

**IN THE COMMONWEALTH COURT OF PENNSYLVANIA**

2006-0302-0037

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JOEL S. ARIO  
Insurance Commissioner of the  
Commonwealth of Pennsylvania,

Plaintiff,

v.

RELIANCE INSURANCE COMPANY,

Defendant.

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DOCKET NO. 269 M.D. 2001

**EIGHTH REPORT OF THE LIQUIDATOR TO THE COURT ON THE  
IMPLEMENTATION OF THE APPROVED PLAN FOR THE ALLOCATION OF  
POLICYHOLDER COLLATERAL OF CONSOLIDATED FREIGHTWAYS  
CORPORATION**

Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as Statutory Liquidator ("Liquidator") of Reliance Insurance Company ("Reliance") hereby makes his Eighth Report to the Court on the implementation of the Liquidator's Plan for the Allocation of Policyholder Collateral pursuant to the Court's Order of October 4, 2006 (the "Collateral Allocation Order")<sup>1</sup>.

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<sup>1</sup> A copy of the Collateral Allocation Order is attached as Exhibit "A".

### Background As Reported in Previous Status Reports to the Court

Reliance issued policies of insurance to Consolidated Freightways Corporation ("CF") for workers compensation and automobile/general liability ("AL/GL"). Most of the CF policies were issued with deductible provisions. Other CF policies contained retrospective premium obligations payable to Reliance. To secure its deductible reimbursement and retrospective premium obligations, CF posted collateral with Reliance in the total amount of \$100 million in the form of a \$55 million Letter of Credit (the "LOC") and a \$45 million surety bond issued by CNA (the "Bond" and jointly with the LOC, the "CF Collateral").

After Reliance was placed in liquidation in October 2001, claims which had arisen under the CF policies were sent to the guaranty associations ("GAs"). Subject to statutory limitations, the GAs assumed the obligation to pay CF's workers compensation claims, but most GAs rejected the AL/GL claims and these files were returned to CF for handling within their deductible obligation (the "Non-Covered Claims").

After Reliance was placed in liquidation, in September 2002 CF itself filed for bankruptcy. At that time CF ceased paying deductible reimbursement or retrospective premium obligations and ceased handling the Non-Covered Claims. As a result of the CF bankruptcy, the Non-Covered Claims were for some time essentially un-adjusted and their precise value unknown.

In June 2004, the Pennsylvania legislature enacted an amendment to the Pennsylvania Insurance Department Act, 40 P.S. §221.23a ("Section 523.1"), which controls a liquidator's maintenance and administration of collateral posted by an insured to secure deductible and other policy obligations. If an insured fails to fund these obligations, the liquidator may draw the collateral to reimburse GAs for payments within a deductible and to pay an insurer for retrospective premium obligations. Section 523.1 also provides that if claims are not covered by any GA – such as the Non-Covered Claims – the liquidator shall also utilize the collateral to adjust and pay these claims. If the liquidator determines that the collateral is or may be insufficient to compensate all potential claimants, the liquidator may, subject to court approval, formulate a plan for the equitable allocation and distribution of the collateral among the claimants. Section 523.1 permits the liquidator to utilize up to 3% of the collateral to reimburse the liquidation estate for actual expenses incurred in fulfilling obligations under the Section ("Section 523.1 Expenses").

Although at the time of the enactment of Section 523.1 Reliance held significant CF Collateral, in view of the large number of workers compensation

claims resting with the GAs and the unknown valuation of the Non-Covered Claims, the Liquidator concluded that the adequacy of the CF Collateral was in question and formulated a plan for (1) the evaluation of the Non-Covered Claims; and (2) for an interim allocation and distribution of CF Collateral to the GAs and to Reliance (the "CF Plan"). The Liquidator filed a Petition to Approve a Plan for Policyholder Collateral of Consolidated Freightways Corporation for approval of the CF Plan. Based upon the First Petition, on October 4, 2006 the Court issued the Collateral Allocation Order.

The Collateral Allocation Order authorized the Liquidator to utilize the CF Collateral to reimburse the GAs \$30,254,461 for deductible claims paid by the GAs through December 31, 2005; to pay Reliance \$766,443 in retrospective premium due from CF through December 31, 2005; and to use up to \$20 million of the CF Collateral to adjust and pay the Non-Covered Claims through a third-party administrator. The Collateral Allocation Order directed the Liquidator to make periodic status reports to the Court and, by October 31, 2007, to provide the Court with a comprehensive evaluation of the status of all CF claims and of the adequacy of the CF Collateral to reimburse those claims. The Liquidator would at that time also be authorized to make an application for reimbursement of Section 523.1 Expenses.

The Collateral Allocation Order posited three scenarios for the October 2007 comprehensive evaluation: a determination that the CF Collateral was adequate and the filing of a final plan for on-going full claim payments; a determination that the CF Collateral was inadequate and the filing of a formal pro rata allocation plan; and a scenario where the Liquidator was still unable to precisely evaluate the overall adequacy of the CF Collateral. With respect to this last scenario, the Collateral Allocation Order, Section 6.c., stated:

If by October 31, 2007, the Liquidator determines that actuarial projections remain too imprecise to finally allocate and pay the [CF] Collateral, but that further partial allocation and payment is appropriate, the Liquidator will promptly file with the Court a Petition to Partially Allocate Collateral, setting forth the terms upon which [he] proposes to allocate and pay part of the [CF] Collateral. Upon approval by the Court, the Liquidation shall be entitled to proceed to allocate and pay the [CF] Collateral as directed by the Court.

Upon issuance of the Collateral Allocation Order, the Liquidator promptly reimbursed the GAs over \$30 million with respect to deductible reimbursement claims covered by the GAs and Reliance was paid \$766,443 in retrospective premiums. As directed by the Order, Reliance, working with CF, retained a third party administrator to begin the process of adjusting and paying the Non-

Covered Claims. However, shortly after the adjustment process began and without prior notice, CF filed a complaint and related motions in its bankruptcy court, including one seeking a restraining order enjoining Reliance from accessing the CF Collateral, which prevented the Liquidator from on-going compliance with the Collateral Allocation Order (the "Adversary Proceeding").

The Adversary Proceeding was exceptionally complex, but for purposes of the instant Report can be summarized as pursuing four primary CF objectives:

- (1) that the CF Collateral be ordered released to the CF bankruptcy estate;
- (2) that the Non-Covered Claims be adjusted and paid as general unsecured claims in the CF bankruptcy estate;
- (3) a determination that interest accruing on drawn, but unreleased CF Collateral, be considered part of and re-deposited in the CF Collateral; and
- (4) a determination that a 2005 agreement between Reliance and CNA, the issuer of the Bond component of the CF Collateral, whereby the CF Collateral would be drawn between the bond and the LOC in proportional amounts was void. CF sought issuance of a bankruptcy court order directing that the bond be exhausted in the first instance prior to any further draws upon the LOC (the "Priority of Draw").

As a part of the Adversary Proceeding, CF obtained a temporary restraining order (the "TRO") which precluded the Liquidator from accessing the CF Collateral, thereby frustrating the continued adjustment and payment by the Liquidator of the Non-Covered Claims.

The Liquidator vehemently objected to CF's first two objectives. The Liquidator had no objection to the redeposit in CF Collateral of the accrued interest. The Liquidator maintained that the matter of Priority of Draw between the LOC and the Bond was an issue to be litigated between CF and CNA and a matter of no concern to the Liquidator as long as the overall integrity of and access to all CF Collateral was maintained. Following the institution of the Adversary Proceeding, the parties engaged in very extensive motion practice in the bankruptcy court.

Ultimately, the parties began negotiations to resolve the adversary proceeding and, in February 2008, CF and the Liquidator executed a Settlement Agreement which resolved all of the issues in the Adversary Proceeding. In its most significant provision, the Settlement Agreement represents a return to the status quo ante. The Settlement Agreement provided that:

- (1) Non-Covered Claims will be adjusted and paid by Reliance utilizing the CF Collateral as contemplated in the Collateral Allocation Order;
- (2) The Liquidator agreed that Reliance could be named along with CNA as a necessary party in an action maintained by CF in bankruptcy court to litigate Priority of Draw between the LOC and the Bond (the "CNA Action"). The Liquidator would not object to the CNA Action unless the Liquidator determined that the action could impair the Liquidator's rights under the CF Collateral or CF asserted an abuse of discretion by the Liquidator;
- (3) The Liquidator agreed not to contest the TRO obtained by CF in the Adversary Proceeding while CF pursued the CNA Action, provided, however, that CF agreed that Collateral may be drawn to adjust and pay Non-Covered Claims and Reliance retrospective premium as provided in the Collateral Allocation Order and to fund a further Collateral release;
- (4) Interest on drawn but un-released CF Collateral would be re-deposited in the CF Collateral.

Upon execution of the Settlement Agreement, on May 29, 2008, the Liquidator filed a Fifth Report of the Liquidator on the Implementation of the Approved Plan and, in conjunction therewith and part thereof, the Liquidator's Second Petition to Partially Allocate Collateral. The Second Petition requested that the Court approve the release of further CF Collateral as follows: (1) the release of an additional \$7,552,981 from the CF Collateral so that the Liquidator could reimburse the GAs for workers compensation deductible paid claims for the time period from January 1, 2006 through September 30, 2007; (2) the release of \$58,147 to Reliance from the CF Collateral to pay CF's retrospective premium obligations to Reliance for the period January 1, 2006 through September 30, 2007; and (3) the release of \$1,087,365 to Reliance to compensate Reliance in part (up to the 3% cap provided in Section 523.1 of the Act) for expenses of administering collateral and reimbursing the GAs in the two distributions. The Liquidator committed to providing the Court with periodic status reports on the implementation of the Collateral Allocation Order.

On July 18, 2008, the Court granted the Liquidator's Second Petition. Collateral was released as approved by the Court.

#### Current Status

Following is a status update on matters relating to the implementation of the Collateral Allocation Order since the Seventh Status Report of March 19, 2009.

- (1) Uncovered AL/GL Claims – the adjustment and payment of the Non-Covered AL/GL claims is almost complete. 174 of the 176 claim files have been settled for total payments of \$4,440,167. The remaining 2 AL claim files are in active negotiation and carry “demand” reserves<sup>2</sup> of \$2,119,469. The 40 claims for allocated loss adjustment expenses (“ALAE”) within the deductibles have been settled for a total of \$162,000. As previously noted, it is clear that, based upon the current paid claims and claim reserves, the \$20 million in collateral authorized in the Collateral Allocation Order will be sufficient to dispose of all Non-Covered AL/GL claims and ALAE claims.
- (2) Adversary Proceeding – Settlement of the Adversary Proceeding has been concluded. CF and CNA agreed that the Collateral would be drawn under Section 523.1 in the proportion posted, i.e., 55% from the LOC and 45% from the Bond. In the event it is determined that there is excess CF Collateral, the Collateral will be returned to the parties also in the proportion posted with, however, an additional \$400,000 of the funds which would have gone to the Bond, credited to the LOC. The bankruptcy court issued an order dismissing the Adversary Proceeding with prejudice on June 15, 2009.

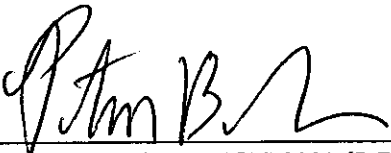
#### Future Collateral Releases and Reporting

With the dismissal of the Adversary Proceeding and virtual completion of settlement of the AL/GL claims, the Liquidator will soon be in a position to re-evaluate the adequacy of the CF Collateral. Reliance claims and actuarial staff are engaged in a detailed review of reserves for the approximately 300 open GA workers compensation claims. Once that review is complete, the Liquidator will provide the Court with a new plan of allocation as provided by the Collateral Allocation Order. The Liquidator anticipates reporting to the Court in that regard in the next 30-60 days. Preliminary indications suggest that the CF Collateral will be deemed adequate to fund all on-going claims.

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<sup>2</sup> A “demand” reserve is the amount the claimant had indicated will settle the claim. It represents a maximum anticipated exposure. Reliance is, however, negotiating to reduce these demands.

Respectfully submitted,

By:   
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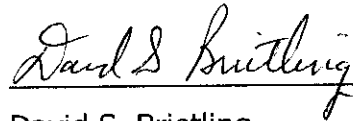
Attorney for Joel S. Ario,  
Insurance Commissioner of the  
Commonwealth of Pennsylvania, in his  
Official capacity as Liquidator of  
Reliance Insurance Company

Dated: July 30, 2009

**VERIFICATION**

I, David S. Brietling, am Chief Liquidation Officer of Reliance Insurance Company (In Liquidation). I hereby verify that the facts set forth in the foregoing Seventh Report of the Liquidator to the Court on the Implementation of the Approved Plan for the Allocation of Policyholder Collateral of Consolidated Freightways Corporation 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: July 30, 2009



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David S. Brietling  
Chief Liquidation Officer  
Reliance Insurance Company (In  
Liquidation)



## **CERTIFICATE OF SERVICE**

I, Marilyn K. Kincaid, hereby certify that on or about this day, service of the foregoing Eighth Report of the Liquidator to the Court on the Implementation of the approved Plan for the Allocation of Policyholder Collateral of Consolidated Freightways Corporation was made to K. Morgan Enterprise Inc., 805 Broadway, Suite 205, Vancouver, WA 98660 via first class mail. Pursuant to the Court's Order of December 12, 2008, service was made on the attached Master Service List through the transmission of a Notice of Filing via e-mail and through posting of a true and correct copy in PDF file format on the Reliance Documents website ([www.reliancedocuments.com](http://www.reliancedocuments.com)).

Dated: July 30, 2009

  
MARI~~L~~YN K. KINCAID

## Master Service List

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v.

Reliance Insurance Company

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

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# Exhibit A

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

v.

Reliance Insurance Company,  
Defendant.

269  
No. 296 M.D. 2001

In Re: Petition to Approve Plan for  
Allocation of Policyholder Collateral for  
Consolidated Freightways Corporation

2006 OCT -4 A 9 47

RECEIVED AND FILED  
COMMONWEALTH COURT  
OF PA (PHILA)

ORDER

AND NOW, this 4<sup>th</sup> day of October, 2006, upon consideration of the Petition of M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her capacity as Liquidator of Reliance Insurance Company ("the Liquidator") for Approval of Plan for Allocation of Policyholder Collateral of Consolidated Freightways Corporation (Plan), and the absence of any objection thereto, the Court finds that the Plan complies with Section 523.1 of Article V of the Act of May 17, 1921, P.L. 789, *as amended*, added by the Act of June 28, 2004, P.L. 443; 40 P.S. §221.23a (known as the Insurance Company Law of 1981 (Act)), and equitably allocates the collateral of Policyholder Consolidated Freightways Corporation (the "Collateral") currently in the possession of Reliance Insurance Company ("Reliance").

The Court finds as follows:

- A. Reliance currently holds the Collateral, which consists of \$100 million.
- B. The Collateral was posted by CF with Reliance to secure its deductible reimbursement obligations under policies of insurance issued by Reliance to Consolidated Freightways Corporation ("CF") for workers compensation

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coverage and automobile/general liability (“AL/GL”) coverage and also to secure its obligations for retrospective premium adjustments (the “CF Policies”).

C. The CF Policies consist of the following:

Policy Number	Effective Date	Expiration Date	Line of Business	Policy Type
NKC0131913	10/1/1996	10/1/1997	AL	\$3,000,000 Deductible
NKC0131913	10/1/1997	10/1/1998	AL	\$3,000,000 Deductible
NKC0131913	10/1/1998	10/1/1999	AL	\$3,000,000 Deductible
NKC0131913	10/1/1999	10/1/2000	AL	\$3,000,000 Deductible
NKC0131914	10/1/1996	10/1/1997	AL	\$3,000,000 Deductible
NKC0131914	10/1/1997	10/1/1998	AL	\$3,000,000 Deductible
NKC0131914	10/1/1998	10/1/1999	AL	\$3,000,000 Deductible
NKC0131914	10/1/1999	10/1/2000	AL	\$3,000,000 Deductible
NKC0131915	10/1/1996	10/1/1997	AL	\$3,000,000 Deductible
NKC0131915	10/1/1997	10/1/1998	AL	\$3,000,000 Deductible
NKC0131915	10/1/1998	10/1/1999	AL	\$3,000,000 Deductible
NKC0131915	10/1/1999	10/1/2000	AL	\$3,000,000 Deductible
NGB0131922	10/1/1996	10/1/1997	GL	\$500,000 Deductible
NGB0131922	10/1/1997	10/1/1998	GL	\$500,000 Deductible
NGB0131922	10/1/1998	10/1/1999	GL	\$500,000 Deductible
NGB0131922	10/1/1999	10/1/2000	GL	\$500,000 Deductible
NWA0131923	10/1/1996	10/1/1997	WC	\$2,000,000 Deductible
NWA0131923	10/1/1997	10/1/1998	WC	\$2,000,000 Deductible
NWA0131923	10/1/1998	10/1/1999	WC	\$2,000,000 Deductible
NWA0131923	10/1/1999	10/1/2000	WC	\$2,000,000 Deductible
NWA0131924	10/1/1996	10/1/1997	WC	Retro
NWA0131924	10/1/1997	10/1/1998	WC	Retro
NWA0131924	10/1/1998	10/1/1999	WC	Retro
NWA0131924	10/1/1999	10/1/2000	WC	Retro
NWA0158556	10/1/1999	10/1/2000	WC	\$2,000,000 Deductible

- D. The Collateral is in the form of a \$55 million letter of credit and a \$45 million surety bond issued by CNA.
- E. After Reliance was placed in liquidation in October 2001, claims which had arisen under the CF Polices were sent to the guaranty associations (“GAs”). Subject to applicable statutory limitations, certain GAs assumed the obligation to pay CF workers compensation claims. These are referred to as the “Affected GAs”. The Affected GAs which paid and are paying CF workers compensation claims and the amounts they had paid through December 31, 2005 are as follows and the payments made total \$30,052,708.97:

<u>Guaranty Association</u>	<u>Total Paid</u>
Alaska	691.00
Alabama	206,006.00
Arkansas	45,407.00
Arizona	85,461.00
California	10,994,010.44
Colorado	151,953.00
Connecticut	242,424.00
Florida	2,040,453.00
Georgia	587,810.00
Hawaii	176.00
Iowa	533,854.00
Illinois	2,287,987.00
Indiana	52,814.00
Kansas	250,135.00
Kentucky	22,277.00
Louisiana	76,627.00
Massachusetts	767,217.00
Maryland	275,271.00
Maine	128,617.00
Michigan	325,728.00
Minnesota	409,698.00
Missouri	395,709.00
Mississippi	128,169.00
Montana	51,976.00
North Carolina	756,715.97
Nebraska	110,792.00
New Jersey	681,887.00
New York	2,489,331.00
Oklahoma	150,058.00
Oregon	134,036.00
Pennsylvania	1,855,509.00
Rhode Island	57,653.00
South Carolina	845,504.56
Tennessee	1,318,042.00
Texas	804,927.00

Utah	323,585.00
Virginia	460,400.00
Vermont	4.00
Wisconsin	3,794.00
Grand Total All States	30,052,708.97

- F. Three Affected GAs – California, Pennsylvania and Texas - initially funded some AL claims within the CF deductible in the amount of \$201,753.00.
- G. In addition to claims under the workers compensation and AL/GL deductible policies, some of the CF Policies provided for retrospective premium adjustments. From the date of liquidation through December 21, 2005, CF owed Reliance \$766,443.12 for retrospective premium adjustments.
- H. CF also has an as yet undetermined amount of claims that are not covered by GAs.

**Accordingly, it is hereby ORDERED and DECREED as follows:**

1. The Liquidator will retain a third party administrator (“TPA”) to adjust and settle known, but unresolved, non-covered AL/GL claims.
2. From the Collateral, the Liquidator will make available an initial sum of \$20 million to settle the non-covered AL/GL claims within the deductible (“the Settlement Fund”). No settlement will be eligible for payment unless it releases the Liquidator and the Reliance Estate. To the extent claimants, GAs or CF have submitted POCs for any claim which is settled according to this process, the Liquidator shall be entitled to issue a NOD with an amount of \$0 at the appropriate statutory priority. The reasonable administrative expenses of CF and the costs of the TPA may be paid from the Settlement Fund.
3. The Liquidator shall pay to the Affected GAs from the Collateral the amounts set forth above at paragraph E.
4. The Liquidator shall pay to the California, Pennsylvania and Texas GAs \$201,753.00 that they paid in AL/GL claims.
5. The Liquidator shall reimburse Reliance from the Collateral for the amount of \$766,443.12 that was due and owing in retrospective premium through December 31, 2005.
6. **Ongoing Collateral Review**
  - a. No later than October 31, 2007, the Liquidator shall complete a review and evaluation of the Collateral and claims under CF Policies in order to determine whether there is sufficient collateral, including any Collateral



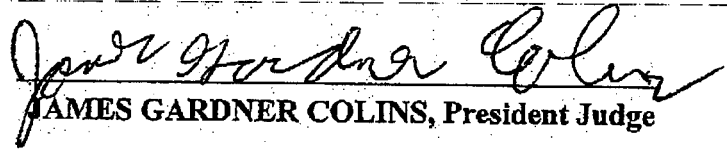
remaining in the Settlement Fund, to fund all remaining known, outstanding and anticipated claims, retrospective premium and administrative expenses.

- b. If by October 31, 2007, the Liquidator determines that there is sufficient collateral, she shall promptly file with the Court a Petition to Finally Allocate Collateral, setting forth the terms upon which she proposes to allocate and pay the Collateral. Upon approval by the Court, the Liquidator shall be entitled to proceed to allocate and pay the Collateral asset forth as directed by the Court.
  - c. If by October 31, 2007, the Liquidator determines that actuarial projections remain too imprecise to finally allocate and pay the Collateral, but that a further partial allocation and payment is appropriate, the Liquidator will promptly file with the Court a Petition to Partially Allocate Collateral, setting forth the terms upon which she proposes to allocate and pay part of the Collateral. Upon approval by the Court, the Liquidator shall be entitled to proceed to allocate and pay the Collateral as directed by the Court.
  - d. At each year anniversary of October 31, 2007, as updated and more accurate information is obtained, the Liquidator will complete a collateral review and determine whether to proceed under paragraph (b) above if the collateral is determined to be sufficient, or paragraph (c) above if the collateral review remains inconclusive.
  - e. No payments shall be made from the Collateral without approval of the Court.
7. **Insufficient Collateral.** If the Liquidator determines at any time that the Collateral is insufficient to reimburse all claims paid by the Affected GAs, pay all non-covered AL/GL claims, pay all retrospective premiums due and owing, as well as administrative expenses, the Liquidator shall file with the Court and seek the Court's approval of an amended plan establishing an equitable *pro rata* allocation formula against the Collateral controlling all future distributions. If the Collateral is exhausted without the full payment of all non-covered AL/GL claims and reimbursement of all claims paid by the Affected GAs in full, the remaining claims or partial claims shall be claims against the Reliance Estate and subject to compliance with the proof of claim process established by the Act and the September 9, 2002 Order of this Court, and any amendments or supplements thereto.
8. **Liquidator Expenses.** The Liquidator may withdraw up to 3% of the Collateral for reasonable actual expenses incurred in the administration of Section 221.23a of the Act. After each annual plan review, the Liquidator shall include in the Petition a statement of and request for approval of reimbursement of the Liquidator's administrative expenses. The Liquidator shall file the Petition with the Court, along with any response received.

9. **FURTHER**, within three months of the date of this Order and every four month period thereafter, the Liquidator shall file a report detailing the complete status of the Plan.

**AND FURTHER**, it is **ORDERED** that the Liquidator shall serve a copy of this Order upon all listed on the Master Service List, and also, shall file with this Court no later than October 13, 2006, an affidavit that service has been effectuated.

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**JAMES GARDNER COLINS, President Judge**