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COMMONWEALTH COURT
OF PENNSYLVANIA
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Attorneys for Proposed
Intervenor Aurora National
Life Assurance Company

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE:
Reliance Insurance Company
In Liquidation

NO. 1 REL 2001

**Application for Leave to Intervene for a Limited Purpose and to File
Response and Memorandum of Law in Opposition to Application for
Approval of Administration Agreement Related to Certain
Structured Settlement Annuity Contracts and
Transfer of Ownership of Those Annuity Contracts**

Interested party Aurora National Life Assurance Company (the
“Intervenor”), by its undersigned counsel, hereby respectfully submits this

Application pursuant to Rules 3775 and 123 of the Pennsylvania Rules of Appellate Procedure for leave to intervene in the above-captioned matter for the limited purpose of responding to the Application for Approval of Administration Agreement Related to Certain Structured Settlement Annuity Contracts and Transfer of Ownership of Those Annuity Contracts (the “Annuity Transfer Application”) filed on or about March 10, 2014 by Michael F. Consedine, Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as Statutory Liquidator (the “Liquidator”) of Reliance Insurance Company (“Reliance” or the “Estate”), and submitting the attached Response and Memorandum of Law in Limited Opposition to the Annuity Transfer Application. In support of its proposed intervention, Intervenor states as follows:

1. Rule 3775(a) authorizes intervention by any person with a “direct and substantial interest in the administration of the insurer’s business or estate.” Where the proposed intervenor’s “interest involves a discrete controversy relating to the administration of the insurer’s business or estate,” Rule 3775(c)(2) authorizes “limited intervention to participate as a party in the discrete controversy.” The Court is specifically authorized to grant such limited intervention to an interested party seeking to “[o]ppose an application by the receiver for an order relating to the administration of the insurer’s business or of estate.” Pa.R.A.P. 3775, *note*.

2. Intervenor seeks limited intervention in this case for the purpose of opposing the Liquidator's Annuity Transfer Application. A true and correct copy of the Intervenor's proposed Response and Memorandum of Law is attached hereto as Exhibit A.

3. As outlined in the proposed Opposition, the Liquidator's proposed transfer of ownership of certain annuities issued by Intervenor ("SSAs") may give rise to immediate, direct and substantial adverse consequences and burdens for Intervenor, justifying Intervenor's request to be heard on this matter.

4. Reliance originally purchased certain structured settlement annuities (the "ELIC Annuities") from Executive Life Insurance Company ("Executive Life") to fund Reliance's periodic payment obligations under certain structured settlements.

5. Pursuant to Executive Life's Rehabilitation Plan (the "Plan"), on September 3, 1993, the ELIC Annuities were restructured and assumed and reissued by Intervenor.¹ As of the date of this filing, there remain forty (40) SSAs issued by Aurora and owned by Reliance.

6. Under the Annuity Transfer Application, the Liquidator proposes to transfer the ownership of three (3) SSAs (the "Subject SSAs") from Reliance to the

¹ As explained in greater detail in the attached proposed Memorandum of Law, Intervenor is not responsible for the full amount of payments due under the SSAs.

payees under the Subject SSAs, and to receive a discharge of the corresponding periodic payment obligations, in order to “accomplish[] the goals of finality and expense reduction.” Annuity Transfer Appl. ¶ 18.²

7. As explained in the attached proposed Response and Memorandum of Law, the transfer of the Subject SSAs, in addition to triggering potential adverse tax consequences for the payees of the Subject SSAs (who have not been given effective notice of the Annuity Transfer Application), may require Intervenor to undertake costly tax reporting and withholding obligations and subject Intervenor to potential damage claims of aggrieved payees.³

8. Intervenor’s interests are not adequately represented by the Liquidator or any other current party, as neither the Liquidator nor any other current party shares Intervenor’s interests and is in a position to oppose the relief sought in the Annuity Transfer Application and to promote alternative measures that may avoid or mitigate the adverse effects of the proposed transfer.

² The remaining thirty-seven (37) SSAs issued by Aurora and owned by Reliance are the subject of a “qualified assignment” within the meaning of Section 130(c) of the Internal Revenue Code of 1936, as amended, and thus are not the subject of the Annuity Transfer Application. The qualified assignment is the subject of a separate Application filed by the Liquidator seeking this Court’s approval of the same.

³ In mentioning the prospect of damage claims by payees, Intervenor is not implying that such claims would have any merit; they would not. However, Intervenor cannot disregard the risk that payees deprived of the tax benefits associated with their structured settlements will assert claims against the life insurers that fund the settlements.

WHEREFORE, Intervenor respectfully request that the Court enter an order (a) granting Intervenor leave to intervene for the limited purpose of opposing the Liquidator's Annuity Transfer Application, and (b) accepting the filing of the proposed Response and Memorandum of Law in Limited Opposition to the Annuity Transfer Application attached hereto as Exhibit A.

Dated: April 9, 2014

Respectfully submitted,



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**EXHIBIT A TO
APPLICATION FOR LEAVE TO INTERVENE**

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Attorneys for Respondent,
Aurora National Life
Assurance Company

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE:
Reliance Insurance Company
In Liquidation

NO. 1 REL 2001

**Response in Limited Opposition to Application for Approval of
Administration Agreement Related to Certain Structured Settlement Annuity
Contracts and Transfer of Ownership of Those Annuity Contracts**

COMES NOW, Aurora National Life Assurance Company ("Aurora"),
through its undersigned counsel, and files this Response in Limited Opposition to
Application for Approval of Administration Agreement Related to Certain

Structured Settlement Annuity Contracts and Transfer of Ownership of Those Annuity Contracts (the “Annuity Transfer Application”) filed on March 10, 2014 by Michael F. Consedine, Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as Statutory Liquidator (the “Liquidator”) of Reliance Insurance Company (“Reliance” or the “Estate”), pursuant to Rule 3776 of the Pennsylvania Rules of Appellate Procedure, and in support thereof, avers as follows:

1. Structured settlements were created primarily for the benefit of injured people. Instead of taking one lump sum in a personal injury lawsuit, the injured party could choose a structured settlement whereby the defendant agreed to pay him or her regular payments over a specified time to match his or her specific needs. Congress incentivized the use of structured settlements through the tax code, partly due to the concern that injured people who take a lump sum often spend it all before meeting future obligations.

2. As the property and casualty insurer for defendants in certain personal injury actions, Reliance was ultimately responsible for paying the injured parties. Rather than undertaking the burden of making structured settlement payments to all of the injured parties to whom it was obligated, Reliance elected to purchase certain structured settlement annuities (the “ELIC Annuities”) from Executive Life

Insurance Company (“Executive Life”) to fund Reliance’s periodic payment obligations under certain structured settlements.

3. Pursuant to Executive Life’s Rehabilitation Plan (the “Plan”), on September 3, 1993, the ELIC Annuities were restructured and assumed and reissued by Aurora (the restructured annuities resulting from the Plan and issued by Aurora are referred to herein as the “SSAs”). As of the date of this filing, there remain forty (40) SSAs issued by Aurora and owned by Reliance.

4. Under the Annuity Transfer Application, the Liquidator proposes to transfer the ownership of three (3) structured settlement annuities (the “Subject SSAs”)¹ from Reliance to the payees under the Subject SSAs, and to receive a discharge of the corresponding periodic payment obligations, in order to “accomplish[] the goals of finality and expense reduction.” Annuity Transfer Appl. ¶ 18.²

5. As explained in the accompanying Memorandum of Law in Support of this Response, which is incorporated herein by reference, the transfer of the

¹ The remaining thirty-seven (37) SSAs issued by Aurora and owned by Reliance are the subject of a “qualified assignment” within the meaning of Section 130(c) of the Internal Revenue Code of 1936, as amended, and thus are not the subject of the Annuity Transfer Application. Rather, the qualified assignment is the subject of a separate Application filed by the Liquidator seeking this Court’s approval of the same.

² The Annuity Transfer Application also seeks this Court’s approval of a certain Administration Agreement between Aurora and Reliance, which approval Aurora does not oppose. Pursuant to the Administration Agreement, Aurora agrees to undertake for a period of time all administration responsibilities in connection with the Subject SSAs, including ownership responsibilities, while specifically reserving Aurora’s right to object to the Annuity Transfer Application.

Subject SSAs will trigger potential adverse tax consequences for the payees of the Subject SSAs. Therefore, the proposed ownership transfer is not on “such terms and conditions as are fair and reasonable,” as required by The Insurance Department Act of 1921 (the “Act”). *See* 40 P.S. § 221.23(9).

6. In addition, though the Liquidator is authorized by the Act “to enter into contracts as are necessary to carry out the order to liquidate,” the payees under the Subject SSAs have not entered into any contracts or agreements regarding the Annuity Transfer Application, nor have they consented to owning the Subject SSAs. *See* 40 P.S. § 221.23(9).

7. In addition, if approved, the Annuity Transfer Application may require Aurora to undertake costly tax reporting and withholding obligations, and may subject Aurora to potential damage claims of aggrieved payees.³ As a result, the Annuity Transfer Application does not “assure a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims,” as required by the Act. *See* 40 P.S. § 221.46.


WHEREFORE, for the reasons set forth herein and in the accompanying Memorandum of Law, the Annuity Transfer Application should be denied insofar

³ In mentioning the prospect of damage claims by payees, Aurora is not implying that such claims would have any merit; they would not. However, Aurora cannot disregard the risk that payees deprived of the tax benefits associated with their structured settlements will assert claims against the life insurers that fund the settlements.

as it requests that ownership of the Subject SSAs be transferred to the payees thereunder.

Dated: April 9, 2014

Respectfully submitted,



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Attorneys for Respondent,

Aurora National Life Assurance Company

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE:

Reliance Insurance Company

In Liquidation

NO. 1 REL 2001

**Memorandum of Law in Support of Response in Limited Opposition to
Application for Approval of Administration Agreement Related to Certain
Structured Settlement Annuity Contracts and Transfer of Ownership of
Those Annuity Contracts**

COMES NOW, Aurora National Life Assurance Company (“Aurora”),
through its undersigned counsel, and files this Memorandum of Law in Support of
Response in Limited Opposition to Application for Approval of Administration
Agreement Related to Certain Structured Settlement Annuity Contracts and
Transfer of Ownership of Those Annuity Contracts (the “Annuity Transfer
Application”) filed on March 10, 2014 by Michael F. Consedine, Insurance
Commissioner of the Commonwealth of Pennsylvania, in his capacity as Statutory
Liquidator (the “Liquidator”) of Reliance Insurance Company (“Reliance” or the

“Estate”), pursuant to Rule 3776 of the Pennsylvania Rules of Appellate Procedure. For the reasons set forth herein, the Annuity Transfer Application should be denied insofar as it seeks the transfer of ownership of the Aurora annuity contracts discussed herein.

I. BACKGROUND FACTS

Structured settlements were created primarily for the benefit of injured people. Instead of taking one lump sum in a personal injury lawsuit, the injured party could choose a structured settlement whereby the defendant agreed to pay him or her regular payments over a specified time to match his or her specific needs. Congress incentivized the use of structured settlements through the tax code, partly due to the concern that injured people who take a lump sum often spend it all before meeting future obligations. In addition to the financial security often provided by structured settlements, injured parties typically are able to take advantage of the tax benefits associated with the payments, the investment income of which remains untaxed as to the injured parties.

As the property and casualty insurer of defendants in personal injury actions, Reliance was ultimately responsible for making periodic payments (“Periodic Payments”) to certain injured parties. Rather than undertaking the burden of making structured settlement payments to all of the injured parties to whom it was obligated, Reliance elected to purchase certain structured settlement annuities (the

“ELIC Annuities”) from Executive Life Insurance Company (“Executive Life”) to fund Reliance’s obligation to make the Periodic Payments. Pursuant to Executive Life’s Rehabilitation Plan (the “Plan”), on September 3, 1993, the ELIC Annuities were restructured and assumed and reissued by Aurora (the restructured annuities resulting from the Plan and issued by Aurora are referred to herein as the “SSAs”).¹

On or about September 10, 2012, Reliance filed an Application for Approval to Transfer Ownership of Structured Settlement Annuity Contracts (the “September 2012 Application”), through which it sought to transfer the ownership of more than 3,400 structured settlement annuities from Reliance to the payees of those annuities. At Reliance’s request, the September 2012 Application was stayed while the various life insurance companies issuing the annuities which were the subject of the September 2012 Application, including Aurora, sought alternative options to the relief sought in the September 2012 Application.

Since the time that the September 2012 Application was stayed, Aurora has effectuated, subject to the approval of this Court, a “qualified assignment” within

¹ When the original ELIC Annuities were restructured, contract values and terms of the original contracts were adjusted as required by the Plan. Therefore, the amount of “Benefit Payments” provided by Aurora under an SSA may be less than the Periodic Payments originally payable under the ELIC Annuities. Further, pursuant to the Plan, certain state life insurance guaranty associations (“PGAs”) agreed to provide additional funds to Aurora to enhance the SSAs. A percentage of the “Benefit Payment” amount includes an enhancement by a PGA. Aurora is not responsible for a “Benefit Payment” if it is not paid by the PGA or if the PGA defaults on its obligations.

the meaning of Section 130(c) of the Internal Revenue Code of 1986, as amended (the “Qualified Assignment”), with respect to thirty-seven (37) of the SSAs.

Subject to the approval of this Court, under the Qualified Assignment, ownership of those 37 SSAs and the obligation to provide the Benefit Payments thereunder were transferred from Reliance to another entity, Treasury Funded Structured Settlement.² For various reasons, three (3) of the SSAs (the “Subject SSAs”) were not made a part of the Qualified Assignment.

In the Annuity Transfer Application, the Liquidator seeks to transfer the ownership of the Subject SSAs from Reliance to the payees under the Subject SSAs. The Annuity Transfer Application also seeks this Court’s approval of a certain Administration Agreement, which approval Aurora does not oppose.³

II. ARGUMENT

A. The Proposed Ownership Transfer Could Subject the Payees Under the Subject SSAs to Adverse Tax Consequences, and Therefore, the Terms of the Proposed Annuity Transfer Are Not Fair and Reasonable, As Required by The Insurance Department Act of 1921.

Ownership of the Subject SSAs by their payees is fundamentally incompatible with the tax structure of structured settlements. Typically, the

² The Qualified Assignment is the subject of a separate Application filed by the Liquidator seeking this Court’s approval of same.

³ Aurora is a party to the Administration Agreement with Reliance, pursuant to which Aurora agrees to undertake for a period of time all administration responsibilities in connection with the Subject SSAs, including ownership responsibilities, while specifically reserving Aurora’s right to object to the Annuity Transfer Application.

amount of damages received on account of personal physical injuries or sickness, including damages received in the form of periodic payments, are excludable from the recipient's gross income. *See* I.R.C. §104(a)(2). However, according to the Internal Revenue Service, if the payee of a structured settlement annuity has actual or constructive receipt or the economic benefit of the lump sum damage payment invested for the payee's benefit, "none of the income from the investment of such payment is excludable under section 104." Rev. Rule 79-220, 1979 WL 51028, at *1 (1979); PLR 9017011, 1990 WL 699180 (1990) (citing Rev. Rule 79-220). *See also Monarch Life Ins. Co. v. Estate of Tarone*, 2011 WL 1813665, at *8 (E.D. Pa. May 10, 2011) ("if the annuitant is deemed to own or control the lump-sum fund used to purchase the annuity, the tax benefits of the structured settlement are lost"). Accordingly, a payee under a Subject SSA who becomes outright owner of the SSA cannot expect to be able to exclude future earnings on the SSA from the payee's taxable income.

Indeed, the threat posed to payees by the Annuity Transfer Application has been acknowledged by Reliance. In an email dated February 27, 2013 to this Court, Reliance's counsel acknowledged that the transfer of annuity ownership from Reliance to another entity (as opposed to the payees under the annuities) "is designed to protect the tax benefits to annuity payees who are, in general, personal injury settlement beneficiaries whose settlements are paid by these annuities and

whose payments are currently considered tax free.” *See* Email dated February 27, 2013 from Ann Laupheimer, Esq. to Jean Warrick, a copy of which is attached hereto as Exhibit “A.” Thus, preserving ownership of the Subject SSAs by an entity other than the payees under the Subject SSAs would serve the goal of “preserving the payees’ tax benefits.” *Id.*

Under The Insurance Department Act of 1921 (the “Act”), the Liquidator has the power, *inter alia*:

To . . . sell, transfer, abandon or otherwise dispose of or deal with, any property of the insurer **at its market value or upon such terms and conditions as are fair and reasonable . . .**

40 P.S. § 221.23(9) (emphasis added).

It is respectfully submitted that the proposed transfer of ownership of the Subject SSAs from Reliance to the payees thereunder is not on “such terms and conditions as are fair and reasonable,” as required by the Act. To the contrary, the Annuity Transfer Application threatens to deprive the payees of the Subject SSAs of the tax benefits that led the payees to accept the Periodic Payments, as opposed to lump sum damages. Having promoted structured settlements to settling claimants (and, in some cases, to its own insureds) as a source of assured tax-free income, Reliance is now proposing to put payees in a position in which substantial portions of their Periodic Payments could become taxable. Such an unfair and unreasonable proposition should not be sanctioned by this Court, and the Annuity

Transfer Application should be denied insofar as it requests that ownership of the Subject SSAs be transferred to the payees thereunder.

B. In Addition, the Payees Under the Subject SSAs Have Not In Any Way Agreed to the Proposed Ownership Transfer.

Under the Act, the Liquidator has the power, *inter alia*:

To enter into such contracts as are necessary to carry out the order to liquidate, and to affirm or disavow any contracts to which the insurer is a party. . . .

40 P.S. § 221.23(11) (emphasis added).

Though the Act authorizes the Liquidator “[t]o enter into such contracts as are necessary to carry out the order to liquidate,” the payees under the Subject SSAs have not entered into any contracts or agreements regarding the Annuity Transfer Application, or agreed to the proposed ownership transfer in any way.

In light of the lack of any contract between Reliance and the payees under which the payees agree to own the Subject SSAs, the Annuity Transfer Application should be denied insofar as it requests that ownership of the Subject SSAs be transferred to the payees thereunder.

C. In Addition, the Proposed Ownership Transfer Does Not Assure a Reasonable Balance Between the Expeditious Completion of the Liquidation and the Protection of Unliquidated and Undetermined Claims, Including Third Party Claims, As Required by the Act.

The Act further requires that:

[T]he liquidator shall pay distributions in a manner that will assure the proper recognition of priorities and a

reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims.

40 P.S. § 221.46 (emphasis added).

As noted in Section II.A., *supra*, the payees of the Subject SSAs may suffer adverse tax consequences in the event the Annuity Transfer Application is approved. As a result, Aurora may be exposed to potential damage claims by payees under the Subject SSAs.⁴ If approved, the Annuity Transfer Application may also subject Aurora to costly tax reporting and back-up withholding obligations for which it never bargained. Thus, contrary to the Act's mandate, too much attention has been given to the expeditious completion of the liquidation, while Aurora stands to suffer due to the lack of attention paid to the potential burdens and risks to Aurora.

For this reason as well, the Annuity Transfer Application should be denied insofar as it requests that ownership of the Subject SSAs be transferred to the payees thereunder.

III. CONCLUSION

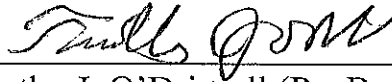
In light of the foregoing, Aurora National Life Assurance Company respectfully requests that this Court deny the Annuity Transfer Application insofar

⁴ In mentioning the prospect of damage claims by payees, Aurora is not implying that such claims would have any merit; they would not. However, Aurora cannot disregard the risk that payees deprived of the tax benefits associated with their structured settlements will assert claims against the life insurers that fund the settlements.

as it requests that ownership of the Subject SSAs be transferred to the payees thereunder.

Dated: April 9, 2014

Respectfully submitted,



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**EXHIBIT A TO
MEMORANDUM OF LAW**

From: Laupheimer, Ann [<mailto:Laupheimer@BlankRome.com>]
Sent: Wednesday, February 27, 2013 4:30 PM
To: Warrick, Jean
Cc: 'craig.ulman@hoganlovells.com'
Subject: Reliance Structured Settlement Annuities

Hi Jean: I am delighted to report that Genworth and Reliance have completed and executed a letter agreement and have substantially agreed upon a draft Private Letter Ruling request to the IRS that will, if agreed to by the IRS, provide comfort that the transaction they are contemplating will resolve their differences and ensure that the payees under structured settlements funded by Genworth annuities retain the favorable tax status of their annuity payments and that there are no adverse tax consequences to Reliance.

The PLR request is substantially complete and will be sent to the IRS in the next week or so. At this time, Genworth and Reliance jointly ask that this Court enter an indefinite extension on responses to Reliance's Application for Approval to Transfer Ownership of Structured Settlement Annuity Contracts until the IRS has ruled. Once the IRS rules, and assuming it rules favorably, the parties will complete the transaction. The transaction entails transferring the Genworth structured settlements from Reliance to a New Subsidiary majority owned by Genworth. This transaction is designed to resolve the future status of approximately 95 Percent of Reliance's structured settlements.. The remainder are settlements funded by annuities issued by life insurers other than Genworth. Genworth has agreed to assist Reliance in communicating with those other life insurers and urging them to enter into arrangements that could resolve the future status of many of those remaining settlements.

All of this is designed to protect the tax benefits to annuity payees who are, in general, personal injury settlement beneficiaries whose settlements are paid by these annuities and whose payments are currently considered tax free. We and Genworth see this as very beneficial progress that accomplishes, if successful, both goals of relieving the estate of structured settlement obligations and preserving the payees' tax benefits.

I have copied Genworth's counsel on this email and I have also attached a proposed Order that states that Reliance's Application will be held in abeyance until further order of the Court. Please let me know if you believe the Judge would like to speak to me and Craig Ulman from Hogan Lovells in DC who represents Genworth. He and I are in agreement on this request. In addition, if necessary, we will submit a joint request for the indefinite extension. While there are no rules with respect to timing, our best estimate is that the IRS may not rule on this request for more than 6 months. Thank you so much Jean. ANN

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CERTIFICATE OF SERVICE

I hereby certify that I am this day serving the foregoing document upon the persons and in the manner indicated below, which service satisfies the requirements of Pa.R.A.P. 121 and Pa.R.A.P. 3780:


Service by first class mail addressed as follows:

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Dated: April 9, 2014



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IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE:
Reliance Insurance Company
In Liquidation

NO. 1 REL 2001

[PROPOSED] ORDER

AND NOW, this ____ day of _____, 2014, upon consideration of Aurora National Life Assurance Company's Application for Leave to Intervene for a Limited Purpose and to File Response in Limited Opposition to Application for Approval of Administration Agreement Related to Certain Structured Settlement Annuity Contracts and Transfer of Ownership of Those Annuity Contracts, and any response thereto, it is hereby ORDERED that,

(a) Said Application for Leave to Intervene is GRANTED, and Aurora Life Assurance Company is hereby permitted to participate as a party for the limited purpose of opposing the Liquidator's Application for Approval of Administration Agreement Related to Certain Structured Settlement Annuity Contracts and Transfer of Ownership of Those Annuity Contracts; and

(b) The proposed Response in Limited Opposition to Application for Approval of Administration Agreement Related to Certain Structured Settlement Annuity Contracts and Transfer of Ownership of Those Annuity Contracts, attached as Exhibit A to the Application for Leave to Intervene, shall be deemed to have been filed with the Court as of _____, 2014.

BY THE COURT:

, J.