NOT FOR PUBLICATION WITHOUT THE
APPROVAL OF THE APPELLATE DIVISION

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-6972-03T5

IN THE MATTER OF
THE LIQUIDATION OF
INTEGRITY INSURANCE COMPANY

Argued January 24, 2006 - Decided October 2, 2006

Before Judges Kestin, Hoens and Seltzer.

On appeal from the Superior Court of New Jersey, Chancery Division, General Equity Part, Bergen County, C-7022-86.

Michael R. Cole argued the cause for appellant Reinsurance Association of America (DeCotiis, Fitzpatrick, Cole and Wisler, and Budd Larner and Associates, and Debra J. Hall, of the Washington, D.C. bar, admitted pro hac vice, attorneys; Mr. Cole, Joseph J. Schiavone, and Ms. Hall, on the brief).

Thomas S. Novak argued the cause for respondent Commissioner of Banking and Insurance of the State of New Jersey in her capacity as Liquidator of the Estate of Integrity Insurance Company (Sills Cummis Epstein and Gross; Mr. Novak and James M. Hirschhorn, of counsel and on the brief and Elisa M. Pagano, on the brief).

LeBoeuf, Lamb, Greene and MacRae, attorneys for amicus curiae Association of Bermuda Insurers and Reinsurers; International Underwriting Association; Underwriters at Lloyd's, London; and Property Casualty Insurers Association of America; and Baach Robinson and Lewis (Washington, D.C. law firm), attorneys for amicus curiae Equitas

Reinsurance Limited (Jessica L. Biamonte, on the brief).

Bressler, Amery and Ross, attorneys for respondent New Jersey Property-Liability Insurance Guaranty Association did not file a brief.

PER CURIAM

Reinsurance Association of America (Association) appeals from an August 11, 2004, Chancery Division order, approving the Fourth Amended Final Dividend Plan (FDP) proposed by the Liquidator of an insolvent insurer, Integrity Insurance Company. We conclude that two sections of the FDP are legally unsupportable. Accordingly, we reverse and remand to permit consideration of a plan that addresses the deficiencies we identify.

Some background, taken from the testimony given to the court overseeing the liquidation proceeding, is necessary to understand the issues presented by this appeal. Integrity Insurance Company wrote commercial umbrella and excess liability insurance policies. Those policies insured against claims arising in areas such as product liability, environmental tort, and occupational disease. Many of the claims against which the policies insured are not likely to be discovered until after the passage of a substantial period of time. Consequently, claims for payment under Integrity's policies would not be expected to

be presented, if at all, until well after the policy in question was first written. Integrity spread its risk under its policies by entering into contracts of reinsurance, pursuant to which it was able to recover a portion of the payments it was required to make on claims under the policies that it issued. Many of the reinsurers, in turn, themselves reinsured the risks incurred through the policy of reinsurance issued to Integrity.

Integrity was determined to be insolvent by a March 24, 1987, order of the Chancery Division. It thereupon became subject to the Insurer Liquidation Act, N.J.S.A. 17:30C-1 to -31 (Act), which governs the liquidation of insolvent insurance companies. The Commissioner of Insurance (Liquidator) was appointed to marshal and liquidate the assets of Integrity. March 25, 1988, was established as the bar date by which claims against the Integrity estate were to be filed. See N.J.S.A. 17:30C-30. The order establishing the bar date, however, permitted claimants who had not yet been presented with a specific loss to file "policyholder protection claims." The filing of such a claim would permit a specific claim to be filed when the particulars became known, even if that should occur after the March 25, 1988, bar date.

Some 26,000 claims, including several thousand policyholder protection claims, have been filed. The claims fall into three

categories: "paid loss" claims; "outstanding losses;" and "incurred-but-not-reported" (IBNR) claims. "Paid loss" claims are those in which liability to a specific claimant in a specific amount has been identified. "Outstanding losses" are those for which a claim has been made by an identified party but the fact of liability and the amount of the claim are unresolved. IBNR claims are those that may, by virtue of historical experience, be expected to be filed, although the claimant, the nature of the claim, the responsibility for the claim and the amount of the claim are all unknown. The Liquidator has allowed $598,000,000 in paid claims and has estimated a potential liability on the policyholder protection claims of $2,055,335,000.

The Liquidator had several options to consider when she selected the manner in which the insolvent estate was to be closed. She might have chosen an absolute "cut-off" date. In that case the assets of the estate would have been marshalled and distributed to those claimants whose claims were actually determined by the given date. Claimants whose claims were not matured by the cut-off date would not share in the distribution. For that reason, a "cut-off" favors reinsurers and disfavors those holding IBNR claims.

Alternatively, the Liquidator might have selected a "run-off" in which the estate would have been kept open until substantially all of the claims had been liquidated, at which time the assets would be distributed. This plan disfavors policy holders with matured claims because they receive no payment until all claims are presented. It favors reinsurers because they pay only established claims and payment is not accelerated. It also has the effect of depleting the estate because of the administrative costs necessary to continue to manage the estate.

The Liquidator chose a middle course that was initially selected in January 1996. The FDP represents the fourth version of that plan. The FDP contemplates that the policyholders will submit an actuarial estimate of their IBNR claims, document the estimate by showing how it was calculated, and then discount the claim to present value. The claim will then be presented to the reinsurer responsible for that policy year. The reinsurer may participate in this process. If it declines to do so, it may still object to the allowance of a claim. The FDP requires that the objection be resolved by a special master appointed by the liquidation court although the reinsurance policies invariably contain clauses requiring disputes to be resolved by arbitration.

The Association's appeal challenges those provisions of the plan which permit the Liquidator actuarially to estimate claims not yet known but which may be presented at some time in the future and to compel Integrity's reinsurers to pay the sums thus computed to be distributed in accordance with the plan. The appeal also challenges that provision of the plan requiring the reinsurers to forfeit their contractual right to arbitration of disputes in favor of a dispute resolution monitored by the Chancery Division.

In support of its appeal, the Association argues that IBNR losses do not constitute a "claim" within the meaning of either the relevant insurance, and reinsurance, policies or the Act's provisions as set forth in N.J.S.A. 17:30C-20 and N.J.S.A. 17:30C-26(c)(4); that IBNR losses can never meet the conditions precedent to payment imposed by N.J.S.A. 17:30C-28a; and that the Act provides no authority to abrogate the contractual provisions for arbitration of disputes relating to the contracts of reinsurance.

The issues implicated by this appeal relate to the interpretation of statutory language and the provisions of insurance policies, and present legal, not factual, questions. Micheve, L.L.C. v. Wyndham Place at Freehold Condo. Ass'n., 370 N.J. Super. 524, 529-30 (App. Div. 2004) certif. denied, 186

N.J. 256 (2006); Fastenberg v. Prudential Ins. Co. of America, 309 N.J. Super. 415, 420 (App. Div. 1998). The trial court's resolution of legal issues is not entitled to any special deference and, accordingly, we review the order on appeal de novo. See Balsamides v. Protameen Chem., Inc., 160 N.J. 352, 372(1999); Manalapan Realty L.P. v. Twp. Committee of Manalapan, 140 N.J. 366, 378 (1995).

The judge concluded that IBNR claims meet the statutory requirements for participation in the estate. We disagree. That participation requirement is set out in N.J.S.A. 17:30C-28. N.J.S.A. 17:30C-28a sets out the general rule:

> a. No contingent claim shall share in a distribution of the assets of an insurer which has been adjudicated to be insolvent by an order made pursuant to [N.J.S.A. 17:30C-30] except that such claims shall be considered, if properly presented, and may be allowed to share where
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> (1) Such claim becomes absolute against the insurer on or before the last day fixed for filing of proofs of claim against the assets of such insurer[.]

The statute does not define the term "absolute." However, "the basic rule is that the statutory language should be given its ordinary meaning absent specific intent to the contrary." Mortimar v. Bd. of Review, 99 N.J. 393, 398 (1985). In common usage, "absolute" means "[f]ree; unconditional; unrestricted; not dependent on or pertinent to something else." (Ballentine's

Law Dictionary, 6 (3d ed. 1969)); "[f]ree from restriction, qualification, or condition; conclusive and not liable to revision." (Black's Law Dictionary, 7 (7th ed. 1999)). We take the term then to be synonymous with "unconditional" or "non-contingent".

IBNR claims are actuarial estimates and are, therefore, not absolute. They are derived from standards of measurement that vary according to the judgment of the valuator. They are nothing more than an estimate of the value of a potential actual loss that accounts both for the possibility that the loss will not occur and for the possibility that the extent of the loss will differ form the actuarial estimate. Accordingly, IBNR claims are not absolute and are prohibited by the statute from sharing in the estate.

Similar conclusions have been reached by other courts considering the issue. See Quackenbush v. Mission Ins. Co., 54 Cal. Rptr. 2d, 112, 113 (Ct. App. 1996) (holding the payment of estimated future IBNR losses are barred by a state statute prohibiting "unliquidated or undetermined" claims from sharing in the insolvent insurer's estate; In the Matter of the Liquidation of Am. Mut. Liab. Ins. Co., 747 N.E.2d 1215, 1233-34 (Mass. 2001) (commenting in dicta that allowing IBNR claims to share in an insolvent estate would be contrary to Massachusetts

law). See also Mary Cannon Veed, Cutting the Gordian Knot: Long-Tail Claims in Insurance Insolvencies, 34 Tort & Ins. L.J. 167, 183 (1998) (criticizing the trial court's prior published opinion[1] determining that IBNRs would be allowed to share in the insolvent estate.).

The Quackenbush court issued its ruling under a statutory provision analogous to N.J.S.A. 17:30C-28a:

> Claims founded upon unliquidated or undetermined demands must be filed within the time limit provided in this article for the filing of claims, but claims founded upon such demands shall not share in any distribution to creditors of a person proceeded against under section 1016 until such claims have been definitely determined, proved and allowed. Thereafter, such claims shall share ratably with other claims of the same class in all subsequent distributions.
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> An unliquidated or undetermined claim or demand within the meaning of this article shall be deemed to be any such claim or demand upon which a right of action has accrued at the date of the order of liquidation and upon which the liability has not been determined or the amount thereof liquidated.
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> [Cal. Ins. Code § 1025 (West 1996).]

We take that section, despite the Liquidator's claims to the contrary, to be the substantive equivalent of N.J.S.A. 17:30C-

[1] In the Matter of the Liquidation of Integrity Insurance Co., 299 N.J. Super. 677 (Ch. Div. 1996).

28. In ruling that INBR claims were not entitled to share in the estate, the California court said:

> While the Commissioner's policy and economic arguments may be persuasive, they cannot trump section 1025's express language. The Commissioner notes that actuarial estimates are used to assess the value of future liabilities, and are relied on in the insurance industry to set reserves and estimate future losses. The point of section 1025, however, is to preclude present payment of such contingent and unliquidated claims. The statutory scheme requires several steps. Even unliquidated and contingent claims must be filed before a court-set date. Claims not so filed are forever barred. Then, the claims must be made certain and liquidated before they can be paid. If the Commissioner chooses to liquidate an insolvent company quickly, some claimants who cannot make their claims certain and liquidated will lose their chance to participate. To avoid this result, the Commissioner could delay liquidation, continue to manage the insolvent company's assets, and give claimants more time to make their claims certain. Section 1025 simply precludes him from doing both. . . .

That language, of course, is not binding on us. See Meadowlands Basketball Assoc. v. Director, Div. of Taxation, 340 N.J. Super. 76, 83 (App. Div. 2001). Nevertheless, we find it persuasive and reach the same conclusion on the same analysis.

Nor can the Liquidator assert that the claim becomes absolute upon her determination to settle the claim. That is an alchemy, transmuting a contingent claim into an absolute claim,

that may be permissible under the policy, but not under the statute.

We understand that IBNR claims are recognized in the industry and assume, for purposes of this opinion, that they may be computed in a reasonable commercial manner. Nevertheless, the use of the IBNR estimates in the industry are limited to voluntary agreements relating to matters such as mergers and acquisitions, extensions of credit, selling reserves, and filing tax returns. These uses cannot justify the use proposed by the Liquidator. Indeed the testimony provided to the liquidation court was unanimously to the effect that the estimates will not achieve "100 percent accuracy." The opinions of the experts as to matching IBNR to reality included opinions that a recognition that they would not be an accurate match; that the likelihood of matching was zero, that the likely result would be some insurers paying more than their rightful share; and that the estimates would range within plus or minus twenty percent of the true outcome.

At least one other court has reached a contrary conclusion. See Angoff v. Holland-America Ins. Co. Trust, 937 S.W.2d 213 (Mo. Ct. App 1996). That case, however, was decided under a scheme pursuant to which the legislature had "specifically endorsed" the estimation of such claims. Id. at 217. For the

same reason, we believe the liquidation court's reliance, in upholding the provisions of the plan respecting IBNR claims, on bankruptcy cases was misplaced. Those cases were grounded, in large part, on 11 U.S.C.A. 502(c)(1), which specifically permits estimation "for purpose of allowance under this section [of] any contingent or undated claim, the fixing or liquidation of which is the case maybe would unduly delay the administration of the case." The Act has no analogous provision and the cases cited are, therefore, inapposite. The Liquidator cites an unpublished California decision, Fuller-Austin Insulation Co. v. Highlands Ins. Co., 200 W.L. 31005090 (Cal. Super. Ct. 2000). That case does not constitute precedent, see R. 1:36-3, and, pursuant to California rules, may not be cited or relied upon in any other action. See Cal. Rule 977(a). The decision was reversed in any event. 135 Cal. App. 4th 958 (2006). Although the liquidator asserts the reversal does not undermine the California trial court decision, we disagree. In any event, we find the trial court decision unpersuasive. We conclude, therefore, that IBNR claims cannot share in the estate under the general rule imposed by N.J.S.A. 17:30C-28a.

N.J.S.A. 17:30C-28b contains an exception to the general rule and permits contingent claims filed on behalf of a person with a cause of action against an insured of Integrity:

> b. Where an insurer has been so adjudicated to be insolvent, any person who has a cause of action against an insured of such insurer, shall have the right to file a claim in the liquidation proceeding, regardless of the fact that such claim may be contingent, and such claim may be allowed
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> (1) If it may be reasonably inferred from the proof presented upon such claim that such person would be able to obtain a judgment upon such cause of action against such insured[.]

IBNR claims cannot fall within this exception. By their very nature, they do not represent a claim by a particular person having a cause of action against an insured of Integrity. Nor is there any mechanism for demonstrating the likelihood that a given person would be able to obtain a judgment on the cause of action. IBNR claims, by their nature, are bulk claims representing all potential claimants and demonstrate only that historical experience suggests the insurers might have to pay an amount approximated actuarially. The statute prohibits the participation of unidentified claimants whose claims are unlikely to be reduced to judgment in the estate.

We are satisfied that the statutory bar prohibits the provisions of the plan allowing estimated claims to be reduced to present value. We do not, therefore, have occasion to discuss the Association's alternative argument that an IBNR loss cannot constitute a "claim." Accordingly, the provisions of the

plan permitting the use of IBNR losses is reversed and the matter remanded for consideration of any of the other available mechanisms for closing this estate. While the Liquidator has substantial discretion in choosing such a mechanism, she may not select one that contravenes the plain language of the Act.

Although we have determined that the plan may not be approved as currently drawn, we deal, nevertheless, with the Association's objection to the provisions of the plan requiring disputes to be resolved by the liquidation court and abrogating the arbitration clauses contained in the contracts of reinsurance. Integrity's reinsurance contracts include arbitration clauses. Section 5.5 of the FDP, on the other hand, prohibits arbitration of disputes concerning setoffs; the allowance, amount, and priority of distribution of claims; the allocation of allowed claims to reinsurance contracts; and other issues specifically relating to the application of the Act. Section 5.5 makes those disputes non-arbitrable.

Two federal acts require contractual arrangements for arbitration to be enforced: The Federal Arbitration Act, 9 U.S.C.A. §§ 1-16 (2004)(FAA) and The Convention on the Recognition and Enforcement of Foreign Arbitral Awards,

9 U.S.C.A. §§ 201-208 (2004) (The Convention). The Convention applies to arbitration agreements in a legal commercial relationship between a United States and a foreign citizen. 9 U.S.C.A. § 202 (2004). The Convention specifically permits removal of a state court action to a federal district court, which is authorized to compel arbitration. 9 U.S.C.A. §§ 205, 206 (2004). The FAA applies to arbitration clauses in a contract involving interstate commerce. Gras v. Assoc. First Capital Corp., 346 N.J. Super. 42, 47 (App. Div. 2001) certif. denied, 171 N.J. 445 (2002). Section 2 of the FAA, analogous to N.J.S.A. 2A:24-1, provides that arbitration agreements covered by the Act "shall be valid, irrevocable and enforceable, except as they may be subject to revocation" under general contract principles. 9 U.S.C.A. § 2 (2004). "In enacting Section 2 of the FAA, 'Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.'" Martindale v. Sandvik, Inc., 173 N.J. 76, 84 (2002) (quoting Southland Corp. v. Keating, 465 U.S. 1, 10, 104 S. Ct. 852, 858, 79 L. Ed. 2d, 1, 12 (1984)).

Those statutes, however, are subject to Section 1012 of the McCarran-Ferguson Act. 15 U.S.C.A. § 1012. That Act states in

Subsection (b): "No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance . . . unless such act specifically relates to the business of insurance." The Association claims that the Convention and the FAA invalidate the FDP provisions respecting arbitration; the Liquidator asserts that since the Act regulates insurance, the McCarran-Ferguson Act authorizes New Jersey to invalidate arbitration clauses in a liquidation proceeding.

This issue has been directly addressed by the Third Circuit in Suter v. Munich Reins. Co., 223 F.3d 150, 152-54 (3d Cir. 2000). The Third Circuit analyzed the issue:

> Under § 1012, state laws reverse preempt federal laws if (1) the state statute was enacted for the purpose of regulating the business of insurance, (2) the federal statute does not specifically relate to the business of insurance, and (2) the federal statute would invalidate, impair, or supersede the state statute.
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> (Id. at 160 (quotations omitted) (citing U.S. Dept. of Treasury v. Fabe, 508 U.S. 491, 501, 113 S. Ct. 2202, 2208, 124 L. Ed. 2d 449, 459 (1993)).]

Finally, the court conceded that the Insurer Liquidation Act, at least for purposes of its decision, should be presumed to have the purpose of regulating the business of insurance. Id. at

161. It concluded, however, that application of the FAA would not impair operation of the Insurer Act. It reasoned:

> The Liquidator's argument that the arbitration of this controversy and the enforcement of any award by the District Court will impair New Jersey's Liquidation Act ignores several obvious facts. This is not a delinquency proceeding or a proceeding similar to one. Nor is it a suit by a party seeking access to assets of the insurer's estate. Moreover, even if it were such, the Superior Court would have express authority to enjoin the plaintiff from proceeding in the event that it were to interfere with the proceedings before it. What this proceeding is a suit instituted by the Liquidator against a reinsurer to enforce contract rights for an insolvent insurer, which, if meritorious, will benefit the insurer's estate. Accordingly, we fail to perceive any potential for interference with the Liquidation Act proceedings before the Superior Court.
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> It is true, as the Liquidator stresses, that if the District Court or an arbitrator should decide the reinsurance agreement does not cover the disputed expenses, the estate will be smaller than if that issue was resolved in the Liquidator's favor. But the mere fact that policyholders may receive less money does not impair the operation of any provision of New Jersey's Liquidation Act.
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> [Ibid.]

Accordingly, it found that there was "no potential friction between The Liquidation Act and having this controversy decided

by an arbitrator[.]" Ibid. Consequently, the arbitration provisions in the contracts of reinsurance must be enforced.

We recognize that Suter is not binding upon us. See Dewey v. R. J. Reynolds Tobacco Co., 121 N.J. 69, 80 (1990). But we also recognize that we should accord due respect to that decision. Ibid. In any event, we find the decision directly on point and extremely persuasive. The result in Suter has been adopted by other courts. Amsouth Bank v. Dale, 386 F.3d 763, 780-83 (6th Cir. 2004); Northwestern Corp. v. National Union Fire Ins. Co. of Pittsburgh, 321 B.R. 120, 121 (Bankr. D. Del. 2005); Costle v. Fremont Indem. Co., 839 F. Supp. 265 (D. Vt. 1993).

We recognize that other federal courts have reached contrary decisions. See Davister Corp. v. United Republic Life Ins. Co., 152 F.3d 1277, 1280-82 (10th Cir. 1998), cert. denied, 525 U.S. 1177, 119 S. Ct. 1112, 143 L. Ed. 2d 108 (1999); Munich American Reins. Co. v. Crawford, 141 F.3d 585, 590-96 (5th Cir.), cert. denied, 525 U.S. 1016, 119 S. Ct. 539, 142 L. Ed. 2d 448 (1998); Stephens v. Am. Int'l. Ins. Co., 66 F.3d 41, 43-45 (2d Cir. 1995). Nevertheless, those cases are not persuasive.

Reversed and remanded for further proceedings consistent with this opinion.