Insurance Insolvency – Or What to Do If Your Insurance Company Goes Broke

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****** IMPORTANT NOTE***

Insolvency, Conservatorship, Rehabilitation, and Liquidation:

" . . . [Insurance company] 'insolvency' means either of the following: ¶ (1) Any impairment of minimum . . . [State required assets] ¶ (2) An inability of the insurer to meet its financial obligations when they are due."[1]

If an insurance company is "insolvent" "[t]he superior court . . . shall, upon the filing by the [insurance] commissioner of . . . [a] verified application . . . issue its order vesting title to all of the assets of that . . . [insurance company] in the commissioner."[2] That vestment is called a "conservatorship."[3] " [A] [conservatorship] proceeding contemplates, not the liquidation of the company involved, but a conservation of the assets and business of the company over the period of stress by the commissioner who thereafter yields the control and direction to the regular officers of the company."[4] The insurance commissioner, in his or her role as appointed conservator, is obligated to develop and present to the superior court a plan for rehabilitation of the insurance company[5]

"If at any time after the issuance of an [conservatorship] order . . . it shall appear to the commissioner that it would be futile to proceed as conservator with the conduct of the business

****** Unless otherwise specified, all statements regarding law refer to California law only;***

[1] Insurance Code Section 985(a)
[2] Insurance Code Section 1011
[3] Insurance Code Section 1011
[4] Caminetti v. Superior Court 16 Cal.2d 838, 843 (1941)
[5] See Carpenter v. Pacific Mutual Life Ins. Co. 10 Cal.2d 307, 323 (1937)

of . . . [the insurance company], he may apply to the court for an order to liquidate and wind up the business of said . . . [insurance company]."[6]

So, just because an insurance company is insolvent does not necessarily mean that it will be liquidated; the insurance commissioner may first try to rehabilitate the insolvent insurer; if that rehabilitation does not work, then liquidation is in order. Liquidation is authorized and conducted under state law.[7] The state in which the stressed insurance company is domiciled conducts the liquidation.[8]

So what does all of this mean to the insured contractor?

Three Considerations When Buying a Commercial General Liability ("CGL") Insurance Policy:

Here are some ways that a contractor can protect him, her, or itself when a CGL policy is first purchased.

The Broker; and A.M. Best:

There is much to be said for the trust that often develops between the contractor and the contractor's insurance broker. If that trust is founded on solid facts the contractor might want to listen well to the broker. But, the contractor can do some independent research on insurers' financial health. A.M. Best rates insurance companies' financial well-being. It may be worth a contractor's time to go to "ambest.com", and follow the prompts that that lead to the grades given to individual insurers.

The California Insurance Guarantee Association ("CIGA"):

Another thing that the contractor can do when buying a CGL policy is make sure that the insurer is a member of CIGA. "[A]ll insurers [who provide, generally speaking

[6] Insurance Code Section 1016
[7] Insurance Code Section 1064.1, et seq.
[8] Insurance Code Section 1064.2

property/casualty insurance and workers' compensation insurance (see footnote #9), and who are]. . . admitted to transact insurance in this state" are members of CIGA.[9] Take note that just because an insurer may not be entitled to transact insurance business in California does not mean that such an insurer doesn't sell insurance to Californians. So, the question should be asked, is this insurer admitted to transact insurance in California?

A Description of CIGA:

CIGA insures against insolvency.[10] "CIGA issues no policies, collects no premiums, makes no profits, and assumes no contractual obligations to the insureds."[11] "CIGA is not, and was not created to act as, an ordinary insurance company. It is a statutory entity that depends on the Guarantee Act[12] for its existence and for a definition of the scope of its powers, duties, and protections. CIGA is an involuntary, unincorporated association of insurers admitted to transact business in California. Each insurer is required to participate in CIGA as a condition of doing business in this state. The statutory purpose of CIGA is to provide for each insurer member insolvency insurance to pay the claims arising out of policies issued by an [insurer who becomes insolvent]. . . . CIGA is limited to the payment of 'covered claims'." [13] [Internal citations and quotations omitted; Footnote #12 is not in the original.]

[9] Insurance Code Section 1063(a) states that "all insurers, including reciprocal insurers, admitted to transact insurance in this state of any or all of the following classes only in accordance with the provisions of Chapter 1 (commencing with Section 100) of Part 1 of this division: fire (see Section 102), marine (see Section 103), plate glass (see Section 107), liability (see Section 108), workers' compensation (see Section 109), common carrier liability (see Section 110), boiler and machinery (see Section 111), burglary (see Section 112), sprinkler (see Section 114), team and vehicle (see Section 115), automobile (see Section 116), aircraft (see Section 118), and miscellaneous (see Section 120), . . . [are members of CIGA].

[10] Insurance Code Section 1063(a)

[11] Isaacson v. CIGA 44 Cal.3d 775, 787 (1988)

[12] The Guarantee act is at Insurance Code Sections 1063, et seq.

[13] Isaacson v. CIGA 44 Cal.3d 775, 786 (1988)

CIGA's limitation to pay only "covered claims" is important. "Covered claims," as that phrase is used in CIGA law is a "word of art" [sic].[14] What CIGA will pay is not only defined by the insurance policy written by the now-insolvent insurer, but is also defined by what is and what isn't a "covered claims" under the Guarantee Act.[15]

While there are many things that are defined as "covered claims" and as "not" "covered claims"[16], perhaps one of the most disappointing aspect of CIGA insurance is that "[CIGA] 'covered claims' [do] not include that portion of any claim, other than a claim for workers' compensation benefits, that is in excess of five hundred thousand dollars ($500,000)."[17]

However, to the limited extent that an insurance company can successfully sue an insured of an insolvent insurer (see below for information on that limited extent), "the insured of the insolvent insurer is entitled to a credit or setoff in the amount of the policy limits of the insolvent insurer's policy, or in the amount of the limits remaining, where those limits have been diminished by the payment of other claims."[18]

Being the unwitting insured of CIGA can have some positive affects. In order to understand this, a little understanding of the concept of insurance in general is needed. A main purpose of insurance is to spread risks.[19] A hit of $X to any one person could be devastating. By buying insurance one puts one's money into a pool of money with many other persons, and shifts that $X hit to the pool of insurance money and the insurance company that holds that pool. That pool of insurance money and the insurance company that holds it can take the $X hit.

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[14] Middleton v. Imperial Ins. Co. 34 Cal. 3d 134 (1983)
[15] Stonelight Tile v. CIGA 150 Cal.App.4th 19 (2007); the Guarantee Act is at Insurance Code Section 1063, et seq.
[16] Much, but not all of what are and aren't covered claims can be found at Insurance Code Section 1063.1(c)(1) – (c)(13)
[17] Insurance Code Section 1063.1(c)(7)
[18] Insurance Code Section 1063.1(c)(5)
[19] See 74 UMKC L. Rev. 435, 447 (2005)

Key to insurance is the society's confidence that purchased insurance will be available when it is needed. "CIGA's role is similar to that of the Federal Deposit Insurance Corporation in banking and serves to enhance public confidence in the insurance industry."[20] Probably because of the importance of public confidence in insurance and probably because risks generally should be spread amongst solvent insurers rather than amongst people who did the responsible thing and bought insurance, which through no fault of the insurance buyers became insolvent, "An insurer . . . may not maintain, in its own name or in the name of its insured, any . . . legal action against the insured of the insolvent insurer for contribution, indemnity or by way of subrogation, except insofar as, and to the extent only, that the claim exceeds the policy limits of the insolvent insurer's policy.[21]

Also, the Legislature has decreed that a claim is not a "[c]overed claim[] . . . to the extent it is covered by any other insurance . . . available to the claimant or insured . . . ."[22] So, if "an insured has overlapping insurance polices and one insurer becomes insolvent, the other insurer, even if only a secondary or excess insurer, is responsible for paying the claim."[23]

Even if the "any other insurance" available to satisfy the claim belongs to someone other than the insured of the insolvent insurer, that other insurance must pay not CIGA. So, in the situation where the developer/general contractor and a subcontractor are jointly and severally liable for covered damages, and one of those two is insured by a solvent insurer while the other is insured by an insolvent insurer, the solvent insurer must pay for those damages, not CIGA.[24]

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[20] Stonelight Tile v. CIGA 150 Cal.App.4th 19 (2007)
[21] Insurance Code Section 1063.1(c)(5); the full cited sentence reads, "An insurer, insurance pool, or underwriting association may not maintain, in its own name or in the name of its insured, any claim or legal action against the insured of the insolvent insurer for contribution, indemnity or by way of subrogation, except insofar as, and to the extent only, that the claim exceeds the policy limits of the insolvent insurer's policy."
[22] Insurance Code Section 1063.1(c)(9)(i)
[23] Stonelight Tile v. CIGA 150 Cal.App.4th 19, 33 (2007)
[24] Parkwoods Community Association v. CIGA 141 Cal.App.4th 1362

CIGA is protected. The next question is whether the CIGA insured is protected in this situation. One often encounters an argument from lawyers on this point, but the statutory and case law supporting the conclusion that the CIGA insured indeed is protected in this situation is formidable to say the very least, some would say that it is impenetrable.

To review briefly: CIGA is not liable if there is "any other insurance" available to address a claim;[25] that "any other insurance" can be insurance that is owned by someone other than the CIGA insured.[26]

Insurance Code Section 1063.1(c)(9) defines as not "covered claims" claims where there is "any other insurance" available to address the claim, and most claims brought by anyone "other than the original claimant." (That section used to be numbered Insurance Code Section 1063.1(c)(7).[27] For the sake of simplicity, the denomination "Insurance Code Section 1063.1(c)(9)" will be used here even when the court was referring to the old statutory number.)

In Roth v. L.A. Door[28] an employee was injured by an overhead door. The employee was paid workers' compensation benefits pursuant to the employer's workers' compensation insurance policy. Under that policy the employer had a "self-insured retention."[29] The court decided that the employer was "an 'insurer' providing 'other insurance' within the meaning of Insurance Code Section 1063.1(c)(9)."[30] The employer then sought reimbursement from the manufacturer of the overhead door, claiming that it was responsible for the employee's injuries.

Under common law an insurer's payment for a workers' compensation claim can be recovered from the party who actually caused the injury In Roth that party was the manufacturer

[25] Insurance Code Section 1063.1(c)(9)(i)
[26] Parkwoods Community Association v. CIGA 141 Cal.App.4th 1362
[27] See Collins-Pine Co. v. Tubbs Cordage Co. 221 Cal.App.3d 882, 886 (1990)
[28] 115 Cal.App.4th 1249 (2004)
[29] Roth, supra at 1251
[30] Roth, supra at 1260

of the overhead door. But, the Roth court never reached the merits of the lawsuit – because the overhead door manufacturer was insured by an insolvent insurer. Insurance Code Section 1063.1(c)(9) says that a claim is not a "covered claim" if there is "any other insurance" available to address it; there was "any other insurance" available, that insurance being the workers' compensation insurance; the court said that under such circumstances, "when a claim against CIGA is not a 'covered claim,' the claimant cannot pursue an action for indemnity against the insured whose insurer is insolvent."

In Collins-Pine v. Tubbs Cordage Co.[31] the court dealt with the other clause contained in 1063.1(c)(9), that clause being the one that says that a claim by someone "other than the original claimant" is not a "covered claim."[32] The Collins-Pine court ruled that when a claim is a not "covered claim" under Section 1063.1(c)(9), CIGA and the CIGA insured are not liable.

In E.L. White v. City of Huntington Beach[33] 2 parties (White and Royal Globe) were seeking judgment against the insured of an insolvent insurer (the City of Huntington Beach). CIGA was barred from paying on the claim by Insurance Code Section 1063.1(c)(9). The E.L. White court explained why a Section 1063.1(c)(9) prohibition against liability as to CIGA was also a prohibition against liability as to a CIGA insured:

> "White and Royal Globe contend, however that regardless of whether Royal Globe's claim is a 'covered claim,' there is nothing in the CIGA legislation that prevents them from obtaining a judgment of indemnity against Huntington Beach. This argument is unpersuasive.
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> "If Huntington Beach was required to indemnify Royal Globe . . . and CIGA assumed Reserve's [the insolvent insurer for Huntington Beach] insurance obligation to Huntington Beach, the result would be the same as if CIGA made direct payment to Royal Globe, an

[31] Collins-Pine Co. v. Tubbs Cordage Co. 221 Cal.App.3d 882 (1990)
[32] Collins-Pine Co. v. Tubbs Cordage Co. supra at 886
[33] 183 Cal.App.3d 366 (1982)

> action expressly proscribed by section 1063.1. The fact that the payment would go from CIGA to a subrogated insurer through the conduit of an insured of an insolvent insurer does not sanitize the transaction. Such is merely an artifice aimed at circumventing the clear command of the Legislature.
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> "On the other hand, if CIGA did not pay Huntington Beach after it had been ordered to indemnify Royal Globe, Huntington Beach would be forced to satisfy the judgment from its own assets. This is equally objectionable, because the overriding purpose of the Legislature in creating CIGA was to protect just such a party as Huntington Beach, the insured of an insolvent insurer."[34]

Thus, the answer to the question as to whether the CIGA insured is protected in the situation where the developer/general contractor and a subcontractor are jointly and severally liable for covered damages, and one of those two is insured by a solvent insurer while the other is insured by an insolvent insurer, seems to be a solid "yes". The same answer would apply to any other similar joint and several liability situation outside of the construction context.

Accessing CIGA Insurance:

Some insureds of insolvent insures may elect not to take advantage of CIGA insurance,[35] but that would be a very unusual situation. The usual situation is addressed here; the contractor's insurer has become insolvent, the contractor has been sue, and thus the contractor wants and needs CIGA insurance.

Remember that CIGA can only pay on "covered claims." One of the prerequisites to a "covered claim[]" status is the "present[ation] . . . [of the] claim to the liquidator in this state or

[34] E.L. White, supra at 371
[35] See Middleton v. Imperial Ins. Co. 34 Cal.3d 134, 137

. . . [CIGA] on or before the last date fixed for the filing of claims in the domiciliary liquidating proceedings."[36] The "domiciliary liquidating proceedings" take place in the state in which the insolvent insurer is domiciled.[37]

"When a liquidator . . . is appointed in this state for any [CIGA] member insurer, the liquidator shall promptly give notice of his or her appointment and a brief description of the contents of . . . [the laws related to CIGA] and of the nature and functions of . . . [CIGA] by prepaid first-class mail, to . . . all insureds of the [insolvent] insurer."[38]

An insured of the insolvent insurer should ascertain the "the last date fixed for filing of claims" and *should file before that date*! But, what if the insured does not know about the claim? What if there has been no lawsuit or any other actual claim made against the insured before "the last date fixed for filing of claims"?

This issue does not appear to have ever been addressed by the courts (but see Middleton v. Imperial Ins.[39] regarding what can happen if the liquidator fails to send the required notice.) So, the answer to the question is currently unknown. But, "stay tuned"; case law may develop in this area.

Perhaps the best response to the posed question is not really an answer – just some sound advise – file multiple "contingent claims" prior to "the last date fixed for filing of claims." If an insured of an insolvent insurer doesn't know if he/she/it is going to be sued regarding . . . X, file a claim; file enough claims so that there is a contingent claim for every possible future claim that should have been covered by the now-insolvent insurer. This may be a difficult task that may involve detailed analyses of relevant statutes of limitations, but it should be done.

[36] Insurance Code Section 1063.1(c)(1) (iii)
[37] See Insurance Code Section 1064.1
[38] Insurance Code Section 1063.7
[39] 34 Cal.3d 134 (1983)

If no claim has been filed by “the last date fixed for filing of claims”, file a late claim with the liquidator, showing good cause for the tardiness; do the same with CIGA. Doing so may provide a base for a legal argument for CIGA coverage. As of July, 2007 CIGA provides a “courtesy defense” if the liquidator accepts a late claim.

Conclusion:

Insurance insolvency is not fun, but insureds of insolvent insurers do have protections, protections of which they can take advantage.