



COALEX STATE INQUIRY REPORT - 108
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TOPIC: BANKRUPT SURETY COMPANY

INQUIRY: Does a bankrupt surety company's estate have priority over the collateral securing a bond when the bond was established for the limited purpose of insuring the required reclamation of a mine site? In particular, in what priority position would the Department, being a state agency and having filed a proof of claim, take as to the collateral securing the bond and as to the bankrupt surety's claim against the same collateral?

SEARCH RESULTS: Research was performed using state and federal case law on LEXIS. The decisions identified as a result of the research are discussed below. Copies of these decisions are attached. An article containing additional relevant information is also included.

No decisions were identified that address the specific question of priority over the collateral of reclamation bonds. However, a number of cases were retrieved which discuss the conditions under which a State may claim priority in the distribution of the assets of an insolvent insurance company; i.e., if the State is acting in its sovereign capacity then it has preference over general creditors; if the State is acting as a "trustee" then it may not receive priority payments. NOTE: The most relevant cases involve insurance company failures from the depression and earlier.

IN MATTER OF LLOYDS INSURANCE CO. OF AMERICA, 5 N.Y.S.2d 112 (N.Y. App. Div., 1938), the State argued that it should have priority for payments to two funds set up under Workmen's Compensation laws. The court ruled that the State "did not intend to bring into the State Treasury moneys with which to enable the State to defray its ordinary governmental expenses." The State was acting "as a trustee or in [an] administrative capacity in the collection and distribution of the funds" and, therefore, was not entitled to priority in the receipt of payments.

The headnote to MATTER OF GENERAL INDEMNITY CORP. OF AMERICA, 251 A.D. 236, 295 N.Y.S. 981 (N.Y. App. Div., 1937) defines the "State as sovereign" more fully: "The State, as the sovereign power, has a preference over other creditors in insolvency proceedings, the purpose of which is to protect the revenue of the State and to insure against loss of governmental moneys, to meet the expenses of government and to discharge public debts and obligations of the State."



As in *LLOYDS INSURANCE*, above, this case involves New York's Workmen's Compensation Law. Here, the claims are for the "principal amount of a surety bond" executed by the insolvent insurance company. The court determined that the State had a legitimate claim but was not entitled "to a preference to the [defunct company's] assets...." The court reasoned: "While the bond [of indemnity] in form is for the benefit of the People of the State of New York, the obligation thereunder actually runs to the compensation claimants...the claim under the bond could not result in bringing funds into the State for the support of its government...."

One judge dissented, stating: "...the origin of the bond and its purpose indicate as clearly as its form that it was intended as a debt due to the People as sovereign."

Quoting from a Supreme Court decision, he added that the Workmen's Compensation Law was "a reasonable exercise of the police power of the State" and that the matter was one "in which 'the public has a direct interest as affecting the public welfare.'"

The question of a State's sovereignty was determined by the Supreme Court in *MARSHALL v NEW YORK*, 254 U.S. 380 (1920). The Court held the following: "...the State, as sovereign, succeeded to the crown[of Great Britain]'s prerogative right of priority; and that the priority was not limited to amounts due for taxes, but extended alike to all debts due to the State...."

Two cases relate the sovereignty/priority issue to insolvent banks:

In *BOARD v MCFERSON*, 9 P.2d 614 (Colo., 1932), the county, which had general funds on deposit, was not given preference in the distribution of the insolvent bank's assets.

The court ruled similarly in *FIDELITY & CASUALTY CO. OF NEW YORK v UNION SAVINGS BANK CO.*, 162 N.E. 420 (Ohio, 1928), with regard to the deposit of State surplus funds in an insolvent bank.

The priority of claims of creditors in one state against an insolvent insurance company incorporated in another state is questioned in *COMMONWEALTH v CONSOLIDATED INDEMNITY & INSURANCE CO.*, 67 A.2d 434 (Pa., 1949) and the *MATTER OF THE CASUALTY CO. OF AMERICA*, 200 N.Y.S. 639 (N.Y. App. Div., 1923). In the more recent case, the court ruled that Pennsylvania claims did not have priority over other claims (of the same class) against the assets of an insolvent New York insurer. In the earlier case, the New York court held that Texas claims against a trust fund established by the insurer as a requirement for doing business in Texas did have priority over general creditors. (The insurer's general assets in Texas were not involved.)

The enclosed 1987 article by Douglas F. Brennan of the Pennsylvania Department of Environmental Resources relates bankruptcy law to the financial responsibility of bankrupt mine operators. Section IV discusses the government's collection of collateral for bonds and may provide some relevant information.



ATTACHMENTS

- A. MATTER OF LLOYDS INSURANCE CO. OF AMERICA, 5 N.Y.S.2d 112 (N.Y. App. Div., 1938).
- B. MATTER OF GENERAL INDEMNITY CORP. OF AMERICA, 251 A.D. 236, 295 N.Y.S. 981 (N.Y. App. Div., 1937).
- C. MARSHALL v NEW YORK, 254 U.S. 380 (1920).
- D. BOARD v MCFERSON, 9 P.2d 614 (Colo., 1932).
- E. FIDELITY & CASUALTY CO. OF NEW YORK v UNION SAVINGS BANK CO., 162 N.E. 420 (Ohio, 1928).
- F. COMMONWEALTH v CONSOLIDATED INDEMNITY AND INSURANCE CO., 67 A.2d 434 (Pa., 1949).
- G. MATTER OF THE CASUALTY CO. OF AMERICA, 200 N.Y.S. 639 (N.Y. App. Div., 1923)
- H. "Regulating Financial Responsibility for Bankrupt Operators" by Douglas F. Brennan