

THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

RELiance INSURANCE COMPANY,

Defendant


RECEIVED AND FILED
COMMONWEALTH COURT
OF PENNSYLVANIA
NO. 269 M.D. 2001
OCT 11 P 2:48

*In Re: Commutation, Settlement Agreement and Release between
Reliance Insurance Company and European Reinsurance Company of Zurich (Bermuda
Branch)*

SEALED EXHIBIT B TO PETITION FOR APPROVAL OF
COMMUTATION, SETTLEMENT AGREEMENT AND RELEASE

THIS ENVELOPE IS SEALED AND CONTAINS INFORMATION
DESIGNATED CONFIDENTIAL IN THIS CASE. IT IS NOT TO BE OPENED OR THE
CONTENTS THEREOF TO BE DISPLAYED OR REVEALED EXCEPT BY OR UPON
ORDER OF THE COURT.

Respectfully submitted,
PEPPER HAMILTON LLP

By: 
DEBORAH F. COHEN
MICHAEL S. OLSAN
3000 Two Logan Square
18th and Arch Streets
Philadelphia, PA 19103-2799
(215) 981-4000

Attorneys for Plaintiff-Respondent M. Diane
Koken, Insurance Commissioner of the
Commonwealth of Pennsylvania, in her official
capacity as Statutory Liquidator of Reliance
Insurance Company

Dated: October 13, 2006

THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

RELiance INSURANCE COMPANY,

Defendant

CIVIL ACTION

NO. 269 M.D. 2001

RECEIVED AND FILED
COMMONWEALTH COURT
OF PENNSYLVANIA
2006 OCT 13 PM 2:44

*In Re: Commutation, Settlement Agreement and Release between
Reliance Insurance Company and European Reinsurance Company of Zurich (Bermuda
Branch)*

ORDER

AND NOW, this _____ day of _____, 2006, upon consideration of
the Petition for Approval of the Commutation, Settlement Agreement and Release between
Reliance Insurance Company and European Reinsurance Company of Zurich (Bermuda Branch)
submitted by M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania,
in her official capacity as Statutory Liquidator of Reliance Insurance Company (In Liquidation),
it is hereby ORDERED that the Petition is GRANTED, and that the Commutation, Settlement
Agreement and Release, attached as Exhibit A to the Petition, is APPROVED.

James Gardner Colins, President Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

RELIANCE INSURANCE COMPANY,

Defendant

CIVIL ACTION

NO. 269 M.D. 2001

RECEIVED AND FILED
COMMONWEALTH COURT
OF PENNSYLVANIA
2006 OCT 13 2 21 PM

**PETITION FOR APPROVAL OF COMMUTATION, SETTLEMENT AGREEMENT
AND RELEASE**

Petitioner M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her capacity as statutory liquidator (“Liquidator”) of Reliance Insurance Company (In Liquidation) (“Reliance”), respectfully requests that this Court enter an Order approving the Commutation, Settlement Agreement and Release between Reliance and European Reinsurance Company of Zurich (Bermuda Branch) (“Reinsurer”). The Commutation, Settlement Agreement and Release is attached hereto as Exhibit “A”.

In support of this petition, the Liquidator avers the following:

1. On October 3, 2001, this Court found Reliance insolvent and appointed the Commissioner as Liquidator of Reliance pursuant to Article V of the Insurance Department Act of 1921, 40 P.S. § 221.1 et seq. (hereinafter, the “Act”).

2. The Act confers broad powers on the Liquidator to marshal the assets of Reliance in order to maximize the value of the insolvent insurer’s estate for eventual distribution to its policyholders and creditors.

3. The Reinsurer is part of the Swiss Re group of companies, which is one of the largest reinsurance company groups in the world.

4. In 1999 Reliance and the Reinsurer entered into the “Accident Year Aggregate Excess of Loss Reinsurance Agreement,” (hereinafter “Reinsurance Agreement”) under which Reliance ceded 1999, 2000 and 2001 accident year losses and the Reinsurer assumed such losses in accordance with the terms and conditions contained therein.

5. Due to the Reinsurer’s status as an unauthorized reinsurer, in order for Reliance to take statutory credit for reinsurance ceded to the Reinsurer, the Reinsurer was required to collateralize its obligations under the Reinsurance Agreement with letters of credit. However, pursuant to the treaty terms, Reliance is obligated to reimburse the Reinsurer for the costs of maintaining these letters of credit.

6. Pursuant to the terms of the agreement, the remaining limit that Reliance may collect from the Reinsurer is \$96.3 million. This amount decreases over time because the Reinsurer’s letter of credit costs erode the limit.

7. As of this date, Reliance is ceding an amount of paid losses and case reserves to the Reinsurance Agreement that is equal to the remaining limit of that agreement.

8. The Reinsurer agrees that they will eventually pay the remaining available limit under the Reinsurance Agreement. However, there is disagreement over whether the amount of Reliance’s covered paid losses have begun to exceed the retention.

9. Under the Reinsurance Agreement, the Reinsurer is allowed to audit and verify the records supporting the amounts being ceded.

10. Based on the size and scope of a prospective paper file audit, as well as its experience with the Corporate Stop Loss reinsurance treaty audits for previous accident years, Reliance estimates that it will be a minimum of 15 months before the audit is completed and all post audit queries and reconciliation are completed.

11. Therefore, absent this commutation, it will be at least 15 months before the Reinsurer will remit any payments to Reliance under the Reinsurance Agreement.

12. After negotiation, both parties were willing to forego the audit and agree to settle for \$90 million today. A payment of \$90 million today invested at 5.5% per year return is worth the same as a payment of \$96.3 million in 15 months.

13. As Reliance envisions no scenario where we would receive any payments sooner than 15 months, this settlement amount of \$90 million represents fair value to the estate.

14. In addition, Reliance actuaries forecasted payment patterns and determined that under all likely scenarios, that Reliance would maximize its value under the contract by accepting this payment now rather than collect the funds over time after an audit.

15. Therefore, Reliance has determined that it is in the best interests of its policyholders, creditors, and the public at large to terminate and commute the Reinsurance Agreement.

16. Under the terms of the Commutation, Settlement Agreement and Release, the Commutation Amount will be released to Reliance after satisfaction of the following conditions: (1) execution of the Commutation, Settlement Agreement and Release by the authorized representative of Reliance; (2) execution of the Commutation, Settlement Agreement and Release by the authorized representative of Reinsurer; (3) approval of the transaction by this Court; and (4) appropriate notice.

17. The Commutation Amount was negotiated between Reliance and Reinsurer, and the Liquidator has taken the necessary steps to determine whether the terms of the Commutation, Settlement Agreement and Release are fair and reasonable to the estate of Reliance and in the best interests of Reliance's policyholders, claimants and the general public. See 40 P.S. §§ 221.1(c), 221.23(9). As the Confidential Affidavit of Keith Kaplan (attached as Exhibit "B") of Keith Kaplan, a career reinsurance expert establishes, the Liquidator has identified a key advantage to the estate arising from the consummation of the transaction memorialized in the Commutation, Settlement Agreement and Release in that the estate will be

receiving the same economic benefit as it would if the parties went through the customary reinsurance audit process without the delay inherent in that process.

18. Based on the analysis of the terms of the Commutation, Settlement Agreement and Release, and the evaluation of the transaction as a whole by the Liquidator, her staff and Reliance staff members familiar with Reliance's dealings with Reinsurer in connection with the Reinsurance Agreement, the Liquidator has determined that the payment of the Commutation Amount is a fair and reasonable commutation of Reinsurer's obligations to Reliance under the Reinsurance Agreement.

19. The Insurance Department Act authorizes the Liquidator to take such actions as she deems "necessary or expedient to . . . conserve or protect [the insolvent insurer's] assets or property[,]" including the power to "compromise" claims involving assets of the insolvent insurer in order to accomplish or aid in the achieving the purposes of liquidation. See 40 P.S. § 221.23(6, 9, and 23). Because the Commutation, Settlement Agreement and Release settles future claims against the Reinsurer under the Reinsurance Agreement, and because the Commutation, Settlement Agreement and Release requires the payment to Reliance of ninety million dollars thus increasing the assets of the estate by that amount, the Liquidator believes that the Commutation, Settlement Agreement and Release is necessary and appropriate to conserve and maximize the invested assets of Reliance and reduce the future burden of administering the business Reinsurance Agreement.

20. The Liquidator further believes that the Commutation, Settlement Agreement and Release will help her in achieving the objectives of liquidation under the Insurance Department Act, 40 P.S. § 221.1 et seq. The commutation transaction will assist the Liquidator in marshalling and maximizing Reliance's immediately available assets and minimize any unavoidable loss to policyholders, claimants and creditors resulting from Reliance's insolvency and hazardous financial condition. See 40 P.S. § 221.1(c).

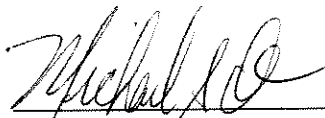
21. Accordingly, the Liquidator respectfully requests that this Court (1) approve the terms of the Commutation, Settlement Agreement and Release as set forth in Exhibit "A"; (2) authorize the execution and delivery of the Commutation, Settlement Agreement and Release on behalf of Reliance by the Liquidator or her designee; and (3) authorize the Liquidator to perform the Commutation, Settlement Agreement and Release pursuant to her authority under 40 P.S. § 221.23.

22. Notice has been provided to the Master Service List, as required by this Court's Order dated April 1, 2004.

WHEREFORE, the Liquidator respectfully requests that this Court grant the Petition, enter an Order in the form attached hereto, and order such other relief as this Court deems necessary and appropriate.

Respectfully submitted,

PEPPER HAMILTON LLP



DEBORAH F. COHEN
MICHAEL S. OLSAN
3000 Two Logan Square
18th and Arch Streets
Philadelphia, PA 19103-2799
(215) 981-4000

Attorneys for Plaintiff-Respondent M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her official capacity as Statutory Liquidator of Reliance Insurance Company

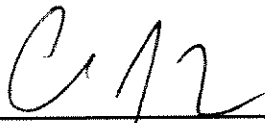
Dated: October 13, 2006

CERTIFICATE OF SERVICE

I hereby certify that on October 13, 2006, true and correct copies of the Liquidator's Petition for Approval of Commutation, Settlement Agreement and Release, without the attached Confidential Affidavit, and Proposed Order were served upon the following:

Via Notice of Filing

Members of the Reliance Master Service List



Christopher J. Lowe

EXHIBIT A

COMMUTATION, SETTLEMENT AGREEMENT AND RELEASE

THIS COMMUTATION, SETTLEMENT AGREEMENT AND RELEASE (“Agreement”), made effective and entered into this 11th day of October, 2006, by and between European Reinsurance Company of Zurich (Bermuda Branch), Hamilton, Bermuda (hereinafter known as the “Reinsurer”) and M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her capacity as Statutory Liquidator of Reliance Insurance Company (In Liquidation) (hereinafter known as the “Cedant”). David S. Brietling, Liquidation Operating Officer, is acting on behalf of M. Diane Koken, who is acting on behalf of the Cedant pursuant to the powers granted to her under Title 40, Purdon’s Statutes, Section 221.20, et seq. and other applicable statutes, regulations and laws.

PREAMBLE

A. The Reinsurer and the Cedant entered into a contract of reinsurance wherein the Reinsurer obligated itself to accept from the Cedant the cession of a certain percentage of liabilities with respect to risks written or assumed by the Cedant and/or agents of the Cedant, and;

B. The reinsurance agreement referred to in Preamble A above is set out on Exhibit A attached hereto and are herein referred to as “the Contract”, and;

C. Pursuant to the Contract, there are loss developments, the total amount of which are not fully known or not yet capable of determination, representing liabilities which are or may come due from the Reinsurer to the Cedant, and;

D. The parties hereto recognize and understand that, based upon current economic projections, a substantial portion of the Reinsurer’s obligations to the Cedant may become payable in the future rather than at present; that the Reinsurer’s future liabilities and obligations to the Cedant pursuant to the Contract have been evaluated, but cannot be determined in an

amount certain at this time; and that a settlement and commutation of the Reinsurer's obligations to the Cedant based upon present calculations of outstanding losses, including incurred but not reported losses, will eliminate the uncertainty of contingent liabilities for presently unresolved or unasserted claims, and;

E. Pursuant to the terms of the Contract, the Reinsurer has provided Cedant with collateral to secure its obligations thereunder in the form of letters of credit more fully described on Exhibit B attached hereto and are hereinafter referred to as "the LOCs", and;

F. The Reinsurer and the Cedant agree that it is in each of their best interests and in the best interests of their respective policyholders and creditors to adjust and settle their differences and to enter into this Agreement.

NOW THEREFORE, in consideration of the mutual benefits to be received by the parties hereto and the mutual covenants and agreements herein contained, the parties hereto hereby agree as follows:

Commutation of Reinsurance Agreements

Article 1. Subject to the receipt by the Cedant of the Consideration as set out in Article 4 herein, together with any collection expenses and accrued interest due as is more particularly described in Article 9(c) and 10 below, and in further consideration of the release contained in Article 2 herein the Cedant hereby irrevocably releases the Reinsurer, its predecessors, successors, assigns, shareholders, officers, directors, agents, reinsurance intermediaries, sub-agents, brokers and sub-brokers from One Hundred Percent (100%) of all adjustments, obligations, liabilities, offsets, actions, causes of action, proofs of claim, suits, debts, sums of money, accounts, reckonings, bonds, bills, covenants, contracts, conversions, costs, agreements, promises, damages, expenses, judgment claims, and demands whatsoever, whether known or unknown, suspected or unsuspected, fixed or contingent, arising out of, or in connection with the Reinsurer's participations on the Contract, whether or not the contract is void or voidable.

Release of the Cedant

Article 2. In consideration of the release set out in Article 1 herein, the Reinsurer hereby irrevocably releases the Cedant, its predecessors, successors, assigns, shareholders, officers, directors, receivers, liquidators, administrators, agents, sub-agents, brokers and sub-brokers from One Hundred Percent (100%) of all adjustments, obligations, liabilities, offsets, actions, causes of action, proofs of claim, suits, debts, sums of money, accounts, reckonings, bonds, bills, covenants, contracts, conversions, costs, agreements, promises, damages, expenses, judgment claims, and demands whatsoever, whether known or unknown, suspected or unsuspected, fixed or contingent, arising out of, or in connection with the participation of the Cedant on the Contract, whether or not the contract is void or voidable.

Warranties

Article 3. To the best information and belief of each of the parties to this Agreement, the following express warranties apply:

a. There are no pending agreements, transactions, negotiations, regulatory actions or lawsuits in which any of the parties are involved nor are there any threatened regulatory actions or lawsuits of which any of the parties are aware that would render this Agreement or any part thereof void, avoidable, or unenforceable;

b. No party hereto has transferred, assigned, or contracted to transfer or assign to any person, corporation, company or entity any of its rights, title, benefit or obligations directly arising out of or in connection with the Contract, including without limitation any balances, accounts, costs, claims, counterclaims or demands which are within the contemplation of this Agreement;

c. The Reinsurer has not commuted or otherwise settled with or contracted to commute or settle with any person, corporation, company or entity any of their respective rights, title, benefit or obligations directly arising out of or in connection with the Contract, including

without limitation any balances, accounts, costs, claims, counterclaims or demands which are within the contemplation of this Agreement;

Consideration

Article 4. The Reinsurer agrees to pay the Cedant the total sum of Ninety Million United States Dollars (US\$90,000,000) (“the Consideration”). Upon receipt of the approval of the Court as required by Article 16 herein, Cedant agrees, without objection from Reinsurer, to draw down the LOCs in the amount of the Consideration. In the event that, for any reason whatsoever, Cedant’s draws on the LOCs are not honored by the issuing banks within ten (10) business days of the date of such draw, Reinsurer agrees to wire transfer to Cedant the whole or part of the Consideration then remaining due as a result of the bank(s) dishonor of Cedant’s draw(s). The wire transfer shall be completed no later than ten (10) business days following notice to the Reinsurer by facsimile of the failure of the bank to honor the draw (the “Completion Date”) to the following account:

| | |
|-----------------|-------------------------------|
| Name of Bank: | Mellon Bank Pittsburgh, PA |
| ABA Number: | 043000261 |
| Credit: | Reliance Insurance Company |
| CHIPS No.: | 044840 |
| Account Number: | 079-7806 |
| S.W.I.F.T.: | MELN US 3P |
| Ref: | Kathy Lee |

The parties also agree that any claim recoveries including but not limited to salvage and subrogation, any escrow funds with third party claim administrators and any unremitted cash with intermediaries that relate to the Contract is the property of the Cedant.

Release of Collateral Security

Article 5. Within three (3) business days of Cedant's receipt of the whole of the Consideration, Cedant will release the remaining balance(s) of the LOC(s).

Successors and Assigns

Article 6. This Agreement shall inure to the benefit of and bind the Reinsurer and its successors and assigns and the Cedant and their respective successors and assigns.

Independent Investigation

Article 7. Each of the parties acknowledges that it has entered into this Agreement in reliance upon its own independent investigation and analysis of the Contract and its respective rights and obligations thereunder, and not on the basis of any representation made or not made by the other party hereto. Each of the parties further acknowledge that it has read this Agreement, that it has had the opportunity to discuss it with legal counsel, and that it fully understands all of the terms herein.

Integration and Waiver

Article 8. This Agreement shall constitute the entire agreement between the parties pertaining to the subject matter hereof, and supersedes any and all prior or contemporaneous understandings or agreements. No supplement, modification, waiver or termination hereof shall be binding or enforceable unless executed in writing by the parties to be bound thereby. No delay, omission or forbearance on the part of any party to this Agreement in exercising or enforcing any right, power or remedy under this Agreement shall impair such right, power or remedy or operate as a waiver thereof. The single or partial exercise or enforcement of such right, power or remedy shall not preclude any other or further exercise or enforcement thereof or of any other right, power or remedy. The rights, powers and remedies provided in this

Agreement are cumulative and not exclusive of any rights, powers and remedies provided by law.

Remedies

Article 9. In the event that the Reinsurer fails to pay the Consideration to the Cedant by the Completion Date, the Cedant shall have all rights and remedies available at law or in equity. In addition, the Cedant shall have the express right to:

a. deem the entire Agreement null and void by notice in writing to the Reinsurer per Article 12 herein and to seek recovery of all sums due or to become due under the Contract, or;

b. bring suit on the Agreement including interest on the agreed-upon but unpaid amount as set out in Article 9(c).

c. Without prejudice to the Cedant's rights to rescind this Agreement pursuant to Article 9(a) above, if Reinsurer does not pay all of the Consideration recited herein to the Cedant by the Completion Date, the Reinsurer shall pay interest on any unpaid sums at a rate which is equal to one percentage point (1.00%) over the Prime Rate (the base rate on corporate loans at large U.S. money center commercial banks) as published in *The Wall Street Journal*, but in no event shall said interest be calculated at less than six percent (6%) per annum.

Expenses of Collection

Article 10. Subject to the provisions of Article 9(c) herein, if the Reinsurer fails to pay the Consideration to the Cedant by the Completion Date, Reinsurer agrees to reimburse the Cedant for all reasonable expenses including, without limitation, attorney fees which are incurred by the Cedant in the enforcement of this Agreement and collection of the consideration together with any interest accrued upon such reasonable expenses from the date of payment of such expenses at the rate set out in Article 9(c) above.

Choice of Laws

Article 11. The performance and interpretation of this Agreement shall be governed by the laws of the Commonwealth of Pennsylvania with respect to any dispute arising under this Agreement between the Reinsurer and the Cedant;

Notices

Article 12. All notices required under this Agreement shall be as follows:

a. Any notice or other communication under or in connection with this Agreement shall be in writing and shall be delivered personally or sent by first class post/mail (or by air mail if overseas) or by overnight courier service, to the addresses of the parties as set out in Exhibit B attached hereto or to such other person or address as any party may specify by notice in writing to the others.

b. In the absence of evidence of earlier receipt, any notice or other communication shall be deemed to have been duly served if (i) sent by first class post on the second business day after posting; (ii) sent by overnight courier on the next business day after mailing (iii) sent by air mail, six (6) days after posting, and; (iv) if delivered personally, when left during normal business hours at the address set out in Exhibit C or any alternative address specified by the receiving party.

Interpretation

Article 13. The language of this Agreement is the result of negotiation between all parties hereto, and any ambiguities in said language shall not be presumptively construed against or in favor of any party or parties hereto.

Execution and Approval

Article 14. Except as disclosed in Article 16, each party to this Agreement represents that it is authorized to enter into this Agreement and the transactions contemplated herein.

Article 15. Except as disclosed in Article 16, each signatory to this Agreement represents that said signatory is authorized and empowered to execute this Agreement and the transactions contemplated herein and that any and all required corporate approval on behalf of the Reinsurer has been properly executed and that the Agreement is entered into voluntarily.

Article 16. With respect to the Cedant, this Agreement is subject to final approval by the Commonwealth Court of Pennsylvania (the "Court"), which has jurisdiction over the liquidation of Cedant. Upon execution by all parties hereto, the Liquidator of Cedant shall promptly make application to the Court to secure said approval. In the event the Court does not approve this Agreement, then upon such notice of disapproval, the Liquidator of Cedant shall notify the Reinsurer and this Agreement will become null and void and have no further force or effect as between the Reinsurer and the Cedant. In the event the Court approves the Agreement and any person or entity appeals the Court ruling or order granting such approval, then the Agreement shall be deemed to be approved as of the first date upon which such ruling or order is affirmed by the Supreme Court of Pennsylvania. In the event that any such appeal results in the revocation of the Court's approval, the Cedant shall notify the Reinsurer and within ten (10) business days thereafter return to the Reinsurer the Consideration in its entirety together with interest thereupon compounded from date of Cedant's receipt of the Consideration at the 90 Day Treasury Bill Rate then in effect and the parties shall be restored to the positions they were in prior to the execution of this Agreement and this Agreement will become null and void and have no further force or effect as between them.

Article 17. This Agreement may be signed and exchanged in counterpart by facsimile and this Agreement as so signed and exchanged will constitute the binding Agreement of the parties.

Exhibit A

Accident Year Aggregate Excess of Loss
Reinsurance Agreement

Term: January 1, 1999 – December 31, 2001

Reliance Reference No. 904YAA

Exhibit B

| <u>LOC No.</u> | <u>Bank</u> | <u>Amount</u> |
|-----------------------|-------------------------------|----------------------|
| 336227243 | Citibank, N.A. | \$34,536,205 |
| TS-07001706 | Credit Suisse/First Boston | \$62,627,561 |

Exhibit C

For Reliance/The Liquidator

Keith Kaplan
Reliance Insurance Company (In Liquidation)
75 Broad Street
New York, NY 10004
Tel. 212-858-5087
Fax 212-858-5050

IN WITNESS WHEREOF, the parties have hereunto set their hands as of the dates set forth.

RELIANCE INSURANCE COMPANY (In Liquidation)

By: *David S. Brütling*
Title: *Chief Liquidation Officer*
Date: *October 12, 2006*

EUROPEAN REINSURANCE COMPANY OF ZURICH (BERMUDA BRANCH)

By: *Randy D. Iam*
Title: *Member of Senior Management*
Date: *11 October 2006*

By: *Wanda Bluefort*
Title: *EMPLOYEE*
Date: *11 October 2006*