

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff,

v.

RELIANCE INSURANCE COMPANY,

Defendant.

DOCKET NO. 269 MD 2001

REC'D 2 445 PM
FRI DEC 6 12 44 PM
COMMONWEALTH COURT
OF PENNSYLVANIA
JUDICIAL CENTER
300 SOUTH 4TH ST
HARRISBURG, PA 17102

ORDER

This matter having come before the Court on the Emergency Petition of M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania as Liquidator of Reliance Insurance Company, for Approval of Sale of Advantage Capital Florida Partners I, L.P. Senior Notes ("Notes");

IT IS on this ___ day of December, 2001, hereby ORDERED that the Emergency Petition is GRANTED;

IT IS further ORDERED that the Liquidator is AUTHORIZED to accept the bid on the Notes, submitted through Credit Suisse First Boston, provided that the actual purchase price for the Notes at the time of closing shall not be less than \$6,660,929.03.

IT IS further ORDERED that the Liquidator is AUTHORIZED, pursuant to her authority set forth in 40 P.S. § 221.23 and consistent with the terms of this Order, to execute, deliver and perform any agreement effectuating the sale of the Notes after acceptance of the bid.

James Gardner Colins, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN	:	
Insurance Commissioner of the	:	
Commonwealth of Pennsylvania,	:	
	:	
Plaintiff,	:	
	:	
v.	:	DOCKET NO. 269 MD 2001
	:	
RELIANCE INSURANCE COMPANY,	:	
	:	
Defendant.	:	

**EMERGENCY PETITION FOR APPROVAL OF SALE OF
ADVANTAGE CAPITAL FLORIDA PARTNERS I, L.P. SENIOR NOTES**

Petitioner M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania ("Commissioner"), as Liquidator of Reliance Insurance Company ("Liquidator"), respectfully requests that this Court enter an order, on an emergency basis, approving the sale of Senior Notes owned by Reliance Insurance Company ("Reliance"), and issued by Advantage Capital Florida Partners I, L.P. ("Advantage Capital Florida"), to a presently un-named insurance company client of Credit Suisse First Boston ("CSFB").

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

1. Advantage Capital is a venture capital firm based in New Orleans, Louisiana that makes venture capital investments in a variety of states which provide insurance companies with premium tax credits for "qualified" venture capital investments.
2. On April 7, 1999, Reliance purchased privately placed Senior Notes ("Notes") issued by Advantage Capital Florida, a limited partnership whose general partner is Advantage Capital Co. FL-GP I, L.L.C. As part of a program sponsored by the State of

Florida to create investment incentives in that state, the Notes provide the holder with substantial tax credits for qualified insurance premium income earned in the State of Florida. Therefore, while the original par amount of the Notes is \$3,931,131.56, Reliance, because of these tax benefits, paid 2.08242 times par value for the Notes, resulting in a total purchase price of \$8,186,283.69.

3. The Notes are secured by an indenture which created a security interest in the assets of Advantage Capital Florida. The collateral includes non-callable, zero coupon Treasury securities maturing on or near each cash principal payment date.

4. The Notes do not provide Reliance with "interest" income. Rather, in addition to principal payments, Reliance receives additional value from the Notes in the form of premium tax credits for taxable premium income earned in the State of Florida. The tax credits are based upon the original purchase price of the Notes, not the par value, and total annually \$818,628.00. The credits commenced in tax year 2000 and run through calendar year 2009. For the year 2000, Reliance did not have sufficient qualified premium income in the State of Florida to use the entire \$818,628.00 tax credit. Rather, Reliance used only \$237,342.00 in tax credits, resulting in unused Florida premium tax credits of \$581,286.00 for the year 2000. The tax credits provided by the Notes, however, may be carried forward until December 31, 2017. Advantage Capital has represented to Reliance and CSFB that the tax credits and carry-forwards are freely transferable under Florida law to a subsequent purchaser of the Notes.

5. Principal payments on the Notes are payable in five equal annual installments, and commenced on May 15, 2000. The principal payments total \$786,226.32 each. On or

about May 15, 2000 and May 15, 2001, Reliance received two principal payments, leaving a remaining principal balance of \$2,358,678.92 to be repaid over the next three years.

6. Upon entry of the Liquidation Order on October 3, 2001, the Liquidator directed Reliance to market the Notes for sale. Reliance retained two investment firms to market the Notes, namely Lehman Brothers and CSFB. These investment firms solicited bids from the pool of insurance companies who would be able to take advantage of the tax credit features of the Notes. Reliance received two anonymous bids from the investment firms on behalf of un-named insurance companies.

7. The first bidder, procured by Lehman Brothers, did not wish to purchase all of the Notes and submitted an offer of 2.75 times par value for a 1/3 portion of the Notes' remaining principal balance. The Liquidator considered this bid but later rejected it in favor of the second bid which was received shortly thereafter.

8. The second bid, submitted through CSFB, sought to purchase all of the Notes and offered 2.93 times the remaining principal balance, for a total cash purchase price of \$6,910.929.23. The dollar figure of the second bid is tied to certain treasury securities. Thus, as the yield values of these benchmark securities rise or fall based on market fluctuations, the actual purchase price Reliance would receive if the second bid was accepted would similarly fluctuate.

9. After obtaining the second bid, the Liquidator evaluated whether the purchase price of \$6,910.929.23 in cash constituted fair value to the estate of Reliance. See 40 P.S. § 221.23(7), (9) (authorizing the Liquidator to sell assets of the insurer on fair and reasonable terms). Unlike the first bid, the second bid was for the full remaining principal

balance on the Notes and offered a higher multiple of par. The Liquidator, considering (1) the limited marketability of the Notes; (2) that the Notes were marketed by two reputable investment firms to the pool of potential insurance companies able to take advantage of the Notes' tax credits and only two bids were returned; and (3) that the tax credits which drive the value of the Notes are of no value to Reliance given that the Company, since entering run-off and now liquidation, will not generate the qualified premium income in Florida necessary to obtain the benefit of the tax credits, and after consultation with the investment firms, her staff and the investment staff at Reliance, has determined that the second bid provides fair and reasonable value to the estate of Reliance.

10. Given Reliance's present operating and financial condition, the Notes have no value to the Company over the remaining principal balance. The premium tax credits which the holder of the Notes receives can only be used by an insurance company writing premiums in Florida and only for qualified premium income. These requirements render the tax credits valueless to Reliance given its present status and substantially narrows the universe of potential buyers for the Notes. Even given this limited pool of potential buyers, the second bid not only permits the estate of Reliance to recover the full amount of the remaining principal balance, it permits Reliance to realize over \$4.5 million in cash in excess of the remaining principal balance of the Notes from the sale of tax credits which are no longer of value to the Company.

11. The second bid also permits Reliance to recover in full the original purchase price of the Notes. In addition, should the sale of the Notes to the second bidder be approved by the Court, and market conditions remain relatively stable through closing, the

estate of Reliance will realize a modest profit from the transaction. Reliance purchased the Notes for \$8,186,283.69 and has already received two principal installment payments totaling \$1,572,452.64. Deducting the value of the year 2000 tax credit, \$237,342.00, from the remaining principal balance of \$6,613,831.45, Reliance's current cash basis in the Notes is \$6,376,489.15. In accepting the second bid with a current cash value of \$6,910,929.23, Reliance will realize a gain of \$534,440.08 from the sale of the Notes. The existence of this profit further supports the Liquidator's determination that the sale of the Notes to the second bidder is in the interests of Reliance's policyholders and claimants and will yield fair and reasonable value to the Company's estate.¹

12. Given the relatively limited market for the Notes and the fact that the second bidder will likely have qualified premium income for the year 2001, the Liquidator requests that this Petition be considered on an emergency basis. The premium tax credits afforded by the Notes for 2001 will be available for 2001 credit for the benefit of the second bidder only if the transaction closes by the end of this year. If the transaction does not close by the end of 2001, the present value of the Notes to the second bidder, and any similarly situated potential purchasers, if any, diminishes as the purchaser will be unable currently to take advantage of the tax credits for 2001 and, as a result, under the terms of the Notes, these credits will be deferred until 2010 or after. Deferral of the 2001 tax credits until 2010 will impair the value of the Notes as the discounted value of tax credits useable only after 2010 is likely to be substantially less than \$818,628.00.

¹ Reliance's ability to realize a profit from the sale of the Notes is conditioned upon the value of the second bid remaining constant through closing of the transaction. Should the value of the bid be revised due to a change in market conditions, see ¶ 14 infra, the profit realized on the sale of the Notes will be affected.

13. Accordingly, delay in closing the sale of the Notes will negatively impact the value and usefulness of the tax credits to the second bidder, or any potential purchaser, as well as permanently impair the value of the Notes as the tax credits for 2001 become unavailable for current use to any potential purchaser. Because the terms of conveyance documents will have to be negotiated after accepting any bid for the Notes, it is important that the Liquidator be authorized to accept the second bid on behalf of Reliance as soon as possible so that the transaction may close before year-end and maximum value for the Notes can be obtained.

14. Furthermore, the second bid, offering 2.93 times the remaining principal balance, was calculated by the potential purchaser based on (1) the prevailing yield of certain treasury securities in the market, on the date the bid was submitted, and (2) a spread on top of the yield for those securities to account for the risk in the transaction to the purchaser. Because the value of the second bid is tied to the current market yield for the benchmark treasury securities, the actual purchase price for the Notes will fluctuate, tracking the market performance of the benchmark securities. If, at the time the Liquidator is authorized to accept and close on the second bid, interest rates rise, thus affecting the yield of the benchmark treasury securities, the second bid will suffer a decrease in value. To minimize this, and to take advantage of the current relative market stability for the benchmark securities, the Liquidator respectfully requests that this Petition be considered on an emergency basis. See note 1 supra. Also, to account for the floating characteristics of the second bid, the Liquidator requests that she be authorized to accept the second bid provided

that the actual purchase price for the Notes is no less than \$6,660,929.23 at the time of closing as a result of changing market conditions.

15. Under the present market conditions, the second bid, submitted through CSFB, provides fair and reasonable value to the estate of Reliance and in the best interests of the insurer's estate, its policyholders, claimants and the general public. See 40 P.S. § 221.1(c); see also 40 P.S. § 221.23(7) (authorizing the Liquidator to “conduct public and private sales of property of the insurer” and to “acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon or otherwise dispose of or deal with, any property of the insurer at its market value or upon terms and conditions as are fair and reasonable.”) (emphasis added). On November 30, 2001, this Court entered an Order setting forth guidelines governing the disposition of the assets of Reliance by the Liquidator. See Order of the Court (Nov. 30, 2001). Paragraph 3 of the asset guideline order permits the Liquidator to dispose of assets of the Company valued in excess of \$4 million with approval of the Court, provided that sales are at arms length and based on written evaluations. See id. The Notes were marketed through outside and independent investment firms using trading desks for these types of private placement investments. As is common in the investment industry, bids are solicited and obtained orally. The prevailing bid is the leading indicator of market value. As a result of the manner in which these types of market transactions are conducted, the Liquidator was not able to obtain a “written evaluation” of the fairness and reasonableness of the second bid. The urgent timing of this transaction and the delay and expense associated with obtaining an independent, third-party, written evaluation of the

fairness of the second bid may likely cause the Liquidator to lose the present bid and may, as discussed above in ¶ 12, permanently impair the value of the Notes.²

16. The Liquidator further believes that the sale of the Notes will help her in achieving the objectives of liquidation under the Insurance Department Act, 40 P.S. § 221.1 *et seq.* This transaction will assist the Liquidator in maximizing and marshalling the insurer's assets to minimize and apportion equitably any unavoidable loss to policyholders, claimants and creditors resulting from Reliance's insolvency and hazardous financial condition. *See* 40 P.S. § 221.1(c).

17. Accordingly, the Liquidator respectfully requests that this Court (1) authorize the Liquidator to accept the second bid on behalf of Reliance; (2) authorize the Liquidator to negotiate and execute documents and agreements necessary to convey the Notes to the second bidder on terms substantially similar to those set forth above, specifically a purchase price of \$6,910,929.23 or the current market equivalent at the time of closing (provided that the actual purchase price shall not be less than \$6,660,929.03); and (3) authorize the Liquidator to perform any agreement regarding the transfer of the Notes pursuant to her authority under 40 P.S. § 221.23.

² If the Court so requires, the Liquidator is prepared to present to the Court at hearing the oral testimony of Mr. Arthur Mullin in support the fairness and reasonableness of the second bid.

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

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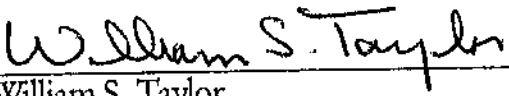
Dated: December 6, 2001

VERIFICATION

I, William S. Taylor, Deputy Insurance Commissioner of the Pennsylvania Insurance Department, Office of Liquidations, Rehabilitations and Special Funds, am authorized by M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, pursuant to 40 P.S. § 221.23, to act on her behalf in her capacity as the Liquidator of Reliance Insurance Company. I hereby verify that the facts set forth in the foregoing Petition are true and correct to the best of my knowledge, information and belief.

I understand that this Verification is made subject to the penalties of 18 P.S. § 4904 relating to unsworn falsification to authorities.

Date: December 4, 2001

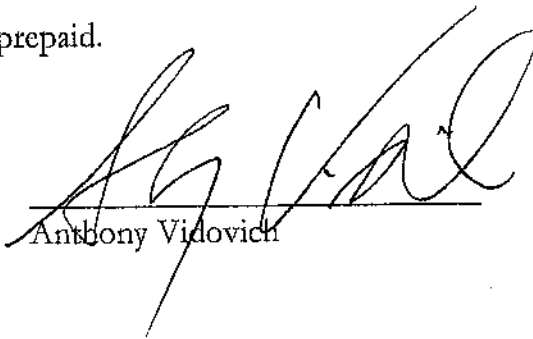


William S. Taylor
Deputy Insurance Commissioner of the
Pennsylvania Insurance Department

CERTIFICATE OF SERVICE

I, Anthony Vidovich, hereby certify that this day a true and correct copy of the foregoing Emergency Petition was served on all persons listed on the attached Master Service List by facsimile and U.S. Mail, postage prepaid.

Dated: December 6, 2001



Anthony Vidovich

Master Service List

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania

v.

Reliance Insurance Company

No. 269 M.D. 2001 (Commonwealth Court of Pennsylvania)

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Nicky Lee Kramer, an Incapacitated Person,
and as Next Friend of Joshua Kramer, Minor
Child of Nicky Lee Kramer, Jason Kramer
and Jason Tarver)

Exhibit A

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

RELIANCE INSURANCE COMPANY,

Defendant

No. 269 M.D. 2001

**AFFIDAVIT OF ARTHUR W. MULLIN
IN SUPPORT OF EMERGENCY PETITION
TO APPROVE SALE OF ADVANTAGE CAPITAL FLORIDA I, L.P. SENIOR NOTES**

ARTHUR W. MULLIN, being duly sworn, deposes and says:

1. I am fully familiar with the facts and circumstances set forth herein.
2. I am the Executive Vice President of KMR Management, Inc., in Willow Grove, Pennsylvania.
3. I have been retained by M. Diane Koken (the "Liquidator"), Insurance Commissioner of the Commonwealth of Pennsylvania as Liquidator of Reliance Insurance Company ("Reliance"), to provide consulting services in the areas of asset management, business disposition, and investment management to Reliance in Liquidation.
4. As part of my duties, I have become familiar with the circumstances surrounding the marketing and proposed sale of Senior Notes ("Notes") held by Reliance and issued by Advantage

Capital Florida Partners I, L.P. ("Advantage Capital Florida"). I submit this Affidavit in support of the Liquidator's Emergency Petition for Approval of the Sale of the Notes to a presently un-named insurance company client of Credit Suisse First Boston ("CSFB").

5. Advantage Capital is a venture capital firm based in New Orleans, Louisiana that makes venture capital investments in a variety of states which provide insurance companies with premium tax credits for "qualified" venture capital investments.

6. On April 7, 1999, Reliance purchased the privately placed Notes issued by Advantage Capital Florida, a limited partnership whose general partner is Advantage Capital Co. FL-GP I, L.L.C. The Notes provide the holder with substantial tax credits for qualified insurance premium income earned in the State of Florida. The original par or principal amount of the Notes is \$3,931,131.56. Because of the substantial tax credits, Reliance paid 2.08242 times par value for the Notes, a total purchase price of \$8,186,283.69.

7. The Notes are secured by an indenture which created a security interest in the assets of Advantage Capital Florida. The collateral includes non-callable, zero coupon Treasury securities maturing on or near each cash principal payment date.

8. In addition to principal payments, Reliance receives value from the Notes in the form of premium tax credits for taxable premium income earned in the State of Florida. The tax credits are based upon the original purchase price of the Notes, not the par value, and total annually \$818,628.00. The credits commenced in tax year 2000 and run through calendar year 2009. For the year 2000, Reliance used only \$237,342.00 in tax credits, resulting in unused Florida premium tax credits of \$581,286.00. The tax credits provided by the Notes may be carried forward until December 31, 2017.

Advantage Capital has represented to Reliance and CSFB that the tax credits and carry-forwards are freely transferable under Florida law to a subsequent purchaser of the Notes.

9. Principal payments on the Notes are payable in five equal annual installments, and commenced on May 15, 2000. The principal payments total \$786,226.32 each. Reliance has received two principal payments, leaving a remaining principal balance of \$2,358,678.92 to be repaid over the next three years.

10. Shortly after entry of the Liquidation Order, Reliance retained the investment firms Lehman Brothers and CSFB to market the Notes. Reliance received two bids from the investment firms on behalf of un-named insurance companies.

11. The first bid, submitted by Lehman Brothers, was on behalf of an insurance company that did not wish to purchase all of the Notes and offered of 2.75 times par value for a 1/3 portion of the Notes' remaining principal balance. The Liquidator considered this bid but later rejected the bid in favor of the second bid, submitted through CSFB.

12. The second bid, submitted by CSFB on behalf of an insurance company, sought to purchase all of the Notes and offered 2.93 times the remaining principal balance, for a total cash purchase price of \$6,910,929.23. The dollar figure of the second bid is tied to certain treasury securities such that as the yield values of these benchmark securities rise or fall based on market fluctuations, the actual purchase price Reliance would receive if the second bid was accepted would similarly fluctuate.

13. After obtaining the second bid, the Liquidator, with the assistance of her staff and Reliance staff members, evaluated whether the purchase price of \$6,910,929.23 in cash constituted fair value to the estate of Reliance. The second bid was preferred over the first because it offered to purchase the full remaining principal balance on the Notes and offered a higher multiple of par. The

second bid not only permitted the estate of Reliance to recover the full amount of the remaining principal balance, it permitted Reliance to realize over \$4.5 million in cash in excess of the remaining principal balance of the Notes from the sale of tax credits which are no longer of value to the Company.

14. Given Reliance's present operating and financial condition, the Notes have no value to the Company over the remaining principal balance. The premium tax credits which the holder of the Notes receives can only be used by an insurance company writing premiums in Florida and only for qualified premium income. These requirements render the tax credits valueless to Reliance because the Company, since entering run-off and now liquidation, cannot generate the qualified premium income in Florida necessary to obtain the benefit of the tax credits.

15. The second bid also permits Reliance to recover in full the original purchase price of the Notes. In addition, should the sale of the Notes to the second bidder be approved by the Court, and provided that market conditions remain relatively stable through closing, the estate of Reliance will realize a modest profit from the transaction. In accepting the second bid with a current cash value of \$6,910,929.23, and assuming interest rates remain relatively constant, Reliance will realize a gain of over \$500,000.00 from the sale of the Notes.

16. The premium tax credits afforded by the Notes for 2001 will be available for 2001 credit for the benefit of the second bidder only if the transaction closes by the end of this year. If the transaction does not close by the end of 2001, the present value of the Notes to the second bidder, and any other potential purchasers, diminishes as the purchaser will be unable currently to take advantage of the tax credits for 2001. These unused tax credits will be deferred until 2010 or after. Deferral of the 2001 tax credits until 2010 will impair the value of the Notes as the discounted value of tax credits useable only after 2010 is substantially less than \$818,628.00.

17. Because the value of the second bid is tied to the current market yield for the benchmark treasury securities, the actual purchase price for the Notes will fluctuate, tracking the market performance of the benchmark securities. If interest rates rise, affecting the yield of the benchmark treasury securities, the second bid will suffer a decrease in value. To account for the floating characteristics of the second bid, I have recommended to the Liquidator that a price floor be established with regard to the second bid such that the transaction should be permitted to go forward provided the market value of the second bid is no less than \$6,660,929.23 at the time of closing.

18. Based on the above, specifically the limited market for the Notes, the value of the second bid, and current market conditions, I have informed the Liquidator that the sale of the Notes to the second bidder will yield fair and reasonable value to the estate of Reliance. My opinion is supported by the fact that the second bid will permit Reliance to recover the original purchase price for the Notes plus a modest profit of approximately \$500,000.00.

19. Based on my recommendation and the information provided by the Investment Committee and Reliance staff members familiar with this investment, as well as his independent review of the transaction, Mr. William S. Taylor, the Liquidator's designee, has determined that the sale of the Notes to the second bidder will enhance the Liquidator's ability to facilitate the statutory goals of liquidation, particularly her ability to marshal the assets of the estate. He has further informed me that the Liquidator believes the sale of the Notes to the second bidder is in the best interests of Reliance's policyholders, certificateholders, creditors, and the public.

Arthur W. Mullin
ARTHUR W. MULLIN

Sworn to and subscribed
before me this 4th day
of December, 2001.

Sandra Pascale
Notary Public

