

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff,

vs.

RELIANCE INSURANCE COMPANY,
Defendant.

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: Docket No. 269-MD-2001
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OF PA (PHILA)

ORDER

AND NOW, this day of 2010, Upon Consideration of the Joint Petition to Approve the Transfer of Escrow Funds Relating to the Reliance Director and Officer Settlement, IT IS ORDERED that the Petition is GRANTED and that BNY Mellon is hereby substituted as the New Escrow Agent, under the terms and conditions of the escrow agreement appended to the Petition.

IT IS FURTHER ORDERED that, in connection with the transfer of the escrow proceeds to BNY Mellon as New Escrow Agent, Sovereign Bank shall wire transfer five million dollars (\$5,000,000.00) of the current escrow account to the Liquidator and the remainder of the escrow account to BNY Mellon.

J.

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**JOINT PETITION TO APPROVE THE TRANSFER OF ESCROW FUNDS
RELATING TO THE RELIANCE DIRECTOR AND OFFICER SETTLEMENT**

Petitioner, Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania (“Commissioner”), in his official capacity as Liquidator (“Liquidator”) of Reliance Insurance Company (“Reliance”), respectfully seeks an Order from this Honorable Court pursuant to the Insurance Department Act of 1921 (“Act”), 40 P.S. §§ 221.1 – 221.63, in the form attached hereto approving the transfer of escrow funds from Sovereign Bank to BNY Mellon, which escrow was created as part of the Court-approved settlement of the litigation commenced by the Liquidator against certain former directors and officers of Reliance.

In support of this Petition, the Liquidator avers as follows:

BACKGROUND

1. On May 29, 2001, this Court entered an order under 40 P.S. §§ 221.14 – 221.15 placing Reliance into rehabilitation proceedings. Subsequently, on October 3, 2001, this Court entered an Order under 40 P.S. §§ 221.19 – 221.20 placing Reliance into statutory liquidation. The Court’s October 3 Order appointed the Commissioner as Liquidator of Reliance.

A. Director And Officer Litigation

2. On June 24, 2002, the Liquidator filed a Complaint in this Court captioned Koken v. Steinberg, et al., Civil Action No. 421-MD-2002 (the “Director and Officer Litigation”), against certain of Reliance’s former directors and officers. Subsequently, Commissioner Joel S. Ario was “substituted” in as the Plaintiff for the former Commissioner, M. Diane Koken upon his being confirmed as the Insurance Commissioner of Pennsylvania.

3. After some discovery and a lengthy Court-sponsored mediation, the parties filed a Petition to Approve Settlement Agreement of Reliance Director and Officer Litigation (“Settlement Agreement”).

4. As part of the Settlement Agreement, the parties entered into an escrow agreement (the “Escrow Agreement”) by which an escrow account (the “Escrow Account”) was created to fund certain litigation expenses which Reliance’s former directors and officers might incur. The Liquidator has an interest in the proceeds of the Escrow Account. There is currently approximately \$13,357,000 in the Escrow Account. A copy of the Escrow Agreement, as approved by the Court, is attached as Exhibit “A”.

5. The Escrow Agreement provides, inter alia, that the proceeds of the Escrow Account shall be invested in a “commercial depository product collateralized by U.S. Government Agency Securities and will guarantee a minimum of 2.5% APY...subject to the Escrow Agent’s fixed 50 basis points fee...”. See Escrow Agreement § 2(b).

6. As a result of the changes in the credit market and the low interest rate environment which has prevailed over the past two or more years, U.S. Government Agency Securities have not been available to purchase at 2.5% APY. As such, Sovereign has been

unable to meet the requirement of the Escrow Agreement that it invest in U.S. Government Agency Securities that pay at least 2.5% APY.

7. The Escrow Agreement further provides as follows:

- The Escrow Agent may resign upon providing sixty (60) days written notice of such resignation. See § 10(c); and
- The Escrow Agent must have at least \$1 billion of combined capital, surplus and retained earnings. See § 10(d).

B. Sovereign Resigns As Escrow Agent

8. On March 17, 2010, Sovereign notified the parties that it intended to resign as Escrow Agent, effective May 31, as it was then in the process of exiting the escrow business.

9. Sovereign has subsequently agreed to remain as Escrow Agent until either July 29, or such earlier date as the Court may issue the type of order sought herein. It is not willing to remain the Escrow Agent beyond July 29, 2010. Sovereign will deposit the proceeds of the Escrow Account with the Court in the event that a new escrow agent is not in place by July 29, 2010. Thus, Petitioner seeks prompt consideration of this Petition.

C. The New Escrow Agent

10. Upon learning of Sovereign's decision to exit the escrow business and to resign as Escrow Agent, the parties undertook to locate a new escrow agent. After inquiry, BNY Mellon was identified as a financial institution with the qualifications and capabilities acceptable to the parties to act as the new escrow agent (the "New Escrow Agent").

11. The parties and the New Escrow Agent have negotiated a new escrow agreement (the "New Escrow Agreement"), a copy of which is attached hereto as Exhibit "B".

12. The New Escrow Agent has a combined capital, surplus and retained earnings in excess of \$1 billion dollars.

13. The New Escrow Agent will first invest the escrow proceeds in U.S. Government Agency Securities with interest rates paid at the market rate, or in such other vehicles as the Parties may later agree. The fee to be charged is set forth in the New Escrow Agreement.

14. Beyond the changes set forth in the aforementioned paragraph, the New Escrow Agreement is substantially similar to the original Escrow Agreement.

15. Nonetheless, since the terms of the prior Escrow Agreement were approved by the Court and because the New Escrow Agreement (with changes reflective of the current market) and New Escrow Agent are being proposed, the parties seek the Court's approval in connection with transferring the escrow proceeds to the New Escrow Agent under the terms as set forth herein.

D. Partial Distribution of Escrow Funds

16. The Escrow Agreement, §12, provides that a portion of the Escrow Fund may be disbursed to the Petitioner by the fifth anniversary of the Effective Date of the Settlement Agreement. As such, at the time of transfer to the New Escrow Agent, \$5,000,000 of the Escrow Proceeds will be transferred to Petitioner.

17. It is contemplated that the remainder of the Escrow Funds (approximately \$8,350,000) will remain in the Escrow Account, subject to possible reduction for the payment of fees, costs and expenses in accordance with the terms of the Escrow Agreement, until December 31, 2011. At that time, the parties will discuss the Escrow Fund being terminated and the amount remaining in the Escrow Account being transferred to the Liquidator, in accordance with the terms of the Settlement Agreement.

18. Defendants in the Director and Officer Litigation join in this Petition.

WHEREFORE, the parties seek an Order in the form attached and permitting transfer of the Escrow Agent pursuant to the terms and conditions as set forth herein.

Dated: June 8 2010

BY: 

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BY: 

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*Acting in this instance only as Liaison
Counsel for the Director and Officer
Defendants in the Director and Officer
Litigation*

EXHIBIT “A”

Exhibit F

ESCROW AGREEMENT

This Escrow Agreement (the "Escrow Agreement") is made this 24th day of February, 2005, by and among the Koken Action Defendants, as that term is defined in the Settlement Agreement (as defined in the Settlement Agreement described below), and Sovereign Bank as Escrow Agent hereunder (collectively, the "Parties").

WITNESSETH:

WHEREAS, the Parties, exclusive of the Escrow Agent, together with M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, and her successors, acting in their official capacities as Statutory Rehabilitator and Liquidator of Reliance Insurance Company (the "Liquidator"), and certain Insurers have entered into a settlement agreement of even date with this Escrow Agreement and to which this Escrow Agreement is a material part and annexed to as Exhibit F (the "Settlement Agreement");

WHEREAS, this Escrow Agreement is entered into and is executed by the Parties hereto in order to accomplish the provisions in paragraph II.B.1.c of the Settlement Agreement;

WHEREAS, the Settlement Agreement contemplates the establishment of an escrow account to be held by the Escrow Agent solely for the benefit of the Koken Action Defendants and the Liquidator as set forth herein; and

WHEREAS, the terms and definitions used in the Settlement Agreement shall also apply to this Escrow Agreement.

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements hereinafter set forth, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged and agreed to, and intending to be legally bound, the Parties agree as follows:

SECTION 1. Creation of The Escrow Fund. Upon execution of this Escrow Agreement, the Escrow Agent shall create and establish an escrow account (the "Escrow Fund") to be held by the Escrow Agent in accordance with the terms of this Escrow Agreement.

SECTION 2. Deposits to the Escrow Fund.

(a) Pursuant to the Settlement Agreement, at the Closing following the Effective Date of the Settlement Agreement, the Escrow Agent under the Settlement Account Escrow Agreement (as defined in the Settlement Agreement) shall pay to the Escrow Agent the sum set forth in Paragraph II.B.1.c of the Settlement Agreement (the "Escrow Amount"). The Escrow Agent shall have no responsibility or obligation to determine the amount to be deposited into the Escrow Fund or to enforce the obligations under the Settlement Agreement to make deposits into the Escrow Fund.

(b) On the date of receipt by the Escrow Agent of the Escrow Amount (if received prior to 1:00 p.m., eastern standard time, on a business day) or on the next business day (if received after 1:00 p.m., eastern standard time, on a business day), the Escrow Agent is hereby authorized and directed, and agrees, to invest all amounts in a Commercial depository product collateralized by U.S. Government Agency securities and will guarantee a minimum rate of 2.5% APY, which can be adjusted upward in accordance with the Federal Funds rate during the period over the life of the account and is subject to the Escrow Agent's fixed 50 basis points fee defined in Section 5 below. The Escrow Agent shall deposit all interest and other distributions received from the investment of the Escrow Fund into the Escrow Fund.

SECTION 3. Payments from the Escrow Fund.

(a) The Escrow Agent shall cause the amounts on deposit in the Escrow Fund to be disbursed to the Koken Action Defendants in accordance with the Agreement Among Defendants, made and signed among the Koken Action Defendants on January 14, 2005 (the "Agreement Among Defendants"). A copy of the Agreement Among Defendants has been provided to the Escrow Agent.

(b) Procedure for Obtaining Payments from the Escrow Fund:

1. As set forth in the Agreement Among Defendants, in order to obtain payment for legal fees and expenses, any counsel for a Defendant seeking payment from the Escrow Fund must submit to the Escrow Agent: (i) a statement detailing the activities giving rise to the legal fees and expenses; and (ii) a Certificate in the form attached hereto as Exhibit A.

2. As set forth in the Agreement Among Defendants, in order to obtain payment for the settlement of civil claims (excluding in all instances the payment of fines and/or penalties), the payment of which has been consented to by the Liquidator in writing ("Claims"), any counsel for a Defendant seeking payment from the Escrow Fund must submit to the Escrow Agent: (i) a statement detailing the proposed settlement amount; and (ii) a true and correct copy of the Liquidator's written consent to the proposed settlement

3. The Escrow Agent shall be permitted to pay the fees of the Master as set forth in Paragraph II.F.1.

(c) Upon receipt of both items set forth in Section 3.b, above, the Escrow Agent shall pay the amount set forth in the statement within thirty (30) days.

(d) No retainer or up-front lump sum payments may be made from the Escrow Fund. Fees and expenses are only eligible to be paid in arrears as they are incurred and submitted to the Escrow Agent for payment in accordance with this Section 3.

(e) The Escrow Agent is entitled to withdraw fees and expenses from the Escrow Fund as set forth in Section 5 of this Escrow Agreement.

(f) Upon termination of the Escrow Fund, any funds remaining in the Escrow Fund, less amounts paid in accordance with this Section 3, shall be paid to the Liquidator.

