

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

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| FRANK J. DALICANDRO | : | |
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| Plaintiff, | : | |
| | : | |
| v. | : | CIVIL ACTION |
| | : | |
| LEGALGARD, INC. d/b/a | : | NO. 99-3778 |
| SANDENHILL, INC. and | : | |
| RELIANCE INSURANCE CO., INC. | : | |
| | : | |
| | : | |
| Defendants. | : | |

MEMORANDUM AND ORDER

YOHN, J. NOVEMBER ____, 2001

Plaintiff, Frank Dalicandro (“Dalicandro”), brought suit against his former employer, Legalgard, Inc (“Legalgard”), now doing business as Sadenhill, Inc. and Reliance Insurance Co. (“Reliance”), for violations of federal and state securities laws, fraud, breach of fiduciary duty, and breach of contract. Reliance was subsequently declared insolvent and placed into liquidation by the Commonwealth Court of Pennsylvania.

Presently before the court is defendants’, Reliance and Legalgard’s, motion to stay this federal action during the pendency of the state liquidation proceedings. I will grant Reliance’s motion to stay based on the application of *Burford* abstention principles. I will deny Legalgard’s motion without prejudice.

BACKGROUND

By order of May 29, 2001, the Commonwealth Court of Pennsylvania placed Reliance into rehabilitation pursuant to the provisions of Article V of the Insurance Department Act of 1921, 40 P.S. §§ 221.1 *et. seq.* Upon consideration of the rehabilitator's recommendation, the Commonwealth Court, on October 3, 2001, entered an order of liquidation ("Order") against Reliance. The Order establishes the exclusive jurisdiction of the Commonwealth Court. Order ¶ 5. Consistent with the Commonwealth Court's intent to exercise exclusive jurisdiction, the Order provides that "[a]ll actions pending against Reliance in the Courts of the Commonwealth of Pennsylvania or elsewhere are hereby stayed." Order ¶ 22. Pursuant to the Order, Reliance and Legalgard bring this motion to stay Dalicandro's federal court action.

DISCUSSION

I. Stay of Claims Against Reliance: *Burford* Abstention

Defendants seek a stay of the present federal action under the *Burford* abstention doctrine. Dft.'s Mem. Supp. Motion to Stay (Doc. No. 38) at 5. Dalicandro counters that *Burford* abstention cannot be applied to the present action because: (1) the standard for *Burford* abstention is not met, and (2) *Burford* abstention does not operate in actions at law. Ptf.'s Mem. Opp'n Motion to Stay (Doc. No. 39) at 7, 10.

The Supreme Court explained the *Burford* abstention doctrine as follows:

Where timely and adequate state-court review is available, a federal court sitting in equity must decline to interfere with the proceedings or orders of state administrative agencies:

(1) when there are “difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar”; or (2) where the exercise of federal review of the question in the case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.

New Orleans Pub. Serv., Inc. v. Council of New Orleans, 491 U.S. 350, 361 (1989). The *Burford* analysis requires a court to make a threshold determination as to whether “timely and adequate state-court review” is available before considering whether abstention is mandated by the presence of difficult questions of state law or the disruption of a coherent policy of state concern. *Riley v. Simmons*, 45 F.3d 764, 771 (3d Cir. 1995).

A. Adequate State Review

Dalicandro argues that because federal courts have exclusive jurisdiction over violations of the federal securities laws, adequate state court review would not be available for his federal securities claim. Doc. 39 at 10. In making this argument, Dalicandro relies heavily on the Third Circuit’s decision in *Riley v. Simmons*. 45 F.3d at 775. The plaintiffs in *Riley* sought relief under the federal securities laws, alleging misrepresentations that induced them to purchase annuities of an insurance company that later became insolvent. *Id.* There were no allegations of a violation of any state securities laws. During the state court rehabilitation proceedings in New Jersey, the rehabilitator brought a common law fraud claim against the insurance company on behalf of all interested parties. *Id.* 768. The district court dismissed the plaintiffs’ federal action under *Burford* abstention principles. The Third Circuit reversed, finding that the district court

erroneously conflated the common law action of fraud, for which the state court has jurisdiction, with the federal securities laws violations. Since Rule 10b-5 establishes a distinct cause of action and remedy from common law fraud, the Third Circuit concluded that state review of the rehabilitator's common law fraud claim did not amount to adequate review of plaintiffs' federal securities claims. *Id.* at 773. In addition, the Third Circuit noted that the district court completely ignored plaintiffs' allegations that defendants had violated sections 5 and 12 of the Securities Act of 1933. As these sections are not at all similar to common law fraud, but rather deal with the filing of a registration statement and the liability of a seller for selling unregistered securities, the Third Circuit was convinced that adequate review of all plaintiffs' federal securities claims could not be had in state court. *Id.* at 774.¹ The decision in *Riley* not to abstain was based on the dissimilarity between the plaintiffs' claims arising under the federal securities laws and the claim of common law fraud.

The present action is clearly distinguishable from the Third Circuit's decision in *Riley*. Unlike the plaintiffs in *Riley*, Dalicandro has asserted a violation of the anti-fraud provisions of both the federal and the state securities laws, and no other violations of the federal securities laws.² The Pennsylvania securities fraud claim, for which the Commonwealth Court has

¹ In *Riley*, the Third Circuit questioned the wisdom of denying abstention, "[c]onsidering the impact such actions may have on procedures for the rehabilitation or orderly liquidation of insolvent insurance companies, which Congress has entrusted exclusively to the states." *Riley*, 45 F.3d at 773 n.10. However, the Third Circuit felt that it could not grant the defendants' motion to dismiss under abstention principles because plaintiffs' federal securities claims were distinct from the common law fraud action, and therefore adequate review could not be had in state court. *Id.*

² Dalicandro has also asserted claims against defendants that do not arise under the securities laws, namely fraud, breach of fiduciary duty and breach of contract.

jurisdiction, is functionally equivalent to the federal securities fraud claim. *McFeeley v. Florig*, 966 F.Supp. 378, 382 (E.D.Pa. 1997). In deciding the merits of the state securities claim, the Commonwealth Court will engage in the same inquiry as it would if deciding the federal claim. *See Feret v. Corestates Fin. Corp.*, 1998 WL 426560 (E.D.Pa. July 27, 1998) (“Section 401 of the Pennsylvania Securities Act is modeled after Rule 10b-5 of the federal securities law. . . . It requires similar elements of proof.”). In addition, the damages available in a private cause of action under the Pennsylvania Securities Act are the same as those available under the Securities Exchange Act. *See* 70 P.S. §1-501; *Randall v. Loftsgaarden*, 478 U.S. 647, 662 (1986) (damages for violations of § 10(b) and Rule 10b-5 usually measured by “out-of-pocket” loss). Since the claims over which the Commonwealth Court has jurisdiction mirror Dalicandro’s federal securities claims, it is possible that the state court review of Dalicandro’s state securities fraud claim will adequately dispose of the issues raised by Dalicandro’s federal securities fraud claim.

Moreover, unlike the district court in *Riley*, this court will not dismiss Dalicandro’s present action. Rather, these proceedings will be stayed until the conclusion of the state liquidation, allowing this court to retain jurisdiction over Dalicandro’s federal securities claims. If, after conclusion of the liquidation proceedings, Dalicandro feels that issues raised by his federal securities claim were not adequately addressed in state court, he will be free to raise these issues in federal court. *See Deakins v. Monaghan*, 484 U.S. 193, 202-03 (1988) (approving Third Circuit rule of staying claims that cannot be heard in the state proceeding); *General Glass Indus. Corp. v. Monsour Med. Found.*, 973 F.2d 197, 204 (3d Cir. 1992); Couch on Insurance § 5.7 (3d ed.) (Stay preserves a federal claim and allows relief to be obtained later should it not be

afforded by the state liquidation proceeding.).³

B. Timely State Review

The state court review of Dalicandro's claims will be timely. The order of liquidation has been entered and the claim process has begun. The Pennsylvania Insurance Department Act establishes a procedure for the orderly resolution of claims asserted against an insurance company in liquidation. 40 P.S. §§ 221.37, 221.45. Pursuant to the Act, Dalicandro must submit his contingent claims to Reliance's liquidator, who will make a decision as to the value of each claim, subject to ultimate review by the Commonwealth Court. *Id.* There is no reason to believe at this junction that the resolution of Dalicandro's claims through this liquidation process will be anything other than orderly and efficient. Should that not turn out to be the case, plaintiff can always return to this court and seek a lifting of this stay.

C. Disruption of a State Policy

³ Dalicandro asserts that abstention is improper because the state liquidation procedure violates his VII Amendment rights by not affording him a trial by jury. Doc. 39 at 13-14. The Supreme Court has held that the Seventh Amendment exists for the purpose of preserving jury trials as provided by common law. *Atlas Roofing Co., Inc. v. Occupational Safety and Health Review Commn*, 430 U.S. 442, 459 (1977). It follows that jury trials are not available in procedures established by statute unless the statute expressly provides. *Har-Bur Assocs. v. Docktor Pet Ctr, Inc.*, 678 F.Supp. 98, 100 (E.D. Pa. 1986) (Seventh Amendment not implicated in statutory proceedings); *Commonwealth v. One 1986 Ford Mustang*, 570 A.2d 958, 959 (Pa. Super. Ct. 1990); *see also* 1 Pa. C.S.A. § 1504 (statutory remedy preferred over common law). Moreover, the Supreme Court has found that the "right to a jury trial turns not solely on the nature of the issue to be resolved but also on the forum in which it is to be resolved." *Atlas Roofing*, 430 U.S. at 461. Since there is no common law basis for the Pennsylvania insurance liquidation statute, nor an express provision in the statute for a jury trial, Dalicandro's claim that abstention unconstitutionally denies him a right to a jury trial is unfounded.

Dalicandro argues that even if the threshold requirement of state court review is satisfied, *Burford* abstention is inappropriate because the exercise of federal jurisdiction will not disrupt a state regulatory scheme.⁴ Doc. 39 at 15. However, contrary to Dalicandro’s assertion, the exercise of federal jurisdiction in this case would be disruptive of Pennsylvania’s detailed and comprehensive insurance regulation.⁵ See 40 P.S. § 1 *et. seq.*; *General Glass*, 973 F.2d 197, 201; *Lac*, 864 F.2d at 1045. “At this point in our jurisprudence, there can be little doubt that parallel federal and state proceedings would disrupt Pennsylvania’s legislative framework for the liquidation of insolvent insurers.” *Feige v. Sechrest*, 90 F.3d 846, 849 (3d Cir. 1996).

Allowing this court to hear Dalicandro’s claims during the pendency of the state liquidation proceedings, will create a situation in which two separate forums are charged with determining the merits of claims asserted against Reliance. Dalicandro’s contingent claims against Reliance would be resolved in a federal forum while the claims of Reliance’s other unsecured creditors, secured creditors and policyholders would be resolved through the state liquidation claims process. This result is contrary to the goal of a liquidation claim filing process centralized in the Pennsylvania Commonwealth Court. 40 P.S. § 221.4. Orderly distribution of Reliance’s assets requires this court to stay Dalicandro’s federal action until the state liquidation

⁴ Defendants do not argue that complex issues of state law are involved in the present federal action.

⁵ Pennsylvania’s insurance regulation was enacted pursuant to the mandates of the McCarran-Ferguson Act. 15 U.S.C. § 1012. The McCarran-Ferguson Act recognized the special status of insurance in the realm of state sovereignty, and the public interest in having states serve as the “preeminent regulators of insurance in the federal system.” *Lac D’Amiante Du Quebec, LTEE v Am. Home Assurance Co.* (“*Lac*”), 864 F.2d 1033, 1045 (3d Cir. 1988).

procedure is complete.⁶

D. *Burford* Abstention in Actions at Law

Additionally, this court must consider defendants' argument that *Burford* abstention is inappropriate because Dalicandro is seeking money damages and not equitable relief. Doc. 39 at 7. Whether *Burford* abstention applied to cases at law was once a matter of much debate and confusion in our caselaw. See *Feige v. Sechrest*, 90 F.3d 846, 849 (3d Cir. 1996). However, recent jurisprudence has established that *Burford* abstention principles allow a court to stay an action for damages. *Id.*

In *Quackenbush v. Allstate*, 517 U.S. 706 (1996), the Supreme Court indicated in dictum that although *Burford* abstention principles did not allow a court to dismiss an action for damages, a court could stay its action until the conclusion of the state court liquidation proceedings. 517 U.S. at 730. The Third Circuit found the Supreme Court's dictum in *Quackenbush* to be instructive. In *Feige* the Third Circuit held that *Burford* abstention allowed the district court to stay its action claiming money damages pending the state court liquidation of the defendant-insurer. 90 F.3d at 851. In entering a stay of its action, the Third Circuit found that the district court did not improperly abdicate its jurisdiction; rather, the court properly postponed the exercise of its jurisdiction until the conclusion of the state liquidation proceeding. *Id.* "This

⁶ Moreover, allowing Dalicandro, a contingent creditor, to go forward with his claim during the state liquidation proceedings may create an impermissible preference under Pennsylvania insurance law. Under Pennsylvania law, priority in Reliance's assets is given to the policyholders. 40 Pa.C.S.A. § 221.44. At this time, it is uncertain whether Reliance has sufficient assets to meet the claims of all its policyholders, let alone its unsecured, contingent creditors. If Dalicandro were to prevail on his claims in federal court, it is possible that Dalicandro's judgment would put him in a superior position to the claims of policyholders, contrary to Pennsylvania law. *Riley v. Simmons*, 45 F.3d 764, 775-76.

approach retains the sensitivity for concerns of federalism and comity implicated by *Burford* abstention, while preserving [a plaintiff's] right to litigate [his] claims in the federal forum should the Pennsylvania courts, for jurisdictional or other reasons, fail to adjudicate them." *Id.* In light of the Supreme Court's dictum in *Quackenbush* and the Third Circuit's decision in *Feige*, this court may properly stay Dalicandro's present action for damages based on the *Burford* abstention doctrine.⁷

II. Stay of Claims Against Legalgard

A stay of Dalicandro's federal action against Legalgard is appropriate as part of the stay against Reliance only if Legalgard is currently an asset of Reliance. Reliance's present ownership of Legalgard is unclear. The amended complaint makes the following allegations of ownership. In 1996, Reliance acquired an eighty-percent interest in Legalgard, making Reliance the majority shareholder. Am. Compl. ¶ 10. Then, in or about March 1999, Reliance sold its entire ownership in Legalgard. Am. Compl. ¶ 37. It is not alleged that Reliance ever acquired complete ownership of Legalgard. However, in defendants' memorandum in support of the motion to stay, Legalgard is referred to as a "wholly owned" subsidiary of Reliance, thereby indicating that Reliance owned 100% of Legalgard. Doc. 38 at 14. Thus, although the allegations

⁷ Defendants' argument that the full faith and credit statute, 28 U.S.C. § 1738, requires this court to honor the liquidation order and stay the present action is without basis. Doc. 42 at 2. The liquidation order is not a final judgment on the merits of plaintiff's tort and securities claims. *See Wade v. City of Pittsburgh*, 765 F.2d 405, 409 (3d. Cir. 1985); *Sullivan v. City of Pittsburgh, Pa.*, 617 F.Supp. 1488, 1498 (W.D. Pa. 1985). The Order simply stipulates the procedure to be followed for the liquidation of Reliance. As the merits of Dalicandro's claims were not decided by the state court, the full faith and credit provision does not require this court to honor the state liquidation order.

contained in the amended complaint lead this court to the conclusion that Reliance no longer owns any portion of Legalgard, the references to Legalgard as a “wholly owned” subsidiary contradict this finding.

In addition, even if Legalgard is a wholly owned subsidiary of Reliance, this court lacks knowledge of the facts and circumstances surrounding the relationship between Reliance and Legalgard that might be relevant to a determination of whether it is necessary to protect Legalgard as an asset of Reliance. The legal separation of Reliance and Legalgard has not been fully briefed by either party. Thus, whether Legalgard is a separate and distinct corporate entity or merely a shell corporation of Reliance is a mystery to this court.

Because Reliance’s ownership of Legalgard is unclear and the formal separation of Reliance and Legalgard has not been briefed, this court is without basis to stay Dalicandro’s action against Legalgard.

CONCLUSION

On the basis of *Burford* abstention, this court will extend comity to the state court liquidation order and stay Dalicandro’s federal action against Reliance.

An appropriate order follows.

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| RELIANCE INSURANCE CO., INC. | : | |
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| Defendants. | : | |

Order

And now, this day of November, 2001, upon consideration of defendants' motion to stay (Doc. 38); plaintiff's response (Doc. 39); defendants' reply (Doc. 41); defendants' supplemental motion to stay (Doc. 42); and plaintiff's response (Doc. 44); it is hereby ORDERED that defendants' motion to stay this federal action is GRANTED as to Reliance Insurance Co., Inc. only. The motion is DENIED without prejudice as to defendant Legalgard, Inc.

William H. Yohn, Jr., Judge

