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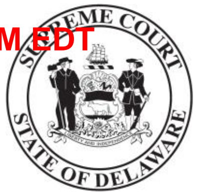

IN THE SUPREME COURT OF THE STATE OF DELAWARE

THE HONORABLE KAREN WELDIN STEWART, CIR-ML, INSURANCE COMMISSIONER OF THE STATE OF DELAWARE, IN HER CAPACITY AS THE RECEIVER OF SECURITY PACIFIC INSURANCE COMPANY, INC. IN LIQUIDATION, SPI-202, INC. IN LIQUIDATION, SPI-203, INC. IN LIQUIDATION, and SPI-204, INC. IN LIQUIDATION,	) No. 204, 2015
Plaintiff below, Appellant,	) Appeal from) Interlocutory) Order of the
v.	) Court of) Chancery
WILMINGTON TRUST SP SERVICES, INC.; JOHNSON LAMBERT & CO., LLP; JOHNSON LAMBERT, LLP; MCSOLEY MCCOY & CO.; and STEPHEN D. KANTNER,	) of the State of) Delaware in) Civil Action) No. 9306-VCP
Defendants below, Appellees.	)

APPELLANT'S REPLY BRIEF

Respectfully submitted,
/s/ Diane J. Bartels
Diane J. Bartels, DE Bar No. 2530
1807 North Market Street
Wilmington, DE 19802-4810
Tel. (302) 656-7207
Attorney for The Honorable Karen Weldin Stewart, CIR-ML, Insurance Commissioner of the State of Delaware, in her Capacity as Receiver of Security Pacific Insurance Company, Inc. in Liq., SPI-202, Inc. in Liq., SPI-203, Inc. in Liq., and SPI-204, Inc. in Liq.

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<u>**ARGUMENT**</u>

As explained in the Opening Brief ("OB") of the Receiver,[1] the Trial Court erred in finding that the public policy of the Delaware Uniform Insurers Liquidation Act (the "Insurers Liquidation Act"), and the Insurance Code generally, do not outweigh the public policy underlying the doctrine of *in pari delicto.* The counter arguments raised by the Appellees in their Consolidated Answering Brief ("CAB") do not change that result.

I. This Court Weighs the Public Policies at Issue

In their Brief, Wilmington Trust and the Auditor Defendants make the puzzling argument that this Court should not balance the public policy behind *in pari delicto* against that of the Insurers Liquidation Act. CAB at Sec. IV, pp. 28-30. They argue that "[a] fundamental tenet of the *in pari delicto* doctrine in Delaware is that the court is excused from weighing fault ***or balancing*** **policies**." (OB at pg. 29) (emphasis added). Presumably their intended support for this proposition is contained in the next sentence: "[q]uite to the contrary, '***that*** is precisely the type of analysis the doctrine is meant to avoid. '" *Id.* (quoting *In re Nortel Networks, Inc.,* 469 B.R. 478, 508 (Bankr. D. Del. 2012) and citing *In re*

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[1] The Receiver uses those party designations defined in her Opening Brief, *i.e.* "the Receiver," "Wilmington Trust," "Johnson Lambert," "McSoley McCoy," and "the Auditor Defendants" (Johnson Lambert and McSoley McCoy).

American Intern. Group, Inc., Consol. Derivative Litigation. ("*AIG II*"), 976 A.2d 872, 883 (Del. Ch. 2009), *aff'd* 11 A.3d 228 (Del. 2011)) (emphasis added).

However, neither *Nortel* nor *AIG II* remotely supports the proposition that a court does not balance public policies when construing the doctrine of *in pari delicto*. The *Nortel* Court's discussion of *in pari delicto* did not mention public policy, much less hold that a court should not balance it. Quoting the full sentence in *Nortel* makes clear that "***that***" refers only to apportioning relative fault: "The court need not engage in a detailed accounting of relative fault as that is precisely the type of analysis the doctrine is meant to avoid." (*Nortel*, 469 B.R. at 508).

Wilmington Trust and the Auditor Defendants' citation of *AIG II* is similarly unavailing. Rather than supporting the bizarre contention that a court does not weigh public policies when determining whether to apply the doctrine of *in pari delicto*, the *AIG II* Court holds the exact opposite: "even if the parties do bear equal fault, *in pari delicto* will not bar an action where the suit involves sufficiently important countervailing interests of public policy." 976 A.2d at 883.

Wilmington Trust and the Auditor Defendants further argue that this Court cannot consider the public policy of the Insurers Liquidation Act in determining the application of *in pari delicto* absent an explicit legislative determination. (CAB at pg. 29-30) Yet, this argument suffers from an endemic flaw -- it takes a single sentence or fragment from a case and presents it out of context to create a

broad proposition of law to support the argument. None of the cases cited by Wilmington Trust or the Auditor Defendants even mentions *in pari delicto*, and they do not support an inference that there must be a legislative determination of the "interplay between the policy goals advanced by *in pari delicto* and the applicable insurance regulatory laws." (CAB at pg. 29). Of course, any such legislative determination would moot the weighing of public policies.[2]

For example, the public policy discussion in *Sternberg v. Nanticoke Mem. Hosp., Inc.*, 62 A.3d 1212 (Del. 2013), is limited to whether a contractual fee-shifting provision (awarding fees to a prevailing party in lawsuits) in a hospital's credentials policy violated public policy based on a provision of the federal Health Care Quality Improvement Act ("HCQIA") allowing fee-shifting where the claim or conduct was "frivolous, unreasonable, without foundation, or in bad faith." *Id.* at 1216. In *Sternberg*, this Court held that "[o]ther state and federal courts, including the U.S. Supreme Court, have recognized that other provisions of the HCQIA do not preempt more stringent state laws or contracts interpreted under state law." *Sternberg*, 62 A.3d at 1217-18. The Court then held that until Congress or the General Assembly created such a limitation, private parties could

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[2] Although the bill which, *inter alia,* would have precluded parties from asserting a defense of *in pari delicto* was withdrawn from consideration due to opposition to unrelated portions, neither the existence of the bill, nor its withdrawal (or conversely, its hypothetical future approval), has any relevance to the issue before the Court: the weighing of the public policies of *in pari delicto* and the Insurer Liquidation Act which does not contain such a provision. Further, there is nothing in the record below concerning this legislation.

contract for broader standards. *Id.* This case does not stand for the proposition asserted by Wilmington Trust and the Auditor Defendants.

Similarly, Wilmington Trust and the Auditor Defendants' citation to *Shea v. Matassa*, 918 A.2d 1090, 1092 (Del. 2007), and *Moss Rehab. v. White*, 692 A.2d 902, 909 (Del. 1997), for the proposition that the General Assembly should resolve competing issues of public policy does not apply, as the quoted language is taken completely out of context. In both cases, the issue was ***not*** the weighing of competing public policies to determine the application of *in pari delicto*. Instead, it was whether the court should allow a common law cause of action (for dram shop liability in *Shea*, and for third party claims for education malpractice by a driving school in *Moss Rehab*). Neither case suggests that this Court should deviate from the long-settled Delaware practice that "the *in pari delicto* defense will not be applied when its acceptance would contravene an important public policy." *In re HealthSouth Corp. S'hlders Litig*., 845 A.2d 1096, *aff'd* 847 A.2d 1121 (Del. 2004). *See also Seacord v. Seacord*, 139 A. 80, 81 (Del. Super. 1927). In addition, both the United States Supreme Court and the Court of Chancery have noted the general practice of courts weighing competing public policies in determining whether to apply the doctrine of *in pari delicto*. *See Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985) ("the public policy considerations that undergirded the *in pari delicto* defense were frequently

construed as precluding the defense even where the plaintiff bore substantial fault for his injury"); *AIG II*, 976 A.2d at 883 n. 24 (quoting 3 JOHN NORTON POMEROY, EQUITY JURISPRUDENCE § 941 ("Whenever public policy is considered as advanced by allowing either party to sue for relief against the transaction, then relief is given to him").

II. The Public Policy Concerns Apply to Captive Insurers

In addition to the quantitative lack of discussion on the contours of the public policy relating to the Insurers Liquidation Act, Wilmington Trust and the Auditor Defendants completely ignore the recently decided case of *Cohen v. State ex rel. Stewart*, 89 A.3d 65 (Del. 2014), in which this Court extensively discussed the public policy that underpins the Insurers Liquidation Act.[3]

Indeed, their Brief is devoid of citation to ***any*** caselaw in its discussion of the public policy relating to insurers. (CAB at pg. 13). Instead, the entirety of Wilmington Trust and the Auditor Defendants' arguments focus on the irrelevant fact that the various entities in liquidation are captive insurance companies, which

[3] *See Cohen*, 89 A.3d at 89 (acknowledging "the important public policy interest of protecting policyholders served by the Insurers Liquidation Act." *Id.* at 79 (citing with approval *Matter of Transit Cas. Co.*, 588 N.E.2d 38, 42 (N.Y. 1992) ("The over-all purpose of the Uniform Act, like liquidation proceedings generally, is not only to preserve available assets for the benefit of creditors, but to protect the interest of persons who purchased insurance policies from a company which has become insolvent")); *Id.* at 93 (under Insurers Liquidation Act, Commissioner "is charged with preventing further damage to an insurer and protecting the remaining assets to pay the potential claims of policyholders and creditors)(citing *Kentucky Cent. Life Ins. Co. v. Stephens,* 897 S.W.2d 583 (Ky. 1995) (the purpose of the Uniform Insurers Liquidation Act is "the protection of the interest of the insured, creditors, and the public generally")).

are formed to essentially "self-insure" the liabilities of each of its participants, and are subject to their own set of regulations.[4] (*Id.*) (citing 18 *Del. C.* §§ 6901 *et seq.* [Captive Insurance Companies]).

Wilmington Trust and the Auditor Defendants later argue that the SPI Entities should be treated the same way as shareholders in derivative actions for purposes of application of the *in pari delicto* argument, as the actual policyholders in this case were "sophisticated corporations" and thus "akin to the sophisticated types of shareholders who typically bring derivative actions." (CAB at pg. 23). The record has not yet been developed as to the extent of the actual policyholders' "sophistication" concerning insurance matters as discovery has not yet been undertaken in the matter below. Neither of these arguments is persuasive.

A. The Insurers Liquidation Act Applies to Captive Insurers

In arguing that "Captive Insurers…are subject to their own set of regulations" (CAB at pg. 13), Wilmington Trust and the Auditor Defendants ignore the fact that those "regulations" specifically include the provisions of the Insurers Liquidation Act. *See* 18 *Del. C.* § 6918 ("To the extent not inconsistent with this chapter, the provisions of Chapter 59 of this title shall apply to captive insurance companies licensed under this chapter (including for this purpose individual

[4] This too is misleading and an irrelevant distinction as many of the provisions of the Delaware Insurance Law that are applicable to non-captive insurers are also expressly made applicable to captive insurers. *See* 18 *Del. C.* §§6903, 6916, 6918. This includes the ***Insurers Liquidation Act***. 18 *Del. C.* § 6918.

protected cells of sponsored captive insurance companies as set forth in § 6938 of this title")). The Liquidation and Injunction Order recites that the Chancery Court is authorized under, *inter alia*, § 6918 to issue the Order. (A-160).

The public policy interests applicable to what Wilmington Trust and the Auditor Defendants refer to as "typical insurance compan[ies]" (CAB at pg. 13) apply with equal force to captive insurance companies. Delaware insurance law provides an integrated scheme that regulates the entire insurance marketplace which is dependent upon the symbiotic role that traditional and captive insurers play in the market Thus, the Insurers Liquidation Act does not treat insurers differently based upon their size or underlying structure.

Indeed, in *Cohen*, the insurance company, Indemnity Insurance Corporation, RRG, was a Risk Retention Group. 89 A.2d at 70. Like the SPI Entities here, risk retention groups are captive insurers under 18 *Del. C.* §§ 6901 *et seq.* *See* 18 *Del. C.* § 6902(12) (including risk retention groups with definition of "captive insurance company").

Wilmington Trust and the Auditor Defendants appear to be arguing that the public policy concerns under the Insurer Liquidation Act do not apply to small

insurance companies. In effect, they argue that three policyholders[5] are not enough, but presumably some indeterminate number would be enough, whether that number is 4, 10, 100 or 1,000. However, this is not the law, and Wilmington Trust and the Auditor Defendants provide no authority or cogent argument for this anomalous position. Not only is such an argument unsupported by authority, but it is also based on fact, which would not be appropriate for a motion to dismiss. Further, as discussed below, there are significant difference between liquidations of captive insurers and shareholder derivative suits.

B. Liquidations of Captive Insurers Are Not Akin to Shareholder Derivative Suits

Wilmington Trust and the Auditor Defendants make the cursory argument that the policyholders were not "mom-and-pop" buyers of retail insurance policies, but were "sophisticated corporations" and that therefore are "akin to the sophisticated types of shareholders who typically bring derivative actions." (CAB at pg. 23). This argument is made without citing any authority, or the suggestion in any case that the size or sophistication of policyholders of an insolvent insurer would nullify the strong public policy underlying the Insurers Liquidation Act.

[5] As set out in the consolidated financial statement of the SPI Entities, the policies provided to OOM, LLC, Ryan Building Group, Inc., and Alexa Holdings, Inc. covered home warranty, construction defect, and mold claims with regard to the homebuilding businesses of each of the policyholder entities. (A-263, 270).

Wilmington Trust and the Auditor Defendants recognize that captive insurers are required to select from a list of audit firms and captive managers that are pre-approved by the Commissioner. (CAB at pg. 35) (citing 18 *Del. Admin. C.* §§ 302-2.4, 302-4.2). What they ignore is that this is required because the participant/policyholders "do not already routinely possess the experience or expertise to supervise and operate their 'insurance company' on their own" and so "rely and are highly dependent upon the experience, expertise, and oversight of outside consultants" including auditors and captive managers. (A-19-20).

As discussed at pages 29-30 in the Receiver's Opening Brief, in dicta in *In re American Intern. Group, Inc., Consol. Derivative Litigation (*"*AIG I*"*),* 965 A.2d 763 (Del. Ch. 2009), aff'd 11 A.3d 228 (Del. 2011), and *AIG II*, the Court of Chancery suggested that claims in a stockholder derivative lawsuit against a company's auditor or other corporate agents would be treated the same as claims against a corporate fiduciary. *AIG I*, 965 A.2d at 828 & n. 246; *AIG II*, 976 A.2d at 895 & n. 60. As the Court of Chancery noted, this would have the effect of allowing such claims to proceed even over a defense of *in pari delicto*. *Id.* Wilmington Trust and the Auditor Defendants, throughout their Brief, consistently elide the distinction between *AIG I*'s holding which applies to corporate agents only under New York law, with *AIG II's* holding that addresses claims against third party co-conspirators. Indeed, Wilmington Trust and the Auditor Defendants

go so far as to assert that they are not "corporate agents" (CAB at pg. 27) despite *AIG I* and *AIG II*'s clear statements that auditors and similar entities were "corporate agents." *AIG I*, 965 A.2d at 828 n. 246, *AIG II*, 976 A.2d at 890 n. 49.

The analysis in the *AIG I* and *AIG II* cases, as well as the cases and commentators cited in those cases, shows that the public policy interests underlying application of the *in pari delicto* doctrine are reduced in claims against corporate agents. The Receiver submits that the public policy underlying *in pari delicto* is further reducted in the case of a captive insurance company, where special reliance is placed on corporate agents such as auditors and captive managers. Further, in a captive insurance company, protection of the public and policyholders is further imperative because policyholders in captive insurance companies are ***not*** protected by guaranty insurance coverage.[6] 18 *Del. C.* § 6913.

C. Cases Relating to Bankruptcy Trustees Are Not Applicable

Wilmington Trust and the Auditor Defendants assert that bankruptcy trustees "stand in the shoes" of the defunct entities and are therefore subject to defenses

[6] Each state has formed guaranty associations or funds (the "Guaranty Associations") which are responsible for making payments on certain claims of policyholders who reside in that state, with the Guaranty Association then becoming a creditor of the insolvent estate and, under some circumstances, succeeding to payment and reimbursement rights of the insolvent insurer. *See generally* Philip A. O'Connell, Jr., Christopher E. Prince, and Joel T. Muchmore, *Insurance Insolvency: A Guide For the Perplexed*, 27 No. 14 Ins. Litig. Rep. 669 (2005). The role of Guaranty Associations is to provide a safety net for the policyholders of insurers that are in liquidation, subject to the limitations and conditions of the Guaranty Associations' enabling statutes. Toward this end, the regulation of delinquent insurance carriers is designed to assure that policyholders are paid timely notwithstanding a liquidation proceeding.

based on the imputed conduct of the entity. (CAB at pg. 24) (citing cases). The appellees then assert, without citation to authority, that "[t]he same principle should apply to a receiver." *Id.* In doing so, the appellees ignore the fact that the very cases they cite suggest that bankruptcy cases on imputation should not be extended beyond the confines of bankruptcy.

In fact, in *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co. Inc.* 267 F.3d 340 (3d Cir. 2001), the Third Circuit made clear that the application of the *in pari delicto* doctrine was based on the fact that 11 U.S.C. § 541 *did not allow* a court to take into account the trustee's status as an innocent successor. *Id.* at 357-58. The Court distinguished this result as different from state-law receivers. The Court recognized that:

> We certainly acknowledge that, in the receivership context, several courts have declined to apply *in pari delicto* to bar the receiver from asserting the claims of an insolvent corporation on the ground that application of the doctrine to an innocent successor would be inequitable. These courts have thought it proper to consider events arising after a corporation enters into receivership. See, e.g., *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on ... [an] innocent entity that steps into the party's shoes pursuant to court order or operation of law."); *Scholes [v. Lehmann]*, 56 F.3d [750] at 754 [(7th Cir. 1995)] (stating that "the defense of *in pari delicto* loses its sting when the person who is in *pari delicto* is eliminated") ***These cases are easily distinguishable, however; unlike bankruptcy trustees, receivers are not subject to the limits of section 541.***

Id. at 358 (emphasis added). Bankruptcy cases provide no support for Wilmington Trust and the Auditor Defendants in this case.

III. The Public Policy Interests Underlying the Insurers Liquidation Act Outweigh Those Underlying the *In Pari Delicto* Doctrine

The *in pari delicto* doctrine is based on principles that "courts should not lend their good offices to mediating disputes between wrongdoers" and that "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality") *AIG II*, 976 at 883, n. 21 (quoting *Bateman Eichler, supra*). These twin purposes lose much of their force in an insurance delinquency proceeding and are outweighed by the public policy behind the Insurers Liquidation Act.

It is important to note that the *in pari delicto* doctrine is ***not*** for the benefit of either party or to punish them, but instead is imposed from motives of public policy. *Id.*, at n. 21. Wilmington Trust and the Auditor Defendants have no "right" that is affected by a denial of their *in pari delicto* defense, and a denial of the defense wreaks no inequity on them. Instead, the sole issues are whether the policy basis of the *in pari delicto* doctrine applies, and whether that policy is outweighed by the public policy of the Insurers Liquidation Act.

A. Application of the *In Pari Delicto* Doctrine to the Receiver Would Not Be an Effective Way to Deter Illegality

Unlike a shareholder derivative claim, or even the case of a corporate receivership, application of *in pari delicto* here will not deter illegality. Wilmington Trust and the Auditor Defendants assert that "when the [Delaware Department of Insurance ("DDOI")] knows that imputation defenses may apply to a claim to recover against a third-party service provider for the fraud perpetrated by an insurer's insiders, the DDOI should be further incentivized to vigilantly exercise its regulatory authority over insurers as well as over service providers to the insurers. "[7] (CAB at pg. 26).

Wilmington Trust and the Auditor Defendants cite no authority for the novel proposition that a government regulator would be incentivized to better exercise its regulatory duties by the inability for a receiver ultimately appointed by the Chancery Court to recover against third parties for distributions under a statutory priority scheme. *Compare AIG II,* 976 A.2d at 895 (listing entities with a direct financial interest in payments as constituencies which would be incentivized by a lack of an ability to recover such payments).

[7] The assertion at footnote 8 (page 26) of the CAB that the DDOI "did not fulfill its oversight duty" is factually incorrect and unsupported by the record.

B. Courts Should Decide Cases Involving the Wrongdoing of Insurers and Their Agents

As the United States Supreme Court has held, relying on long-established equitable considerations, "[T]here may be on the part of the court itself a necessity of supporting the public interests or public policy in many cases, however reprehensible the acts of the parties may be." *Bateman Eichler, supra,* 472 U.S. at 306 (quoting 1 J. Story, Equity Jurisprudence 305 (13th ed. 1886)). This is such a case.

1. General Receivership Cases Show the Decreased Importance of the Policy Considerations Behind *In Pari Delicto*

Wilmington Trust and the Auditor Defendants cite cases from foreign jurisdictions where courts have applied the *in pari delicto* doctrine to the claims of a general receiver. (CAB at pg. 19). Likewise, the Receiver cited cases from foreign jurisdictions where courts hold that the *in pari delicto* doctrine does ***not*** apply to claims brought by a general receiver. (OB at pp. 24-26).

Appellees also cite cases for the proposition that a general receiver "stands in the shoes" of the company for which it is the receiver, and then miscite 65 Am. Jur. 2d Receivers §367 (2011) for the proposition that a receiver is "subject to the same defenses" that could have been asserted against the company for which it was appointed receiver. (CAB at pg. 14).

In doing so, they ignore that the same provision of Am. Jur. upon which they rely further makes clear that "[t]he defenses based on a party's unclean hands or inequitable conduct ***do not generally apply*** against that party's receiver. Actions by equity receivers against third parties are viable, ***even if a member of the entity in receivership participated in a third party's fraud, where the wrongdoer has been removed***." 65 Am. Jur. 2d Receivers § 367 (emphasis added). They also ignore *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.,* 906 A.2d 168, 212 n. 132 (Del. Ch. 2006), *aff'd* 931 A.2d 438 (Del. 2007), which approvingly cited *Scholes v. Lehmann,* 56 F.3d 750 (7th Cir.), cert. den. 516 U.S. 1028 (1995), as "explaining that the defense of *in pari delicto* functions to prevent a wrongdoer from profiting from the recovery awarded by a court for the wrong but that when the wrongdoer will not be able to share in the corporation's recovery the defense of *in pari delicto* 'loses its sting'"). Trenwick, 906 A.2d at 212 and n. 132.

Although none of the cases are directly binding on this Court, they show that the policy interest in applying *in pari delicto* is lessened where, as here, the wrongdoer has been replaced. This Court need not hold that the appointment of a general receiver (not an insurance insolvency receiver) in all cases negates the application of *in pari delicto.* Rather, because the "guilty" party has been

removed, the public policy behind application of the *in pari delicto* argument is reduced. *See, e.g., Trenwick,* 906 A.2d at 212 n. 132.[8]

2. Cases Specifically Relating to Insurance Insolvency Show that the *In Pari Delicto* Doctrine Should Not Be Applied Against the Receiver

The Receiver cited numerous cases of other states which held, for public policy purposes, that a receiver appointed in an insurance insolvency case pursuant to that state's version of the Insurers Insolvency Act does not "stand in the shoes" of the insurer for purposes of a defense of *in pari delicto* because of the nature of that receiver's role in protecting the public, policyholders, and creditors. (OB at pp. 27-34). Wilmington Trust and the Auditor Defendants unsuccessfully attempt to distinguish three of those cases. (CAB at pp. 31-34).

Wilmington Trust and the Auditor Defendants argue that the decisions in *McRaith v. BDO Seidman, LLP*, 909 N.E.2d 310 (Ill. App.), *appeal den.* 919 N.E.2d 354 (Table) (Ill. 2009), and *Reider v. Arthur Andersen, LLP,* 784 A.2d 464 (Conn. Super. 2001), "are readily distinguishable because there was no factual basis upon which to impute the wrongdoing to the corporate master. Indeed, had

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[8] As discussed in the Receivers Opening Brief, the identity of the defendants is further reason the policy behind *in pari delicto* is reduced. In dicta in *AIG I* and *AIG II,* the Court of Chancery suggested that although New York law applied, under Delaware law claims in a stockholder derivative lawsuit against a company's auditor or other agents would be treated the same as claims against a corporate fiduciary. *AIG I*, 965 A.2d at 828 & n. 246; *AIG II*, 976 A.2d at 895 & n. 60. As the Court of Chancery noted, this would have the effect of allowing such claims to proceed even over a defense of *in pari delicto*. *Id.*

these cases arisen outside of the receivership context the outcome, presumably, would have been the same vis-á-vis imputation." (CAB at pg. 32). This is simply dead wrong. Both *McRaith* and *Reider* engaged in a substantial analysis of the public policy relating to insurance insolvencies and held that, ***because of such policy***, the "sole actor" exception to the adverse interest exception to impute the fraud of an individual to the corporation did not apply to the insurance receiver . *McRaith,* 909 N.E.2d at 331-336; *Reider, 784 A.2d* at 472-475.

Further, *McRaith* separately considered the doctrine of *in pari delicto* from that of imputation, and held that:

> In the instant case, the *in pari delicto* doctrine cannot apply because the Liquidator, by statutory definition, is not the wrongdoer; rather, he serves to protect the insurance industry and the public interest by ensuring the victims of the misconduct can recover monies entitled to them. To equate the Liquidator with Engle under *in pari delicto* is illogical and unavailing.

McRaith, 909 N.E.2d at 336.

Wilmington Trust and the Auditor Defendants' attempt to distinguish *Arthur Andersen v. Superior Court,* 79 Cal. Rptr.2d 879 ((1998), *reh. den*. (1998), *rev. den.* (1999), is similarly unavailing. The Consolidated Answering Brief asserts that the *Arthur Andersen* Court allowed the Commissioner (as receiver) to sue for audit malpractice because the Commissioner was a reasonably foreseeable user of the audit reports. (CAB at p. 34) (citing *Arthur Andersen, 79 Cal. Rptr.2d at 896,* 67 Cal. App. 4th at 1506). While ***one basis*** of the Court's decision was, indeed,

that the Commissioner's use of the audit report was foreseeable, Arthur Andersen ("AA") also made ***other*** arguments in the case. The argument and holding which is relevant to this case appears ten pages earlier in the opinion. As the *Arthur Andersen* Court explained:

> ...AA's argument continues by noting that an *ordinary receiver* is generally subject to the same defenses as the entity for whom the receiver acts. In the context of ordinary receiverships, there is a line of cases concerning the circumstances in which the knowledge of the officers or owners of an entity in receivership will or will not be "imputed" to a receiver who is suing a third party on behalf of the entity in receivership. AA argues that these cases apply, and require that the knowledge of Cal–American's CEO and CFO be imputed to the Insurance Commissioner, on the apparent although not expressly stated) [sic] theory that the Insurance Commissioner acts merely as an ordinary receiver. The argument concludes that this "imputation" bars the Insurance Commissioner's claims.

Arthur Andersen, 79 Cal. Rptr.2d at 888, 67 Cal. Appl.2d at 1494-95 (emphasis in original). In short, the identical argument made by Wilmington Trust and the Auditor Defendants was presented to the *Arthur Andersen* Court. As set forth at length in the Receiver's Opening Brief, the *Arthur Andersen* Court rejected this argument based on the fundamental distinction between an "ordinary receiver" and a receiver in an insurance delinquency proceeding. (OB at 33) (quoting *Arthur Andersen,* 79 Cal. Rptr.2d at 888, 67 Cal. App. 4th at 1495).

Arthur Andersen also makes short work of Wilmington Trust and the Auditor Defendants' convoluted attempt to make a distinction between bringing claims "on behalf of" and "for the benefit of." (CAB at pp. 14-18). California's

version of the Insurers Liquidation Act, like Delaware's, does not contain the type of "for the benefit of" language that Wilmington Trust and the Auditor Defendants deem essential. Nevertheless, the *Arthur Andersen* Court, like the Receiver, construed Cal. Ins. Code § 1037[9] in the way the Receiver construes the Insurers Liquidation Act and ¶9 of the Liquidation Order. *Arthur Anderson*, 79 Cal. Rptr.2d at 888-889, 67 Ca. App.4th at 1495-96. In disposing of a similar argument as that made by Wilmington Trust and the Auditor Defendants, the *Arthur Anderson* Court explained:

> First, AA emphasizes that the Insurance Commissioner has conceded that he is not pursuing the claims of individual policyholders or others interested in Cal–American's estate. AA magnifies this concession into an argument that the Insurance Commissioner therefore may not recover damages for the benefit of the policyholders. This does not follow. There is a significant distinction between pursuing a claim of negligent misrepresentation on behalf of the liquidation estate versus pursuing the idiosyncratic claims of numerous policyholders. Some policyholders have insurance claims against Cal–American's estate. The Insurance Commissioner is simply assembling funds to pay those claims. Many policyholder claims have been converted into claims by the California Insurance Guaranty Association ("CIGA"), which paid claims that Cal-American's depleted estate was unable to pay. CIGA therefore now also has claims against Cal–American's liquidation estate. Although the Insurance Commissioner is suing for the benefit of policyholders and CIGA in the sense that he sues to recover for the liquidation estate, since funds in the liquidation estate will be used to pay policyholder and CIGA claims, it is clear that the Insurance Commissioner is not asserting, for example, the claim of any particular individual for a negligent misrepresentation made directly to that individual.

[9] The applicable section of the Cal. Ins. Code is similar to ¶9 of the Liquidation Order, and does not contain "on behalf of" language.

Arthur Andersen, 79 Cal. Rptr.2d at 889-890, 67 Cal. App. 4th at 1496-97 (citations omitted).

The Wilmington Trust and Auditor Defendants offer no reasoned basis for this Court to find in derogation of the numerous insurance insolvency receiver cases cited by the Receiver at pages 27-34 of her Opening Brief holding that the doctrines of imputation and/or *in pari delicto* do not apply to claims brought by a receiver in an insurance delinquency matter.

V. CONCLUSION

For the foregoing reasons, this Honorable Court should reverse that portion of the Trial Court's Order of March 26, 2015, dismissing Counts 2-3, 5-7, and 9-10 of the Complaint.

Dated: July 27, 2015

Respectfully submitted,

/s/ Diane J. Bartels
Diane J. Bartels (Del. Bar No. 2530)
Brandywine Village
1807 North Market Street
Wilmington, DE 19802-4810
Tel. (302) 656-7207

Attorney for The Honorable Karen Weldin Stewart, CIR-ML, Insurance Commissioner of the State of Delaware, in her Capacity as the Receiver of Security Pacific Insurance Company, Inc. in Liquidation, SPI-202, Inc. in Liquidation, SPI-203, Inc. in Liquidation, and SPI-204, Inc. in Liquidation