

IN THE STATE OF SOUTH CAROLINA ) BEFORE THE SOUTH CAROLINA  
 ) PROCUREMENT REVIEW PANEL  
COUNTY OF RICHLAND ) CASE NO. 1988-7

IN RE: PROTEST OF DAVIS-GARVIN AGENCY, INC. )  
BID NO. 6-793-1107200-5/3/88 ) ORDER  
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I. INTRODUCTION

This matter came before the South Carolina Procurement Review Panel ("Panel") for hearing on June 22, 1988, on the protest of Davis-Garvin Agency, Inc., ("Davis-Garvin") of the Intent to Award to the Thomas C. Brown Agency ("Brown") a five-contract for the reinsurance of property insured by the South Carolina Insurance Reserve Fund.

Present at the hearing before the Panel were the Protestant Davis-Garvin, represented by John A. Martin, Esq., and James B. Richardson, Jr., Esq., the Division of General Services, represented by Helen Zeigler, Esq., and Brown, represented by Helen T. McFadden, Esq. and Robert E. Kneece, Jr., Esq. All the parties presented evidence to support their respective positions and, after hearing and considering such evidence, the Panel finds as follows.

II. FINDINGS OF FACTS

On March 8, 1988, the State Budget and Control Board, Division of General Services ("General Services") issued a solicitation for bids to provide reinsurance for the property insured by the state Insurance Reserve Fund ("Fund"). Mr. James E. Bennett, Assistant Division Director in charge of the Fund, testified that the Fund is a division of the Budget and Control

Board that provides insurance coverage for the political subdivisions of the State. The Fund operates like a regular insurance company in that it issues policies to its insureds, which include state agencies and school districts, and collects premiums thereon. The Fund does not have stockholders or agents.

The solicitation in question requested bids for the provision of reinsurance of some \$11 Billion worth of state property. Under the solicitation, the contractor would provide insurance for five years on all losses over and above \$500,000 per risk, \$1,000,000 per location, and \$5,000,000 per occurrence up to a maximum of \$745,000,000 per occurrence.

The bid solicitation contained the following provisions which are at issue here:

Additional General Requirements.

\* \* \*

2. REINSURER QUALIFICATIONS: Any reinsurer submitting a bid must have an A.M. Best financial rating of A or better, and must be licensed as an insurer in the state of South Carolina. . . . Any participant on any layer of reinsurance must carry a Best's size category of V or better and all participants, in sum, must have capacity equivalent [sic] to Best's size category XI or better. A "cut through" endorsement must be included with bids in which a single company is submitting the bid and purchasing "re-reinsurance". A "step down" endorsement must be included for layered bids. A "joint and several" endorsement must be included for pro-rata bids. If the appropriate endorsement is not submitted the bid will be rejected.

(Record, p. 25)(Emphasis Added).

General Services issued Amendment No. 1 which provided:

Add the following paragraphs on page 6 to:

ADDITIONAL GENERAL REQUIREMENTS

Item 2. REINSURER QUALIFICATIONS after the first paragraph:

The wording for the three (3) endorsements is contained in Exhibit 9.

\* \* \*

Add the following items to page 22 TABLE OF CONTENTS:

14. Exhibit IX - Wording for "cut through," "step down" and "joint and several" is added to the specifications.

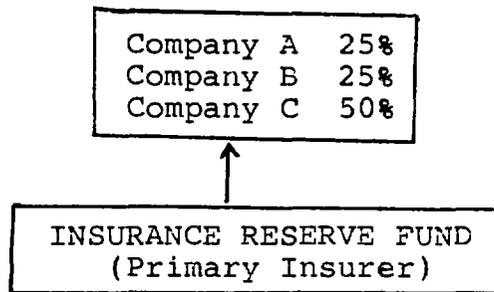
The bidding schedule which must be signed by the reinsurance company submitting the bid provides:

A "cut through" endorsement MUST be included with bids in which a single company is submitting the bid and purchasing "re-reinsurance." A "step-down" endorsement MUST be included for layered bids. A "joint and several" endorsement MUST be included for pro-rata bids. If the appropriate [sic] endorsement is not submitted the bid will be rejected.

(Record, p. 27).

Mr. Bennett explained that one or more or all of the three types of endorsements could be required based on the way a bidder chose to structure its bid. The parties stipulated that the "step-down" endorsement is not an issue in this case. The other endorsements would be required in the following circumstances.

A joint and several endorsement would be required where more than one company is sharing the loss on a pro-rata basis. Mr. Bennett diagrammed that situation thusly:



Under this arrangement each reinsurance company would be responsible for the indicated percentage of any loss over the amounts insured by the Fund. The joint and several endorsement would make certain that, if one (or more) of companies A, B, or C became insolvent or financially unable to meet its obligations, the remaining companies would assume the insolvent company's liability and pay proceeds directly to the Fund.

General Services by Amendment No. 1 attached to the bid solicitation the wording for the three endorsements as contained in Exhibit IX to the Amendment. The wording for the joint and several endorsement is as follows:

It is agreed that in the event the Company issuing this policy shall become insolvent or financially unable to meet its obligations with respect to the property insurance as reinsured under this policy, the listed participating reinsuring Companies shall assume (pro rata according to their shares) the liability of such Company as reinsured under this policy, and shall pay any incurred losses directly to the insured on the basis of the liability of such Company without diminution because of its insolvency or financial inability to meet its obligations, provided the insured shall execute and deliver agreements, assignments or evidence of subrogation satisfactory to the above named Companies respecting any payment or assumption of liability made by them.

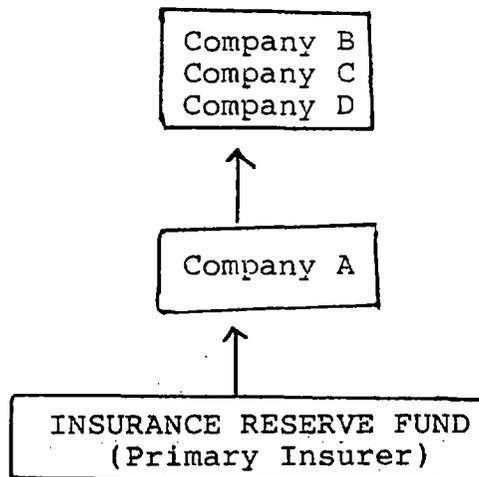
By virtue of an agreement between the listed participating reinsurance companies, it is

provided that if any shall become insolvent or financially unable to meet its obligations with respect to the property insurance as reinsured under this policy, the remaining Companies shall assume the liability of such Company as reinsured under this policy and shall pay any unpaid incurred losses directly to the insured, provided the insured shall execute and deliver agreements, assignments or evidence of subrogation satisfactory to such remaining Companies respecting any payment or assumption of liability by them.

Any loss payment made by or on behalf of the above named Companies, or any of them, under this endorsement shall pro tanto relieve them of liability to the insurer and shall constitute a performance of the reinsurance obligation to the insurer.

(Record, p. 92).

The second type of endorsement, the "cut through", would be required when a single reinsurance company is itself purchasing re-reinsurance. Mr. Bennett diagrammed that situation thusly:



Under this arrangement, companies B, C, and D are in privity of contract and liable only to company A. The cut through endorsement would make Companies B, C, and D directly liable to the

Fund if Company A was placed in the hands of a receiver, assignee, trustee, or successor for the purpose of liquidation or on account of insolvency.

The wording for the cut through endorsement was attached to the bid solicitation as follows:

In respect of the risks reinsured hereunder the reinsurer and the ceding company hereby agree that in the event that the ceding company shall go into the hands of a receiver, assignee, trustee or successor for the purpose of liquidation or on account of insolvency and if written notice be given to the reinsurer of such an event then the reinsurer in lieu of payment to the company shall pay to the assured the reinsurer's share of any loss or losses incurred by the ceding company which are within the limits, terms, and conditions of this policy. Provided that the liability of the reinsurer to the assured shall be reduced by the amount of payments made by the reinsurer on account of the same loss or losses to the company and provided further that the reinsurer shall be entitled to deduct from the amount of loss or losses any premiums or other money due to the reinsurer under this policy. It is fully understood and agreed by the ceding company that it is a condition precedent to this policy that any payments made directly to the assured shall absolve the reinsurer from making any payments to the company or its receiver, assignee, trustee or successor and shall constitute a full discharge and release of the reinsurer from any and all further liability in connection therewith.

(Record, p.92).

Mr. John B. Trussell III, the reinsurance manager for the Fund, testified that it was his understanding that bids might contain some slight variations from the wording provided. At the mandatory pre-bid conference, Mr. Trussell stated,

"We have drafted the wording that we want to use for joint and several endorsement, cut through endorsement and step down endorsement. We've done research and these are fairly standardized wordings and this is the wording that will be used, depending on how you arrange your bid." (Record, p. 108)(Emphasis Added).

In response to its solicitation, General Services received four bids. The bids were:

<u>Agent</u>	<u>Company</u>	<u>Premium(yrly)</u>
Davis-Garvin	International Ins. Co.	\$4,095,428
Davis-Garvin	layered	\$3,283,020
Davis-Garvin	layered	\$3,280,020
Brown	Michigan Mutual	\$2,092,229

General Services declared Brown to be the lowest responsive and responsible bidder at \$2,092,229 yearly premium.

The reinsurance company listed by Brown, Michigan Mutual, has an A.M. Best's financial rating of "A" and is licensed in South Carolina. It has a Best's size category of at least V.

Under the Brown bid, Michigan Mutual is itself reinsured by a pool of companies, known as IRM (for "Improved Risk Mutual Insurance"), who have a total Best's size classification of Class XV. All but two of the companies have a Best's financial rating of "A" or better and all but three are licensed in South Carolina.

Based on the way Brown structured its bid, the bid documents and the comments by Mr. Trussell at the pre-bid conference<sup>1</sup>

<sup>1</sup>"KNEECE: I'm speaking of a pro-rata where Michigan Mutual is... IRM...lead company and then all of those companies are jointly and severally liable. TRUSSELL: In that case I would think that what the primary company in the case you describe being Michigan Mutual, we would need a cut through endorsement from IRM."(Record, p. 49)

required Brown to submit both a joint and several endorsement and a cut through endorsement. The endorsement submitted by Brown is contained in the IRM Reinsurance Certificate (Record, p. 40) and is verbatim (except in several minor instances) the joint and several endorsement provided by General Services. On its bidding schedule, Brown notes, "See attached IRM reinsurance certificate of joint and several liability." (Record, p. 27).

On May 11, 1988, General Services issued an Intent to Award the contract to Brown effective May 27, 1988. The current reinsurance contract expires at 12:01 a.m., July 1, 1988.

On May 23, 1988, the only other bidder, Davis-Garvin, filed a protest of the Intent to Award to Brown, citing four grounds going to the alleged nonresponsiveness of Brown's bid. The Chief Procurement Officer found in favor of Brown on June 10, 1988. Davis-Garvin appealed to this Panel on June 20, 1988, on three of the grounds it relied on below. General Services requested that the Panel hear the matter and issue its order as soon as possible.

### III. CONCLUSIONS OF LAW

#### A. QUALIFICATION OF FIVE OF THE BIDDERS

The first argument asserted by Davis-Garvin is that two of the IRM group do not have a Best's financial rating of "A" or better and three of the IRM group are not licensed in South Carolina, all in violation of the bid requirements. Davis-Garvin concedes that Michigan Mutual has an "A" rating and is licensed in South Carolina.

The general provisions of the bid solicitation require "any reinsurer submitting a bid" to be "A" rated and licensed in South Carolina. (Record, p. 25). The bidding schedule has a blank for the name of the "Reinsurance Company(ies)." (Record, pg. 27). Mr. Bennett testified that the intent of this provision was to require the company contracting directly with the Fund, that is, the reinsurance company, to meet certain minimum standards.

Michigan Mutual is the reinsurer in Brown's bid. It meets the rating and licensing requirements contained in the bid documents. The IRM companies singled out by Davis-Garvin are rereinsurers. The rating and licensing requirement by its terms does not apply to the IRM group. S. C. Code Ann. § 38-25-150(2)(1987 Cum. Supp.) exempts reinsurers from the licensing requirements imposed by the Insurance Commissioner. The Panel finds that Davis-Garvin's first ground is unpersuasive.

B. APPLICABILITY OF 10% SURPLUS  
STATUTE

Davis-Garvin's next argument is that the Brown bid is in violation of S.C. Ann. § 38-55-30 (1987 Cum. Supp.) and any contract with Brown based on the bid would be void ab initio. Section 38-55-30 provides:

Except as otherwise provided in this title, no insurer doing business in this State may expose itself to any loss on any one risk in an amount exceeding ten percent of its surplus to policyholders. Any risk or portion of any risk which has been reinsured must be deducted in determining the limitation of risk prescribed in this section.

S.C. Code Ann. § 38-55-60 (1987 Cum. Supp.) provides that only reinsurance obtained from an approved reinsurer can be deducted as described above. An approved insurer must meet South Carolina capital and surplus requirements.

Davis-Garvin offered the opinion testimony of an expert on the meaning and applicability of §38-55-30. General Services and Brown objected to the qualification of Dr. Samuel T. Pritchett as an expert on reinsurance. The Panel has reviewed Dr. Pritchett's qualifications and his resumé (Record, p.245) and finds that Dr. Pritchett is well-qualified as an expert on reinsurance.

Dr. Pritchett testified that in his opinion § 38-55-30 applies to reinsurers and that the term "any one risk" contained therein means the maximum possible exposure on any one contract, in this case, \$745,000,000. According to Davis-Garvin, the combined surplus of Michigan Mutual and IRM is approximately \$2.035 Billion, allowing them to lawfully insure any one contract where the total risk is no greater than \$203 Million. Davis-Garvin and their expert argue that Michigan Mutual and IRM cannot therefore, legally contract with the Fund to insure a maximum possible loss of \$745,000,000.

General Services offered testimony that it has never considered § 38-55-30 to apply to contracts for reinsurance and that even if it did the term "any one risk" means the risk associated with any one piece of insured property.

In considering whether §38-55-30 applies, the Panel is required to give great weight to the administrative agency

charged with enforcing that section. Chief Insurance Commissioner John G. Richards V issued a written opinion on § 38-55-30, which appears in the Record at page 240. Commissioner Richards also appeared before the Panel and testified that in his opinion reinsurers were exempt from licensing and regulation by the Insurance Commission by virtue of S.C. Code Ann. § 38-25-150(2) (1987 Cum. Supp.), which exempts reinsurers from the licensing requirements of the Commissioner. Commissioner Richards testified that in his and his staff's opinion a reinsurer, because it is exempt from licensing requirements, is not subject to the regulatory standards enforced by the Commissioner, such as § 38-55-30. Commissioner Richards testified that his office protected consumers from reinsurance abuses by strictly regulating the primary insurers and carefully examining their financial statements to insure that only reinsurance by approved reinsurers is deducted in risk limitation calculations.

The Commissioner also testified that in his opinion "any one risk" in § 38-55-30 means the risk attaching to any one piece of property, which in this case is something considerably less than \$745,000,000.

The Panel finds that § 38-55-30 does not apply to reinsurers such as Michigan Mutual and IRM in the present case. The Brown bid is responsive on that ground.

#### C. CUT THROUGH ENDORSEMENT

Davis-Garvin's final argument is that Brown's bid is nonresponsive because it does not contain a cut through

endorsement. It is undisputed that a cut through endorsement was required because in Brown's bid Michigan Mutual, a single company, purchased "re-reinsurance." (Record p. 27). The only endorsement contained in Brown's bid is the endorsement on the IRM Reinsurance Certificate (Record, p.40), which contains language that is virtually verbatim from the wording for the joint and several endorsement given by the State in the solicitation documents. The cut through language given in the bid documents is not used in Brown's bid.

Davis-Garvin contends that Brown's failure to include language of the bid document's cut through endorsement means Brown has no cut through endorsement and is, therefore, nonresponsive. General Services and Brown urge that the essential intent of the cut through, i.e. to give the Fund direct access to the re-reinsurers, is met by the language contained in paragraph three of the IRM Reinsurance Certificate. General Services contends that Brown's failure to include the language contained in the bid documents is a mere technicality which can be waived by the State.

A close comparison of Brown's endorsement with the bid document's cut through reveals more than a superficial difference. Brown's endorsement provides that in the event Michigan Mutual "shall become insolvent or financially unable to meet its obligations," the IRM companies shall assume (pro rata according to their share) the liability of Michigan Mutual and shall pay any incurred losses directly to the Fund. (Record, p.40). The cut

through endorsement given in the bid documents provides that should Michigan Mutual "go into the hands of a receiver, assignee, trustee or successor for the purpose of liquidation or on account of insolvency" and if written notice is given to IRM, then IRM in lieu of payment to Michigan shall pay to the Fund the amounts owed by Michigan. (Record, p. 92).

Under Brown's endorsement, the Fund must demonstrate insolvency or financial inability to meet its obligations on Michigan Mutual's part before it can make a direct claim against IRM. Both of these conditions are inexact and not subject to ready determination. It is foreseeable that the question of insolvency or financial inability to meet obligations would support lengthy litigation and only upon conclusion of such litigation would the Fund be able to collect from IRM.

Under the bid cut through endorsement, all the Fund would have to do is give written notice to IRM that Michigan was in the hands of a receiver, assignee, trustee or successor for the purpose of liquidation or on account of insolvency and IRM would be obligated for Michigan's losses. The appointment of a receiver, assignee, trustee or successor is a concrete occurrence and one that is fairly easily proved. It is foreseeable that under this endorsement the Fund could attempt to collect directly from IRM without creating a lengthy legal issue.

It cannot be assumed that the language of the bid cut through endorsement was chosen without purpose. Mr. Bennett

testified that the language of the cut through was provided by Mendes & Mount, who are leading reinsurance attorneys. General Services stressed in its bid that if "re-reinsurance" was purchased by a single company, then a cut through endorsement "MUST" be included or the bid would be rejected. (Record, p. 27). General Services felt strongly enough about the wording of the endorsements that it issued an amendment specifically setting forth the language to be used. Mr. Trussell at the prebid conference stated that the Fund had done research and drafted the language "we want you to use" and which "will be used" in the bids. (Record, p. 47).

By uncontroverted testimony, due to the arrangement of its bid Brown was required by the solicitation documents to have both the joint and several endorsement and the cut through endorsement. The language in the Brown endorsement gives some direct rights to the Fund. However, the Panel finds that including the language of the bid cut through endorsement adds an element of certainty to, and gives the Fund clearer rights, in the situation where a receiver, assignee, trustee or successor is appointed. It cannot be said that the absence of these rights is a minor technicality which can be waived. The Panel finds that the substance of the cut through in the bid documents is not met by the language in the Brown endorsement.

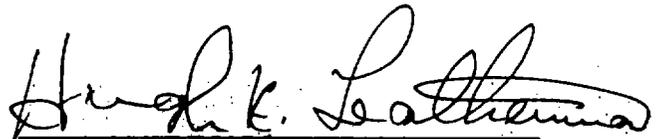
For this reason, the Panel finds that the absence of language substantially similar to the bid cut through endorsement renders the Brown bid nonresponsive.

#### IV. CONCLUSION

Although it was not an issue raised by Davis-Garvin's protest, evidence was presented by all parties on the responsiveness of Davis-Garvin's three bids. Because the issue was not raised by the pleadings and because the Panel did not have enough evidence before it, the Panel makes no finding on the responsiveness of Davis-Garvin's three bids.

The Panel finds that Michigan Mutual meets the licensing and rating requirements required by the state and the Brown bid is responsive on that point. The Panel further finds that S. C. Code Ann. § 38-55-30(1987 Cum. Supp.) is not applicable to reinsurers such as Michigan Mutual and IRM and the Brown bid is responsive on that point. The Panel finds that the bid submitted by the Thomas C. Brown Agency, Inc., does not contain a cut through sufficient to satisfy the requirements of the bid documents. The Brown bid is therefore nonresponsive on that point. Because a bid must be responsive in all aspects and Brown's bid clearly is not, the Panel reverses the Order of the CPO dated June 10, 1988. This procurement is remanded back to General Services for further disposition.

IT IS SO ORDERED.

  
Hugh K. Leatherman, Sr.  
Chairman

JUNE 23, 1988, 1988  
Columbia, South Carolina