

under Section 544(e).² We affirm the Liquidator's determination by adopting the Referee's Report and Recommendation.

Sage filed a timely proof of claim alleging that it was entitled to administrative priority for rent for a portion of the premises at 77 Water Street in New York City, in spite of the fact that neither Reliance nor the Liquidator was in possession of the premises at the time in question and that, during that time, Sage had rented the premises at a higher rent than Sage claimed. The Liquidator filed a Notice of Determination denying Sage's claim for an administrative priority on August 11, 2004. Sage filed a timely objection to that Notice and this Court appointed J. Scott O'Keefe as Referee. Referee O'Keefe filed a Report in which he recommended that we affirm the Liquidator's determination, to which Sage filed Exceptions.

² The referenced sections of the Act read,

§ 221.44. Order of distribution

The order of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is herein set forth. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class.

(a) The costs and expenses of administration, including but not limited to the following; the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the liquidation; any necessary filing fees; the fees and mileage payable to witnesses; reasonable attorney's fees; the expenses of a guaranty association in handling claims.

(e) Claims under nonassessable policies for unearned premium or other premium refunds and claims of general creditors.

In its Exceptions, Sage raises the issue of the Referee's refusal to compel discovery, alleging that the Liquidator failed to properly respond to Sage's interrogatories and requests for production and that the Referee erred in denying Sage's Motion to Compel Discovery. The Liquidator claims that Sage's requests were simply not relevant to the issue of which priority should be assigned to Sage's claim, and we agree. The information sought to be discovered that Sage details in its Exceptions relates to Reliance's business operations while it was in possession of 77 Water Street, and to Reliance's business dealings with the Hartford Insurance Company (Hartford), to which Reliance sublet a portion of the premises prior to surrendering it to Sage. The Liquidator objected to supplying any information regarding its dealings with Hartford on the basis that such information was simply not relevant.³ We agree. The question before us is which priority should be assigned to Sage's claim for unpaid rent. Reliance's conduct of its business during the term of the lease under which the rent was to be paid is not and cannot be relevant to that determination, and thus Sage is not entitled to that information and the Referee did not err in denying Sage's Motion to Compel Discovery.

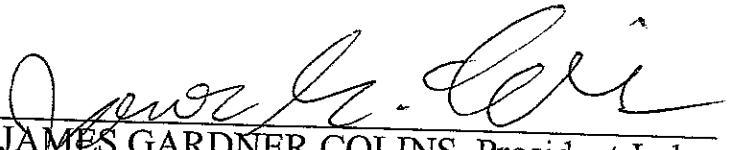
As to the question of whether Sage is entitled to an administrative priority on its claim, we have reviewed the record in this matter, the submissions of the parties and the Report of the Referee and conclude that we can add nothing to

³ Pa. R.C.P. 4003.1(a) provides, in pertinent part,

Scope of Discovery Generally

(a) Subject to the provisions of Rules 4003.2 to 4003.5 inclusive and Rule 4011, a party may obtain discovery regarding any matter, not privileged, which is *relevant* to the subject matter involved in the pending action ... ; (emphasis added)

the Referee's thoughtful, concise, and well-written Report on that issue. Accordingly, we affirm the Liquidator's determination by adopting the Report and Recommendations authored by Referee J. Scott O'Keefe, which is attached here as Exhibit A.



JAMES GARDNER COLINS, President Judge

In The Commonwealth Court Of Pennsylvania

M. DIANE KOKEN, INSURANCE
COMMISSIONER OF THE
COMMONWEALTH OF PENNSYLVANIA

V.

RELIANCE INSURANCE COMPANY

IN RE:
PROOF OF CLAIM NO. 000890447
SAGE REALTY CORPORATION

No. 269 MD 2001

REFEREE'S REPORT AND RECOMMENDATION

PROCEDURAL HISTORY

This matter arises out of a claim by Sage Realty Corporation ("Sage") for unpaid rent for a portion of the premises of 77 Water Street, New York, New York, against Reliance Insurance Company ("Reliance"). On May 29, 2001, the Commonwealth Court placed Reliance into Rehabilitation, and into Liquidation on October 3, 2001. Sage timely filed a Proof of Claim alleging that it was entitled to an administrative priority for rent for the portion of the premises of 77 Water Street in New York, despite the fact that neither Reliance nor the Liquidator of Reliance Insurance Company (Liquidator") was in possession of the premises during the time in question. On August 11, 2004, the Liquidator filed a Notice of Determination denying Sage's claim for administrative priority.

Sage filed a timely Objection to the Notice of Determination on October 8, 2004 and the undersigned was selected as Referee. Discovery was conducted through August 8, 2005, and briefs submitted by the parties.¹

FACTUAL HISTORY

On June 8, 1998, Reliance leased several floors of 77 Water Street in New York. This lease was supplemented and amended on August 31, 1998, October 31, 1998 and December 29, 1999. The term of these leases was through February of 2012. In July of 2000, Sage discovered that Reliance had sublet a portion of the premises to Hartford Insurance, without the consent of Sage. Reliance and Sage entered into a Second Amendment to the lease on September 29, 2000. This Second Amendment provided for the termination of the lease and the gradual surrender of the premises by Reliance. Indeed, Sage found a replacement tenant, Goldman Sachs, who entered into a new lease for a much higher rent for all of the space previously leased by Reliance. Reliance had vacated the premises by April 30, 2001. Reliance paid its rent through May 31, 2001. Although the Second Amendment required Reliance to pay rent through July 31, 2001, this Court entered the Order placing Reliance in Rehabilitation on May 29, 2001. The subject of this litigation is the additional rent for June and July of 2001. It should be noted neither that Reliance, nor the Liquidator were in possession of the premises during that time.

¹ On December 28, 2004, the parties were notified of the undersigned's appointment as Referee. A timetable was set for the completion of discovery by April 29. One sixty day extension was granted to Sage on April 28th. On August 8th a motion to compel discovery and extend the discovery by Sage deadline was denied. A review of the motions clearly showed that the additional discovery sought was not relevant to the issues presented in the Objection to the Notice of Determination.

DISCUSSION

The only issue before the undersigned is whether Sage's claim for rent of the premises which the Liquidator never possessed and which was agreed upon more than a year before liquidation, is entitled to administrative priority pursuant to Section 544(a) of the Insurance Department Act, 40 Pa.C.S. 221.44. The relevant portion of that statute provides:

"The order of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is herein set forth. Every claim in each class shall be paid in full or adequate funds retained for such payment before members of the next class receive any payment. No subclasses shall be established within any class

"(a) The costs and expenses of administration, including but not limited to the following: the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the liquidation; any necessary filing fees; the fees and mileage payable to witnesses; reasonable attorney's fees; the expenses of a guaranty association in handling claims. ...

"(e) Claims under nonassessable policies for unearned premium or other premium refunds and claims of general creditors.

Sage contends that they fall under the administrative priority because "Sage's agreement to permit early surrender by Reliance of its leased space, instead of holding Reliance to the term of the Lease, preserved Reliance's assets by reducing Reliance's rent obligation by millions of dollars." (Brief of Petitioner, p.13). Sage contends that the fact that the agreement between Reliance and Sage was entered into more than a year before the Order of Liquidation, and eight months prior to Reliance being placed in rehabilitation, is of no consequence. Sage further alleges neither the fact that Reliance had vacated

the premises by April of 2001, nor that the Liquidator never possessed the premises is likewise of not material.

It is clear that the rent owed by Reliance for the months of June and July of 2001 are not administrative costs of the Estate. The premises were vacated, and relet at a higher rent, by the end of April, 2001. This was five months before Reliance was placed into Liquidation, and one month prior to being placed in rehabilitation. The Liquidator never took possession of the premises. The rent was a pre-liquidation debt, the same as any other general creditor.

The argument that Sage preserved Reliance's assets by permitting the early surrender of its leased premises, rather than holding them to the lease, likewise fails. The true beneficiary of this surrender was Sage, who re-leased the premises to Goldman Sachs at a higher rent. The allegation that by not holding Reliance to the terms of the original lease, Sage saved Reliance millions of dollars and thereby preserved its assets, does not provide Sage with the priority it seeks. Under the statute, costs of preserving assets are a subcategory of the costs and expenses of administration. Administration means administration of the assets while in statutory liquidation. Therefore, the costs incurred in preserving such assets must be incurred during and pursuant to the administration of the insurer's assets while in the hands of the Liquidator in the course of the liquidation proceedings. There is no dispute that the subject of this claim was incurred prior to rehabilitation or liquidation and in the ordinary course of Reliance's pre-liquidation business. The Liquidator never occupied the premises. Sage had released the premises at a higher rent to Goldman Sachs. Sage was nothing more than a general creditor and appropriately assigned that status.

Claimant cites Foster v. Westmoreland Casualty Company 145 Pa. Commw. 638, 604 A.2d 1131 (1992) as precedent for its allegation. Such trust is misplaced. In that case, two law firms contested the classification of their claims for work performed during the time Westmoreland was under suspension, as that of general creditors. The lawyers contended that fees for their services rendered during the suspension should be given administrative priority because they helped preserve Westmoreland's assets. The Court refused to address this issue, applying the doctrine of equitable estoppel to the case. The Court found that the department had specifically advised the claimants that their fees would be paid as administrative expenses, and it would be a fundamental injustice to not honor the Commissioner's representation that the attorney's fees would be paid. Accordingly, Claimants reliance on Foster is misplaced.

Although there are no reported Pennsylvania cases on this issue, a similar situation was decided by the Court of Appeals of North Carolina in State of North Carolina v. Interstate Casualty Insurance Company, 10 N.C. App. 743, 465 S.E. 2d 73 (1995). In that case, the court held that a claim for pre-rehabilitation services to the insolvent insurer could not be considered an expense of the administration of the insolvent insurer's estate, because the estate was not in existence when the services were rendered. The same reasoning and result should be adopted in the case at bar. The administrative priority should be awarded only to entities which conserve or administer assets of the insurer after the estate has been raised.

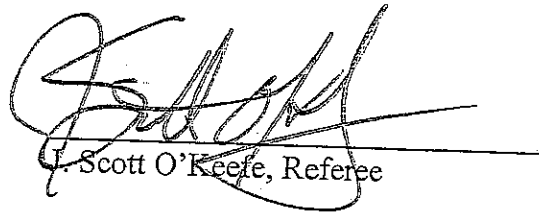
In consideration of the above analysis, it is clear that Sage's claim for rent for premises not inhabited by Reliance, is properly classified as a Class (e) priority level under 40 Pa. C. S. §221.44(e).

RECOMMENDATION

Based on the foregoing, it is recommended that the objection of Sage to the Notice of Determination assigning class (e) priority level to the claim for rent should be dismissed and that the claim be assigned Class (e) priority under 40 Pa.C.S. §221.44(e).

Notice is hereby given that any objections to this Report and Recommendation must be filed with the Commonwealth Court within thirty days of the date of this Report.

Respectfully submitted,


J. Scott O'Keefe, Referee

Date: November 7, 2005