

In Merin, the court relied mainly on the statutory provision empowering it to promote the interests of policyholders, creditors, and the public. It granted the liquidator exclusive standing by reasoning that such a disposition would best promote these interests. To arrive at this conclusion, the court looked first to public policy. It noted the pervasive impact of insurance on society as a whole, and addressed the goals the legislature sought to achieve when it drafted the insol-


vency laws, emphasizing the special concern for protecting ordinary policyholders:

The Uniform Insurers Liquidation Act is a public policy recognizing that insurance companies are not the same as a widget manufacturer. Insurance companies affect the everyday aspects of commercial and private lives of all. Insurance is required to operate motor vehicles, to obtain governmental and private contracts, among other aspects of living. The Federal Bankruptcy Act recognizes the special nature of insurance companies and specifically exclude [sic] such from the provision of that law.\textsuperscript{110}

The insurance industry is highly regulated because of the very nature of its product. The impact on the public is plain and simple, more pervasive and potentially more destructive than other industries. Persons who thought they had insurance protection find themselves without coverage. Injured persons are denied full compensation for damage they sustained.\textsuperscript{111}

The court next turned to administrative efficiency and its relationship to public policy. It noted that, as a practical matter, if the liquidator was deprived of standing to assert certain claims, most policyholders would lack the incentive to sue on their own behalf. Thus, they would not only be prejudiced by the diminished recovery caused by the priority provision, but also might lose the benefit of certain claims entirely, resulting in a windfall to the defendants:

Any party who wrongfully caused, exacerbated or contributed to the insolvency of an insurance company should respond to their wrongdoing. The wrongdoer should not be allowed to escape responsibility through a narrow reading of [the statute]. . . .

The court also finds, in support of [the liquidator's position] that permitting the liquidator to bring these claims is the most expeditious manner to have those claims brought to a full hearing. It prevents the fragmenting of claims and is more likely to result in claims being pursued and brought to fruition, assuming they deserve to do so. The only result in not permitting the Liquidator to have authority would be the potential failure to have wrongdoers compensate those who are injured as a result of the insolvency.\textsuperscript{112}

In sum, notwithstanding substantial conflicts between the statutory language and the court's views regarding public policy and administrative efficiency, the \textit{Merin} court sought to integrate these divergent chords into a harmonious argument based on a willingness to adopt a broad perspective and an appreciation for reality that at least equaled, if not exceeded, the literal constraints of the law. This resulted in a compelling opinion, similar in all important respects to the New York Appellate Division's decision in \textit{Hall}, even though portions analyzed in isolation are subject to criticism.

In \textit{Hall}, the trial court endeavored to transmit a similar message, although the result was somewhat less inspiring:

[The Liquidator's] authority to sue on behalf of Union, its creditors and policyholders . . . furnishes a complete procedure for the protection of all interested parties. This comports with the purpose of Article 74 to ensure equitable

\textsuperscript{110} \textit{Merin}, No. C-16131-88, slip op. at 3-4.

\textsuperscript{111} \textit{Id.} at 9.

\textsuperscript{112} \textit{Id.} at 10-11.
treatment for its creditors and to avoid preferences upon the liquidation of an insurer by providing that any matter affecting the assets available for distribution be the subject of a single, integrated administration. . . . Public policy supports the liquidator's suit as the most fair and efficient mechanism for handling these claims. \(^{113}\)

Though it may lack force, this statement could be of critical importance in the future because it suggests that the court concluded (or at least assumed) that all recoveries by the liquidator would be treated as general assets of the estate to be distributed in accordance with the priority provision in New York's liquidation law. Conversely, the determination of this critical issue was deferred by the New Jersey court. \(^{114}\)

VII. THE DANGERS OF MULTI-PARTY STANDING

The preceding sections already have alluded to many of the legal and practical difficulties that are almost certain to arise if policyholders and creditors are allowed to pursue their own claims against those responsible for a carrier's failure. Multiple standing easily can result in procedural chaos and unnecessary delay in achieving the principal goals of a liquidation proceeding. In the liquidation forum, the liquidator would sue the insurer's managers and auditors for mismanagement and diversion of corporate assets. At the same time, the claimants would sue the same defendants in many different fora for losses caused by fraud and deceit concerning the company's true financial condition. \(^{115}\) Thousands of actions might be commenced at or about the same time and the disposition of each action would be delayed by efforts at complete or partial consolidation, as well as extraordinarily complex—if not unanswerable—questions concerning double recoveries, \(^{116}\) issue preclusion, collateral estoppel, res judicata,

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113. *Hall*, No. 36955, slip op. at 21-22.
114. As noted above, virtually all of the Appellate Division's affirmance in *Hall* is built upon the dual foundations of public policy and administrative efficiency. *See supra* notes 73-95 and accompanying text.
115. *See* Cornick v. Weir, 212 Iowa 715, 237 N.W. 245 (1931), and cases cited therein, for a cogent distinction between a cause of action against directors and officers for negligent mismanagement brought by a bank or its receiver, and a cause of action against the same defendants sounding in fraud and deceit brought by the bank's depositors/creditors. *See also* United States Fiduciary & Guar. Co. v. Corning State Sav. Bank, 154 Iowa 588, 134 N.W. 857 (1912).
116. The problem of subjecting third party defendants to double recoveries is more complex than may initially appear. Assume the liquidator is granted standing to prosecute lawsuits on behalf of both the estate and its policyholder and creditor claimants. Any recovery is treated as a general asset of the estate. When recovery is distributed pursuant to the applicable priority provision, each policyholder receives less than the full amount of his covered claim. If a policyholder subsequently sues the same defend-
and privileges and immunities. Efforts by the liquidation court to stay other actions (with its attendant full faith and credit problems), or to create a class action (with its inherent due process and minimum contacts issues) would merely add to the procedural morass and further delay the primary goals sought to be accomplished in insurance company liquidations: to compensate claimants as much and as soon as possible.

Multiple actions may also neutralize insurance as a source of funds for claimants. Directors and officers will be protected by D&O liability insurance, while auditors and actuaries will be protected by E&O insurance. Such policies contain aggregate limits of liability which, when exhausted, relieve the insurer of any further obligation. Even more significantly, these policies typically provide that defense costs compose part of the liability limit. If expenses reach or exceed the liability limit, nothing will remain to reimburse losses.

ants to recover the difference, is this double or excess recovery from the defendants? The defendants will contend this is double recovery because their full responsibility for the loss was determined by the liquidation court; however, the claimants will argue that it is not double recovery because they have yet to be made whole. Perhaps only the claimants who actually and directly relied on the defendants' misrepresentations should be afforded the opportunity to recover this deficit.

The very definition of double or excess recovery is partly determined by whose perspective is considered appropriate. Even assuming that claimants should be granted the right to bring separate suits against the same defendants sued by the insurer's liquidator, such actions should not be commenced until after all distributions have been made from the estate's assets because, until then, the claimants cannot ascertain the amount of additional recoveries needed to make them whole. See Hartford Casualty Ins. Co. v. Borg-Warner Corp., No. 88-C-0703, slip op. at 5 (N.D. Ill. Apr. 18, 1989) (noting that "this injury will not be determinable until after the amount Hartford [the claimant] recovers from the rehabilitation proceeding is known").

See J. Weinberg, Creditors Bound by Trustee's Settlement of Third-Party Claims, 6 BANKR. STRATEGIST 3 (1989). A class action, however, would not solve the problem because when money damages are sought, class actions require that each member of the plaintiff class be afforded the opportunity to "opt out." Were substantial numbers of policyholders to opt out of the liquidator's action, the end result would be the same as if the liquidator lacked standing to represent their interests originally.


Thus, even if the majority of multiple lawsuits deriving from multi-party standing are withdrawn, stayed, dismissed, or consolidated soon after commencement, defense costs probably would exhaust or substantially diminish further exposure of the D&O and E&O carriers, leaving nothing to compensate successful claimants, including liquidators. Absent personal or corporate deep pockets of the defendants, such lawsuits would result in the depletion of estate assets as well as a reduction of the personal fortunes of policyholders and creditors.

Lawsuits by individual creditors also are less likely to be successful than the same lawsuit by the liquidator. Individual plaintiffs will generally be suing under a fraud theory. To succeed, each plaintiff must prove: (1) a representation made by the defendant to the plaintiff with the intent that the plaintiff rely on the representation; (2) knowledge by the defendant that the representation was false when made; (3) a belief by the plaintiff that the representation was true when made; (4) reasonable reliance by the plaintiff on the defendant's false representation; and (5) injury to the plaintiff as a result of his reliance. The reliance is usually on financial statements and reports that misrepresented the economic status and viability of the insurance company. However, most policyholders, especially those who need and deserve the greatest protection from insolvency, do not

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124. Louis Schlesinger Co. v. Wilson, 22 N.J. 576, 585-86, 127 A.2d 13, 18 (1956); BLACK'S LAW DICTIONARY 594-95 (5th ed. 1979). Negligent misrepresentation, often referred to as equitable fraud, does not require that the defendant know the falsity of his misrepresentation or intend to induce the plaintiff to detrimentally rely thereon. However, it does require a false representation and the plaintiff’s reasonable reliance on the representation, to his detriment. H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 334, 461 A.2d 138, 142-43 (1983); Enright v. Lubow, 202 N.J. Super. 58, 493 A.2d 1288 (Super. Ct. App. Div. 1985), cert. denied, 104 N.J. 376, 517 A.2d 386 (1986). If a policyholder or creditor has difficulty recovering under a fraud theory because he cannot establish the requisite reliance, he will have the same problem if he pleads negligent misrepresentation.
purchase insurance based upon audited financial statements. Therefore, they will be unable to prove their claims.

The liquidator is in a much better position to argue in favor of alternative forms of reliance. First, he may argue that proof of direct reliance is not necessary in the context of an insurance company insolvency. Rather, the liquidator need only establish that the insurance regulators relied on the statutorily mandated representations of the defendants, and the public in turn justifiably relied on the conclusions of the regulators.\textsuperscript{125} A second and related argument that may be advanced by the liquidator is akin to the "fraud on the market" theory adopted in securities law actions under section 10(b) of the Securities Exchange Act of 1934\textsuperscript{126} and SEC rule 10b-5.\textsuperscript{127} Under this theory, a material omission creates a rebuttable presumption of reliance by investors. There is no requirement that the plaintiff, the purchaser of a security, prove that he personally relied on the issuer's misrepresentations.\textsuperscript{128} The third argument, codified as to in-

\textsuperscript{125} The court accepted such a substitute for direct reliance in Bonhiver v. Graff, 311 Minn. 111, 248 N.W.2d 291 (1976), in which the receiver of an insolvent insurer sued its auditors for negligently failing to discover the insolvency-inducing fraud of inside management:

"The defendants knew that the commissioner was conducting his examination in order to determine whether American Allied was financially stable enough to be allowed to continue to do business in Minnesota. They knew that he was relying upon their work in making that determination. Thus . . . . defendants are liable to him for any loss he has suffered as a result of his reliance. . . . However, it would make little sense to speak of loss suffered by the commissioner. He has not been injured—he has no interest in the matter himself. Rather, he is a representative. The duties of the commissioner . . . . to examine and monitor insurance companies which operate in this state are meant to provide protection to certain people who deal with these companies. Policyholders, for example, are not going to examine the books of the companies themselves; their "agent" in this matter is the commissioner. Thus, if they are injured because of reliance by the commissioner upon misrepresentations made by the defendants, and defendants are aware of that reliance, defendants' liability arguably should extend to the injured policyholders . . . ."

\textsuperscript{126} 15 U.S.C. § 78j(b) (1982).

\textsuperscript{127} 17 C.F.R. § 240.10b-5 (1988).

sider defendants in the New York Insurance Law,\textsuperscript{129} presumes fraud in the event of an insurance company insolvency and shifts the burden onto the defendant to rebut this presumption.

The final problem created by multi-party standing involves pre-trial discovery of documents and testimony, which may be as hazardous to defendants as to plaintiffs. The liquidator, having taken over control of the company, its files, and many of its former employees, becomes the clearinghouse for documentary and testimonial evidence needed to prove his case. If actions deriving from the same nucleus of operative fact are proceeding throughout the country, all plaintiffs will need this evidence, and disputes over methods of reproducing and sharing such materials (and funding their copying and transmission) will inevitably arise. A similar situation occurs with the defendants, who will be asked to produce the same documents and witnesses by plaintiffs throughout the country. Although procedures exist for handling complex multi-district litigation, which could be adapted to multi-state insurance liquidation litigation, this would result in unnecessary delay and an extraordinary increase in administrative costs and legal expenses, which in turn would diminish the funds remaining in the estate for distribution. Such consequences are incompatible with the fundamental purpose of the insurance company liquidation proceeding which, as presently constituted, takes many years to complete.

\textsuperscript{129}N.Y. \textsc{Ins. Law} § 1219 (McKinney 1985); \textit{see} Corcoran v. Hall, No. 36955, slip op. at 33-34 (N.Y. App. Div. Aug. 17, 1989).
VIII. A Better Way?

Attempting to rewrite the decisions in Merin and Hall does not evidence a disrespect for the courts from which the opinions emanated. Rather, it indicates an appreciation for the fact that such courts are not specialized “liquidation” tribunals, but trial courts of general jurisdiction with congested dockets. The Merin and Hall courts seemed overimpressed and bewildered by the movants’ hypertechnical emphasis on statutory interpretation. If a different viewpoint on the proper method for construing statutes more in accord with the appellate decision in Hall was adopted, the trial courts may have opined as follows:

Insurance company liquidation laws are designed to provide an orderly and efficient mechanism for liquidating insolvent insurance companies and to ensure equitable treatment to those with claims against insolvent insurers’ estates.\(^\text{130}\) To achieve these goals, lawsuits in a liquidation proceeding must be prosecuted on behalf of all policyholders and creditors by the duly appointed statutory receiver, in this case the Commissioner [Superintendent] of Insurance in his capacity as liquidator of Integrity [Union Indemnity].\(^\text{131}\) If each claimant were to bring a separate action against the same defendants for the same misconduct in the court and forum of his choice, the result would be unbridled administrative chaos and illegal preferences to those capable of obtaining and executing on judgments first.\(^\text{132}\) This would

\(^\text{130}\) Lac D’amiante du Quebec v. American Home Assurance Co., 864 F.2d 1033, 1040-41 (3d Cir. 1988); Ballesteros v. New Jersey Property Liab. Ins. Guar. Ass’n, 530 F. Supp. 1367, 1370 (D.N.J. 1982), aff’d mem., 696 F.2d 980 (3d Cir. 1982) (noting that “[t]he Act provides for a uniform, orderly and equitable method of making and processing claims against defunct insurers and provides for a fair procedure to distribute the assets of defunct insurers”); Murphy v. Ambassador Ins. Co., 195 N.J. Super. 274, 478 A.2d 1243 (Ch. Div. 1984); A. Appleman, supra note 17, § 10721 (stating that “[i]n the distribution of the assets of an insolvent insurance company, the general rule is that all creditors are entitled to share equally in such assets in proportion to their claims”).

\(^\text{131}\) Meyers v. Moody, 693 F.2d 1196, 1206 (5th Cir. 1982), cert. denied, 464 U.S. 920 (1983); Motlow v. Southern Holding & Sec. Corp., 95 F.2d 721, 725-26 (8th Cir.), cert. denied, 305 U.S. 609 (1938); Wheeler v. American Nat’l Bank, 347 S.W.2d 918, 920 (Tex. 1961) (holding that “the Receiver had the right to maintain this cause of action on behalf of the creditors, policyholders, and claimants of the [insolvent insurance company]”).

\(^\text{132}\) In re Liquidation of Sec. Casualty Co., 127 Ill. 2d 434, 537 N.E.2d 775 (1989). An additional result would be that movants would be required to defend thousands of lawsuits throughout the nation. Thus, it may seem strange that they advocate policyholder standing. The paradox evaporates, however, when one realizes that defendants are well aware that the majority of policyholders would, as a practical matter, fail to pursue their individual claims. Insurance Comm. v. New S. Life Ins. Co., 270 S.C. 612, 631, 244 S.E.2d 289, 299 (1978).
defeat the dual goals of the liquidation statute: efficiency and equality.

In *Clark v. Williard*, the United States Supreme Court warned of the danger of "allow[ing] the assets of an insolvent corporation to be torn to pieces at the suit of rival creditors when they could be distributed equally and without sacrifice at the hands of a receiver." The same danger exists when an insurance company is liquidated, and it is the intent of the liquidation statute and the duty of this court to avoid such a danger. Thus, the statute provides that this court shall grant such relief as the nature of the case and the interests of the policyholders require. Having concluded that the policyholders' interests would be devastated by depriving the liquidator of standing to bring this action on their behalf, the statute does not merely permit, but requires, that the court grant the liquidator third-party standing.

Movants interpret the statute differently. They maintain that because the legislature expressly provided that the liquidator may sue on behalf of the insolvent insurance company, but did not expressly provide that he may sue on behalf of its policyholders, it must have intended to reject the latter possibility. Movants have taken the occasionally

133. 292 U.S. 112 (1934).
134. *Id.* at 123.
135. They also place great emphasis upon the section that empowers the liquidator, on behalf of the insolvent's creditors, to recover voidable transfers and fraudulent conveyances. Because the legislature expressly provided for derivative standing in this one instance, it must have meant to exclude such standing on all other occasions. Movants concede, however, that as the statutory successor to the insolvent insurer, the liquidator has standing to assert claims on behalf of the insurer to recover its assets; i.e., assets that belonged to the insurance company prior to the entry of the Liquidator Order. Voidable transfers and fraudulent conveyances are by definition assets of a corporation diverted to third parties. Under the common law, creditors alone may sue on behalf of a corporation to recover such conveyances and bring them back into the corporate coffers. Thus, in the absence of the section relied on by movants, the insolvent’s policyholders and other creditors would be required to sue third parties to recover estate assets for the estate's benefit. The section attempted to avoid this anomaly by making it clear that the liquidator alone may sue third parties to recover improperly diverted corporate assets and bring them back into the estate for the ultimate benefit of all claimants. It is analogous to section 544 Bankruptcy Code, which accomplishes the same function with respect to the trustee in the bankruptcy context. See Moore v. Bay, 284 U.S. 4, 5 (1931); Ocean Energy II, Inc. v. Alexander & Alexander, Inc., 868 F.2d 740, 745-46 (5th Cir. 1989); Motlow v. Southern Holding & Sec. Corp., 95 F.2d 721, 724 (8th Cir. 1938); *In re Baumgartner*, 55 F.2d 1041, 1046 (7th Cir. 1931); Gochenour v. George & Francis Ball Found., 35 F. Supp. 508, 517 (S.D. Ind. 1940), aff’d,
useful maxim that the expression of one thing implies the exclusion of another and have transformed it into an inflexible commandment that is blind to legislative intent, public policy, administrative feasibility, and judicial economy. In essence, they argue that this court should not disturb the sounds of legislative silence.

That statutory interpretation is a compassionate art rather than an antiseptic science has utterly eluded the movants. Maxims of construction must yield to the legislature's intent. Statutory interpretation must be based on common sense and equity and must take into account the practical results that flow from alternative interpretations. Statutes must not be construed literally if doing so will lead to absurd results or evade rather than promote the objectives sought to be achieved by their enactment. A comprehensive examination of statutory construction in this country discloses that reasonableness, justice, and public policy supplement statutory text; that legislative silence does not indicate rejection; that the text itself is but the starting point for interpretation; that great deference is given to an agency's interpretation of a law it is charged with implementing; that courts are obliged to fill in statutory gaps; and that the enactment of laws with textual gaps is the legislature's way of delegating policymaking function to the judiciary.

The aforesaid principles do not reflect a judicial usurpation of the legislative function. Rather, they define the judicial obligation. In ruling that the liquidator may prosecute this action on behalf of the policyholders and creditors of the insolvent insurer, the court is fulfilling this obligation.

117 F.2d. 259 (7th Cir.), cert. denied, 313 U.S. 566 (1941); Davis v. Wiley, 263 F. Supp. 588, 589 (N.D. Cal. 1920), aff’d, 273 F. 397 (9th Cir. 1921); 1 W. COLLIER, COLLIER ON BANKRUPTCY § 544.03 (15th ed. 1989).

136. Marranca v. Harbo, 41 N.J. 569, 574, 197 A.2d 856, 868 (1964); 2A J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 45.12 (4th ed. 1984) (noting that “departure from the literal construction of a statute is justified when such a construction would produce an absurd and unjust result and would clearly be inconsistent with the purposes and policies of the act in question”).


Where legislative source materials fail to supply a clearly dispositive answer concerning how an issue should be decided, it is not a violation of the principle of legislative sovereignty for a court to take extra-judicial as well as legislative source materials into account in deciding what disposition conforms best to public policy.

Moreover, this is not a situation in which the controlling statute expressly provides that the liquidator may not represent the claimants, or that claimants alone shall be vested with standing to sue the movants for losses caused by the insurer's insolvency.

Rather, this is a situation in which the legislature, through the statute, has instructed this court to provide whatever relief is necessary to maximize the protection afforded to the policyholders and creditors. To the extent that there is any validity to movants' contention that the statute is silent or ambiguous, this merely indicates that the legislature has left a gap to be filled by this court through statutory construction. That gap has now been filled.

IX. CONCLUSION

The legislatures in UILA states have drafted with a forked pen. Although their intent seems clear, they have created statutes that are not suited to achieve the desired goal. These laws do not expressly provide the liquidator with standing to commence actions on behalf of policyholders and creditors of the insolvent insurance company. Rather, construed according to conventional maxims of statutory interpretation, they arguably preclude such standing. All things considered, it is fortunate that judges have had the fortitude to stand up to these laws when the issue of standing arises. Nevertheless, because the issue of standing is unclear, valuable estate assets have been wasted on motion practice devoted to the question of standing.

Statutes based on both model laws fail to provide a method for distributing recoveries derived from claims belonging to policyholders and creditors, even assuming the liquidator litigates on their behalf. With the partial exception of New York, no state has addressed the reliance/causation issue, which could foreclose many viable actions at the expense of insolvency victims, resulting in a corresponding windfall to defendants.

Unless courts hold that all claims asserted against those responsi-

138. Movants note that at least thirteen states have liquidation laws expressly empowering the liquidator of an insolvent insurer to prosecute lawsuits on behalf of policyholders and other claimants. Whether a state law or a state court fills in the gap with respect to derivative standing is a fortuitous function of whether the state has adopted the UILA or the NAIC Model Act. The UILA, unlike the NAIC Model Act, does not contain a clause expressly empowering the liquidator to sue third parties on behalf of the insolvent insurance company's claimants.
ble for killing a carrier belong to the decedent, and may therefore be prosecuted by the liquidator as its statutory successor, the statutes must be amended if the legislative intent is to be achieved without resorting to juristic acrobatics (Merin v. Yegen Holdings Corp.) or unjustified leaps in logic (Corcoran v. Hall). These statutes should unequivocally provide that the liquidator has paramount and exclusive standing to sue on behalf of policyholders and creditors; that all recoveries should be treated as general assets of the estate and distributed according to the applicable priority provision; and that claims belonging to the policyholders and creditors may be established by employing doctrines such as secondary or derivative reliance, fraud on the market, or a rebuttable presumption of fraud on the part of the defendants.

Only if such amendments are made will an assurance exist that the letter of the law comports with its spirit. Only then will the frustration and nightmare of recovering from a carrier's "killers" be transformed into a hope and a dream. "To everything there is a season, and a time to every purpose under the heaven."¹³⁹ The time to start amending the laws is now!

¹³⁹ Ecclesiastes 3:1.