

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN,
Insurance Commissioner of the
Commonwealth of Pennsylvania,

Plaintiff,

v.

RELIANCE INSURANCE COMPANY
(IN LIQUIDATION)

Defendant.

NO. 269 M.D. 2001

M. DIANE KOKEN,
Insurance Commissioner of the
Commonwealth of Pennsylvania,

Petitioner,

v.

GOTTLIEB HEALTH RESOURCES, INC.

and

EMPLOYERS REINSURANCE CORP.,

Respondents.

2006 MAR 21 P 3:33
CLERK OF COURT
JULIA G. GIBLIN

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ORDER

AND NOW, this ____ day of _____, 2006, consideration having
been given to the Petition of M. Diane Koken in her official capacity as Statutory Liquidator of
Reliance Insurance Company (In Liquidation) for Declaratory Relief, said Petition is GRANTED
as set forth below.

This Court declares that it has sole and exclusive jurisdiction over all of Reliance's assets, including any and all reinsurance proceeds due and owing from Employers Reinsurance Corporation ("ERC") under agreement between Reliance and ERC; that ERC must pay reinsurance proceeds due and owing under the agreement only to the Reliance Estate, and not directly to Reliance's insured, Gottlieb Health Resources, Inc. ("Gottlieb"); and that Gottlieb must submit any request for direct payment of these reinsurance proceeds to the Liquidator for her approval under this Court's Guidelines and must file any objections to the Liquidator's decision with this Court.

J.

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M. DIANE KOKEN,
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NO. 269 M.D. 2001

PETITION FOR DECLARATORY RELIEF

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania in her official capacity as Statutory Liquidator of Reliance Insurance Company (In Liquidation) ("Liquidator"), petitions this Court for an Order declaring that Employers Reinsurance Corp. ("ERC") must pay reinsurance proceeds due and owing under reinsurance

agreements between ERC and Reliance (“Reliance/ERC Reinsurance Agreements”) only to the Reliance Estate, and not directly to Reliance’s insured Gottlieb Health Resources, Inc.

(“Gottlieb”). If Gottlieb wishes to receive a direct payment of Reliance’s reinsurance proceeds under these agreements, it must make a formal request to the Liquidator for her approval under this Court’s Guidelines and must file any objections to the Liquidator’s decision with this Court.

As more fully set forth below, Reliance’s insured, Gottlieb, filed an action against Reliance’s reinsurer, ERC, in the United States District Court for the Northern District of Illinois (“Illinois Action”), styled Gottlieb Health Resources, Inc. v. Employers Reinsurance Corp., No. 03-cv-08410 (“Illinois Action”), alleging that it is entitled to direct payment of the proceeds from the Reliance/ERC Reinsurance Agreements. Gottlieb alleges, but ERC denies, that Reliance was fronting for ERC when it issued Gottlieb a hospital professional liability policy and that Gottlieb is a third party beneficiary to the Reliance/ERC Reinsurance Agreements. The Liquidator is not a party to that action. The Liquidator now petitions this Court for an Order that will protect Reliance’s interest in these reinsurance proceeds. By her Petition, the Liquidator merely seeks to have this Court ensure that an asset of the Reliance Estate, in accordance with the Liquidation Order and a well-established statutory scheme, is not improperly taken from the Estate. The Liquidator is keenly aware of the well-known proposition that a state court cannot enjoin a federal court action. The Liquidator does not seek to have this Court enjoin the Illinois Action; instead, the Liquidator seeks to have this Court continue to exercise its jurisdiction over the Reliance/ERC reinsurance agreements. The request contained in this Petition is made on behalf of the Liquidator and is intended to bind Gottlieb and ERC with respect to these reinsurance proceeds.

A. The Parties and Jurisdiction

1. Reliance Insurance Company (In Liquidation) is an insurance company incorporated in, and licensed to issue insurance policies in the Commonwealth of Pennsylvania.

2. ERC is a corporation incorporated under the laws of the state of Kansas with its principal place of business in Kansas. ERC entered into a reinsurance agreement with Reliance and, therefore, is a reinsurer that is subject to this Court's jurisdiction under 40 P.S. § 221.4(b).

3. Gottlieb is a corporation incorporated under the laws of the state of Illinois with its principal place of business in Illinois. Reliance issued several insurance policies to Gottlieb. As a Reliance policyholder, Gottlieb has filed several proofs of claim in the Reliance liquidation proceeding. Therefore this Court has personal jurisdiction over Gottlieb.

4. This Court has exclusive jurisdiction over the Reliance Estate and all assets of the Estate, including reinsurance proceeds, pursuant to 40 P.S. §§ 221.4 and 221.5, and this Court's Order of Liquidation dated October 3, 2001.

5. Venue is proper in the Commonwealth Court pursuant to 40 P.S. § 221.4(d).

B. The Underlying Policies and Reinsurance Agreements

6. Between 1988 and 1998 Reliance issued insurance policies to Gottlieb which provided lead umbrella and excess umbrella hospital professional liability coverage ("Gottlieb Policies"). True and correct copies of the Gottlieb Policies are attached as Exhibits A.

7. Each Gottlieb Policy was facultatively reinsured with ERC. True and correct copies of the Reliance/ERC Reinsurance Agreements are attached as Exhibit B.

C. The Reliance Liquidation Proceeding

8. Reliance was placed in liquidation on October 3, 2001. Order of Liquidation dated Oct. 3, 2001.

9. Upon entry of the Order of Liquidation, this Court asserted, “to the fullest extent of its authority, (a) in rem jurisdiction over all assets of the Company ... (b) exclusive jurisdiction over all determinations of the validity and amount of claims against Reliance; and (c) exclusive jurisdiction over the determination of the distribution priority of all claims.” Order of Liquidation dated Oct. 3, 2001 at ¶ 5.

10. Under the Order of Liquidation and pursuant to 40 P.S. § 221.20(c), the Liquidator was “vested with title to all property, assets, contracts and rights of action” of the insolvent insurer and was required to marshal all the assets of Reliance for eventual disbursement to creditors of the Estate. Order of Liquidation at ¶ 5.

11. Reinsurance proceeds are assets of the estate that are to be paid to the estate. *Id.* at ¶ 9. The statutory exception to the general rule is found at 40 P.S. § 221.34. The statute provides:

Payment made directly to an insured or other creditor shall not diminish the reinsurer’s obligation to the insurer’s estate except when the reinsurance contract provided for direct coverage of an individual named insured and the payment was made in discharge of that obligation.

40 P.S. § 221.34.

12. The Liquidator developed Guidelines for the Enforcement of 40 P.S. § 221.34, which establish an orderly process involving both the Liquidator and the Court, to consider, on a “case-by-case basis”, depending upon the unique facts and circumstances of the transaction,

whether an insured is entitled to a direct payment of reinsurance process (“Direct Payment Guidelines”).

13. On April 26, 2002, this Court approved the Direct Payment Guidelines proposed by the Liquidator.

14. The Direct Payment Guidelines established an orderly process to allow the Liquidator to review and determine if applications for direct payment of reinsurance proceeds meet the criteria established by this Court while allowing the Court to retain ultimate approval authority.

15. Gottlieb has not initiated the process established by the Direct Payment Guidelines; instead, Gottlieb only has filed proofs of claim, which the Liquidator is handling in accordance with the Insurance Act and this Court’s Orders..

16. Under Koken v. Legion Insurance Company, 831 A.2d 1196 (Pa. Commw. Ct. 2003), aff’d, No. 204 MAP 2003, 2005 Pa. LEXIS 1479 (Pa., July 19, 2005), Koken v. Reliance Insurance Company, No. 60 MAP 2004 (Pa., November 23, 2005), and Koken v. Reliance Insurance Company, No. 269 M.D. 2001, (Pa Commw. October 5, 2005, Memorandum Opinion and Order, the Commonwealth Court has delineated specific circumstances under which the conduct of the parties permits direct access to the original reinsurance contract, even if the specific requirements of 40 P.S. § 221.34 are not met.

17. The conduct of Reliance, ERC and/or Gottlieb does not meet those requirements to permit direct access.

D. The Proofs of Claims

18. Gottlieb has filed several proof of claims under the Gottlieb Policies with the Liquidator.

19. Proofs of Claim 2116411 and 2116412 were filed under policy numbers NPB 2358231 and NPB 2358232, respectively, for a claim filed against Gottlieb by Ophelia Martinez alleging negligence against Gottlieb's personnel in the labor and delivery of plaintiff ("Martinez Claim"). The proofs of claims for the Martinez Claim were made contingent on any settlement and/or judgment in the action brought against Gottlieb. The Liquidator sent Gottlieb a status request regarding the Martinez Claim on October 31, 2005 and to date no response has been received.

20. Proof of Claim 2116413 was filed under policy number NPB0126944 for a judgment rendered against Gottlieb for \$3,781,382.75 in a wrongful death action filed by Catina Matthews. ("Matthews Claim"). Proof of Claim 2116413 was made contingent on any settlement and/or judgment in the Illinois Action. The Liquidator sent a request for further information on October 13, 2005, and to date no response has been received.

21. Proofs of Claim 2116414 and 2116415 were filed under policy numbers NPB 0126945 and NPB 0126944, respectively, for a negligence claim filed by Juana and Jose Falagan alleging negligence against Gottlieb's personnel in the treatment of a patient who suffered a subarachnoid hemorrhage while a patient at Gottlieb ("Falagan Claim"). Proofs of Claim 2116414 and 2116415 were made contingent on any settlement and/or judgment in the action brought against Gottlieb. The Falagan Claim appears to be within the insured's \$3 million self insured retention, but on October 24, 2005, the Liquidator sent a request for information regarding the erosion of Gottlieb's self-insured retention. To date, no response has been received.

22. Proofs of Claim 2116418 and 2116436 were filed under underlying policy numbers NPB0126944 and NPB0126945, respectively, for a claim filed by Matthew Chimis

alleging negligence against Gottlieb's personnel in the labor and delivery of plaintiff ("Chimis Claim"). Proofs of Claim 2116418 and 2116436 were made contingent on any settlement and/or judgment in the action brought against Gottlieb.. The Liquidator has received no reports from Gottlieb regarding the Chimis Claim since June 14, 2004. On November 17, 2005, the Liquidator requested a status update from Gottlieb on this claim, but no update has been received to date.

23. Proofs of Claim 2116419 and 2116428 were filed under policy numbers NPB0126944 and NPB0126945, respectively, for a claim filed by Rosalba Luna and her mother alleging negligence against Gottlieb's personnel in the labor and delivery of plaintiff ("Luna Claim"). Proofs of Claim 2116419 and 2116428 were made contingent on any settlement and/or judgment in the action brought against Gottlieb. The Luna Claim settled for \$10,000,000. The Liquidator issued a Notice of Determination on Proof of Claim 2116419, under which Gottlieb was designated a class (b) distribution priority and valued at \$7 million, with a possibility of proration should the aggregate allowed amount of all claims made under policy number NPB0126944 exceed the policy limits. United National, as assignee of Gottlieb, has filed an objection to the Liquidator's Notice of Determination on Proof of Claim 2116419, which is presently pending before this Court. United National also provides second layer excess hospital professional liability coverage to Gottlieb, above Reliance's first layer excess coverage.

24. Proofs of Claim 2116421 and 2116470 were filed under policy numbers NPB0126945 and NPB0126944, respectively, for a claim filed by Linda Cardelli alleging negligence against Gottlieb's personnel in failing to timely administer Thromolytic therapy to plaintiff ("Cardelli Claim"). Proofs of Claim 2116421 and 2116470 were made contingent on any settlement and/or judgment in the action brought against Gottlieb.

E. The Illinois Action

25. Instead of complying with this Court's Order and submitting its request to the Liquidator for approval of a direct payment of Reliance's reinsurance proceeds, Gottlieb filed an action against ERC in Illinois state court which was subsequently removed to the United States District Court for the Northern District of Illinois, styled Gottlieb Health Resources, Inc. v. Employers Reinsurance Corp., No. 03-cv-08410 ("Illinois Action"), alleging that Reliance was a fronting company for ERC when Reliance issued policy number NPB0126944 to Gottlieb and that Gottlieb is a third party beneficiary of the Reliance/ERC Reinsurance Agreement and therefore, that Gottlieb is entitled to a direct payment of reinsurance proceeds under the ERC/Reliance Reinsurance Agreements. See Complaint, attached hereto as Exhibit C.

26. In the Illinois Action, Gottlieb contends that ERC is obligated to indemnify its payments on the Matthews Claim, as well as to cover Gottlieb for other claims within the policy period.

27. In response, ERC denied that Reliance was a fronting company and/or that Gottlieb is a third-party or intended beneficiary of any reinsurance or other agreement ERC had with Reliance. See Answer, attached hereto as Exhibit D.

28. According to the Minute Entry in the docket of the Illinois Action, on October 12, 2005, a settlement conference was held in the Illinois Action at which time ERC expressed concern that any settlement it entered into would expose it to further demands by the Liquidator for the same reinsurance proceeds. Both parties agreed to seek guidance from the Liquidator as to whether any settlement they enter would run afoul of the Liquidation Order. See Minute Entry dated 10/12/2005. A true and correct copy of the docket for the Illinois Action is attached hereto as Exhibit E.

29. Around October 25, 2005, counsel purporting to be acting on behalf of both United National and ERC with respect to the Luna Claim, informed the Liquidator of the Illinois Action. However, the parties to the Illinois Action, including counsel, has not contacted the Liquidator regarding whether any settlement they enter they enter in the Illinois Action would run afoul of the Liquidator Order.

30. Out of an abundance of caution, the Liquidator informed counsel for the parties to the Illinois Action that all settlements or payments by ERC in the Illinois Action for the Matthews Claim, Luna Claim, or any other claim that might implicate the Gottlieb Policies reinsured by ERC, must be made directly to the Reliance Estate. The Liquidator also expressly reserved any rights to recover amounts due and owing under its Reliance/ERC Reinsurance Agreement.

31. According to the Minute Entry in the docket of the Illinois Action, on December 16, 2005, Gottlieb and ERC informed the court in the Illinois Action of the Liquidator's position with respect to any settlements or payments by ERC in the Illinois Action. The Parties also indicated that they are now considering whether to continue with the Illinois Action or dismiss it so that the matter can be resolved in the Liquidation proceeding. See Minute Entry dated 12/16/05.

32. According to the Minute Entry in the docket of the Illinois Action, on January 25, 2006, a status hearing was held and the court determined "that the parties are not authorized to settle this case because of the proceeding in the state court of Pennsylvania regarding liquidation." See Minute Entry dated 1/25/06.

33. Therefore, the Liquidator hereby petitions this Court to assert jurisdiction over these parties and to issue an order that is binding on Gottlieb and ERC with respect to reinsurance proceeds due and owing under the Reliance/ERC Reliance Agreement.

34. The proper forum and procedure for resolving this issue is before this Court.

35. Moreover, since the regulation of insurance companies is an important state interest, and since Reliance is a Pennsylvania insurance company currently in liquidation in Pennsylvania, under principles of comity and in recognition of this Court's authority to act and fulfill its mandate as set out in 40 P.S. §§ 221.1-221.63, once this Court assumes jurisdiction over these parties and this dispute, the United State District Court for the Northern District of Illinois may choose to stay or dismiss the Illinois Action. See Tribune Company v. Swiss Reinsurance America Corporation, No. 02 C 4772, 2005 WL 692859 (N.D. Ill., March 21, 2005) attached hereto as Exhibit G. Because the Liquidator is not a party to the Illinois Action, it cannot move to stay or dismiss it.

36. Therefore, the Liquidator respectfully requests that this Court enter an Order declaring that ERC must pay reinsurance proceeds due and owing under the Reliance/ERC Reinsurance Agreements to the Reliance Estate, and not directly to Gottlieb. Gottlieb must submit any request for direct payment of these reinsurance proceeds to the Liquidator for her approval under this Court's Guidelines and must file any objections to the Liquidator's decision with this Court.

For all the reasons set forth above, the Liquidator respectfully requests that the Court grant her petition and enter an Order in the form attached.

Respectfully submitted,

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Dated: February 21, 2006