Declaratory Ruling 88-9459-M

Payment of pre-judgment interest on covered claims

February 29, 1988

I. BACKGROUND

By a letter dated December 15, 1987, Carollo, Inc., sets forth its position that the Michigan Property and Casualty Guaranty Association (the Association) is required to pay and discharge all pre-judgment interest arising from a judgment against Carollo, Inc. The corporation stated the background facts as follows:

> Carollo, Inc. was sued in August, 1983 for a slip and fall accident. During the litigation, the primary insurance carrier (Union Indemnity Insurance Company) went into receivership. The receiver was appointed July 17, 1985. The case then was referred to the Michigan Property & Casualty Guaranty Association for handling. The case went to trial and a jury returned a $190,000 verdict against Carollo, Inc. Michigan prejudgment interest rate is 12% per annum and the Guaranty Association maintains it is not liable for interest on the judgment from the date of filing the Complaint until the date the receiver was appointed. The disputed interest amount, then, would be in the neighborhood of $45,000.

By a letter dated January 4, 1988, Carollo, Inc., requested a declaratory ruling. The corporation identified the issue as whether the Association is responsible for pre-judgment interest allocated to a time period prior to the appointment of a receiver in respect to an insolvent insurer.

The staff of the Insurance Bureau (Staff) by a letter dated January 13, 1988, gave the Association an opportunity to respond to the request. The Association declined to join in the request for declaratory ruling and declined to address the substantive issue raised by Carollo, Inc. Instead, the Association asserted that the Commissioner of Insurance (Commissioner) does not have the authority to issue a declaratory ruling with respect to the Michigan Property and Casualty Guaranty Association Act (Act), MCLA 500.7901 et seq.; MSA 24.17901 et seq., at the request of an insured of an insolvent insurer.

Declaratory rulings with respect to the application of a statute are governed by Section 63 of the Administrative Procedures Act of 1969, as amended (APA), MCLA 24.263; MSA 3.560(163). That section provides:

> On request of an interested person, an agency may issue a declaratory ruling as to the applicability to an actual state of facts of a statute administered by the agency or of a rule or order of the agency. An agency shall prescribe by rule the form for such request and procedure for its submission, consideration and disposition. A declaratory ruling is binding

> on the agency and the person requesting it unless it is altered or set aside by any court. An agency may not retroactively change a declaratory ruling, but nothing in this subsection prevents an agency from prospectively changing a declaratory ruling. A declaratory ruling is subject to judicial review in the same manner as an agency final decision or order in a contested case.

Carollo, Inc., has an intense interest in whether the Association is required to pay the pre-judgment interest in question. The facts it sets forth are actual, not hypothetical. The Act is part of the Insurance Code of 1956, as amended (Code), MCLA 500.100 et seq.; MSA 24.1100 et seq. As established by Section 200 of the Code, MCLA 500.200, MSA 24.1200, the Commissioner is charged with the execution of the laws in relation to insurance and surety business and to perform such other duties as may be required by law. In particular, Section 7949(1) of the Code, MCLA 500.7949(1); MSA 24.17949(1), provides that the operation of the Association at all times shall be subject to the regulation of the Commissioner. Thus, the Commissioner may issue a declaratory ruling as requested by Carollo, Inc.

II. ISSUE

The issue presented by this request for a declaratory ruling is whether pre-judgment interest from the date of the filing a complaint against an insured to the date a receiver is appointed for the insolvent insurer is excluded from being a covered claim by Section 7925(6) of the Code, MCLA 500.7925(6) MSA 24.17925(6).

III. ANALYSIS

Introduction

The Association is required, by Section 7931(1) of the Code, MCLA 500.7931(1); MSA 24.17931(1), to pay and discharge covered claims for the amount by which each covered claim exceeds $10. Covered claims is defined in Section 7925(1) of the Code, MCLA 500.7925(1); MSA 24.17925(1), as follows:

> "Covered claims" means obligations of an insolvent insurer which meet all of the following requirements:
>
> (a) Arise out of the insurance policy contracts of the insolvent insurer issued to residents of this state or are payable to residents of this state on behalf of insureds of the insolvent insurer.
>
> (b) Were unpaid by the insolvent insurer.
>
> (c) Are presented as a claim to the receiver in this state or the association on or before the last date fixed for the filing of claims in the domiciliary delinquency proceedings.

> (d) Were incurred or existed before, at the time of, or within 30 days after the date the receiver was appointed.
>
> (e) Arise out of policy contracts of the insolvent insurer issued for all kinds of insurance except life and disability insurance.
>
> (f) Arise out of insurance policy contracts issued on or before the last date on which the insolvent insurer was a member insurer.

There appears to be no dispute as to whether or not the claim of Carollo, Inc., meets the definition of covered claims. However, the Association asserts that the pre-judgment interest in question is excluded by Section 7925(6) of the Code, which states:

> Covered claims shall not include adjustment fees and expenses, attorneys' fees and expenses, court costs, interest, or bond premiums if the fees, expenses, costs, interest, or premiums were incurred by the insolvent insurer before the receiver was appointed.

This gives rise to two questions. Is the pre-judgment interest in dispute embraced by the term "interest" in Section 7925(6)? Whether or not pre-judgment interest is included, would contingent, undetermined pre-judgment interest be "incurred" as that term is used in Section 7925(6)?

Interpretive Framework

In answering the interpretive questions posed above, it is necessary to understand the purpose of the Association. This will provide a basis for determining whether the terms "interest" and "incurred" should be interpreted narrowly or broadly.

The Michigan Supreme Court has clearly set forth the purpose of the Act in Metry v Mich Guaranty Ass'n, 403 Mich 117 (1978). The court states, at 121-122:

> We conclude that the Court of Appeals correctly found that attorney fees for services rendered prior to insolvency are not covered claims. The act is designed to protect from potentially catastrophic loss persons who have a right to rely on the existence of an insurance policy -- the insureds and persons with claims against the insureds. Persons in such categories are relatively helpless with regard to the insolvency of an insurer. They are not likely to be in a position to evaluate the financial stability of the insurance company and they have no control over the time at which their claims arise. Other creditors of the insurance companies, such as attorneys, have an ongoing relationship with the company and can presumably judge its financial position. Further, they are in a position to protect themselves from the serious consequences of an insurance company's insolvency by negotiating appropriate provisions in their contracts regarding the frequency of billing and payment.

The claims of the plaintiff law firms arise not out of the insurance policies, but rather out of their contracts for legal services entered into with the insurance companies. Accordingly, we conclude that fees for pre-insolvency legal services are not "covered claims."

Similarly, the Michigan Court of Appeals, in Allen v Mich Prop and Cas Guar, 129 Mich App 271, 274 (1983), stated:

> In interpreting the act, we employ certain well-established principles of statutory construction governing insurance laws. Since the insurance business is one affected with a public interest, laws applicable to insurance are to be liberally construed in favor of the policyholders, creditors and the general public. Statutes relative to insurance will be construed in the most beneficial way which their language will permit to prevent absurdity, hardship or injustice, to favor public convenience and to oppose all prejudice to public interests. The statute is to be given a reasonable construction looking to its purpose and the object it seeks to accomplish. [Citations omitted.]

Interest

It is highly significant, particularly in light of the court's discussion in Metry above, that the items listed in Section 7925(6) relate to expenses or obligations of the insolvent insurer towards persons other than insureds or claimants. For example, adjustment fees and expenses would be owed to adjusters. Attorneys' fees and expenses would be owed to attorneys. Court costs may be owed to the court or to a person who paid those costs on behalf of the insurer. Bond premiums would be a litigation expense of the insurer.

In this context, the position advanced by Carollo, Inc., with respect to "interest" is persuasive. The corporation points out in its letter of December 15, 1987, that it is common for attorneys to impose interest charges on fees that are paid late. Since the main thrust of Section 7925(6) is to exclude claims of creditors other than policyholders, it is appropriate to infer that the interest excluded is interest based on those claims. In concluding that "interest" does not include pre-judgment interest, policyholders are protected from hardship.

Interpreting "interest" as not including pre-judgment interest is consonant with Metry. The court underscores the difference in position of insureds and persons with claims against insureds as contrasted with other creditors of the insurance company. The court's analysis suggests that all of the excluded items in Section 7925(6) relate to other creditors of the insurance company that have an ongoing relationship with the company and can judge its financial position. Furthermore, the court notes that the claims of the plaintiff law firms did not arise out of insurance policies, but out of separate contracts for services with the insurance companies. This indicates that "interest" as used in Section 7925(6) relates to interest on contracts for services entered into with the insurance company and does not relate to pre-judgment interest that may arise out of insurance policies.

The significance of the pre-judgment interest to Carollo, Inc., should be underscored. The court in Metry stated that the Act is designed to protect from potentially catastrophic loss persons who have a right to rely on the existence of an insurance policy. The pre-judgment interest that the Association refuses to pay amounted, as of December 15, 1987, to approximately $45,000. According to the corporation's letter, the corporation was threatened with the appointment of a receiver to dissolve it to satisfy the indebtedness. Interpreting "interest" so as to exclude pre-judgment interest will protect Carollo, Inc., from potentially catastrophic loss.

Incurred

An examination of the meaning of "incurred" as used in Section 7925(6) also leads to the conclusion that the Association is obligated to cover all the pre-judgment interest owed by Carollo, Inc. As of the date the receiver was appointed, there was no judgment against the insured. The amount of any pre-judgment interest was unfixed and indeterminable. This does not comport with the definition of incur.

In 42 C.J.S. at page 553, with reference to "incur," it is stated:

> The word refers to an existing or present liability, not to a liability due in the future; and to a completed state of things rather than to an inchoate condition.

With reference to "incurred" it is stated, "It is a word denoting the past tense, and defined as meaning become liable for. . ." As stated in The Princess of Orange, DCNY, 19 Fed Cas, p 1336, No. 11,431:

> Neither in legal phrase, nor common parlance, is the word "incur" used to signify an inchoate or incomplete condition. It has reference to a state of things already passed and fulfilled. To incur a debt, or incur a responsibility, or incur loss, &c., is to have become absolutely liable in that behalf.

In accord with this view is Harris v Mid-Century Ins Co, 115 Mich App 591, 596-597:

Section 3145 of the act [no-fault act] indicates that an action may be brought for benefits "payable" under the act. PIP benefits are "payable" as loss "accrues." MCL 500.3142; MSA 24.13142. The act specifically provides that PIP benefits payable "accrue not when the injury occurs but as the allowable expense, work loss or survivor's loss is incurred." MCL 500.3110(4); MSA 24.113110(4).

In Adkins v Auto-Owners Ins Co, 105 Mich App 431; 306 NW2d 312 (1980), the Court addressed the meaning of the term "incurred" as used in that section of the act dealing with PIP benefits payable for survivor's loss. These benefits include "expenses * * * reasonably incurred." The Court held that "incurred" was comparable to "become liable

for." Therefore, the plaintiff was allowed to recover only for those expenses documented by cancelled checks and not her estimate of the value of her husband's services.

Work loss under the act consists of loss of income from work an injured person would have performed if he had not been injured plus certain expenses. MCL 500.3107; MSA 24.13107. This type of loss cannot be "incurred" under the act unless and until the claimant does not show up for work on any particular day.

In light of the judicial interpretations above, the obligation of the insolvent insurer existed but was not "incurred" at the date the receiver was appointed. The claim of Carollo, Inc., is thus not excluded by Section 7925(6). This interpretation gives insureds and persons with claims against insureds broader protection against the insolvency of their insurers. It conforms to the purpose of the Association and the intent of the Legislature.

IV. FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based on the foregoing considerations, it is FOUND and CONCLUDED that:

1. The Commissioner has authority to issue this declaratory ruling pursuant to Sections 200 and 7949(1) of the Code and Section 63 of the APA.

2. The background facts, as presented by Carollo, Inc., are as follows:

   Carollo, Inc. was sued in August, 1983 for a slip and fall accident. During the litigation, the primary insurance carrier (Union Indemnity Insurance Company) went into receivership. The receiver was appointed July 17, 1985. The case then was referred to the Michigan Property and Casualty Guaranty Association for handling. The case went to trial and a jury returned a $190,000 verdict against Carollo, Inc. Michigan pre-judgment interest rate is 12% per annum and the Guaranty Association maintains it is not liable for interest on the judgment from the date of filing the Complaint until the date the receiver was appointed. The disputed interest amount, then, would be in the neighborhood of $45,000.

3. The Association is required to pay and discharge covered claims by Section 7931(1) of the Code.

4. The claim of Carollo, Inc., meets the definition of "covered claims" in Section 7925(1) of the Code.

5. While some claims may meet the definition of covered claims, they may be excepted pursuant to Section 7925(6). This section states that covered claims shall not include adjustment fees and expenses, attorneys' fees and expenses, court costs, interest or bond premiums if the fees, expenses, costs, interests, or premiums were incurred by the insolvent insurer before the receiver was appointed.

6. The Association asserts that pre-judgment interest for the period from the filing of a lawsuit to the date a receiver is appointed is not a covered claim because it is interest incurred by the insolvent insurer before the receiver is appointed.

7. The Act is designed to protect from potentially catastrophic loss persons who have a right to rely on the existence of an insurance policy--the insureds and persons with claims against the insureds.

8. The laws applicable to insurance are to be liberally construed in favor of policyholders, creditors, and the public.

9. The exclusions contained in Section 7925(6) are litigation expenses of the insolvent insurer. They arise not out of insurance policies, but rather out of contracts the insolvent insurer has entered into for services or other things of value in connection with litigation. The exclusions contained in Section 7925(6) are oriented toward preventing payments to creditors of the insurance companies. In this light, "interest" as used in that section does not include pre-judgment interest.

10. As used in Section 7925(6), "incurred" means to become liable for and has reference to a state of things already past and fulfilled. It does not have reference to the inchoate or incomplete condition of pre-judgment interest in a matter in which no judgment has been entered.

11. The claim of Carollo, Inc., is not excluded by Section 7925(6). The Association is required by Section 7931(1) to pay and discharge the interest on the judgment from the date of filing of the complaint until the date the receiver was appointed.

V. RULING

I therefore enter this Declaratory Ruling that:

1. Pre-judgment interest from the date of the filing of a complaint against an insured to the date a receiver is appointed for the insolvent insurer is not among those items excluded from being a covered claim in Section 7925(6).

2. The Association is required by Section 7931(1) to pay and discharge all the pre-judgment interest arising out of the lawsuit that gave rise to this request for a declaratory ruling.

This ruling is limited to facts which were presented by Carollo, Inc., and the statutory sections identified by Carollo, Inc.

The Commissioner specifically retains jurisdiction of the matters contained herein and the authority to issue such further ruling or rulings as he shall deem just, necessary, and appropriate.

Herman W. Coleman
Commissioner of Insurance