

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE: :
: **No. 1 REL 2001**
Reliance Insurance Company :
In Liquidation :

In Re: Liquidator's Application for Approval of Restructuring Proposal

MEMORANDUM and ORDER

Presently before the Court for consideration is the Liquidator's Application for Approval of Restructuring Proposal (Application) requesting approval of a complex restructuring of a member of a consolidated tax group that includes Reliance. If the Application is approved by the Court, Reliance will keep its significant net operating loss carryovers (NOLs), totaling approximately \$2.5 billion, thereby enabling it to offset future net income and reduce liabilities.¹

In the Application, the Liquidator details the history of the entities involved in the consolidated tax group with Reliance, outlines the proposed restructuring of the involved entities, and emphasizes the importance of the transaction to the Estate, its policyholders, claimants and

¹ According to the Liquidator, the NOLs allow Reliance "to reduce potential tax liabilities due to income generated by reserve reductions that may occur for a variety of reasons, including as a result of the claims settlement process or because no valid [Proof of Claim (POC)] was filed prior to the Claims Bar Date. The potential savings from the application of the NOLs involves tens of millions of dollars. The Restructuring will satisfy the requirements of [Section] 382(l)(5) of the [Internal Revenue] Code so that the NOLs will not be subject to a limitation under [Section] 382(a) after the Restructuring is implemented." Application, ¶ 7.

creditors. The Liquidator's clear description of the restructuring proposal in her Application obviates the need for the Court to restate the intricacies of the transaction here. For the instant purposes, it is worth noting that the two other entities in the consolidated tax group, Reliance Financial Services Corporation (RFS), which owned 100% of the stock of Reliance, and its parent, Reliance Group Holdings, Inc. (RGH), have undergone reorganization following bankruptcy. Following bankruptcy, RFS converted to Reorganized RFS Corporation (Reorganized RFS), remaining in existence in order to collect and liquidate certain assets. According to the Liquidator, Reorganized RFS is now in a position to terminate its existence and dissolve. That dissolution, however, could lead to a change in ownership of Reliance which, under Section 382 of the Internal Revenue Code of 1986 (Code), 26 U.S.C. § 382, could adversely affect Reliance's NOLs. Therefore, in order to avoid jeopardizing the NOLs, the Liquidator seeks approval of the following proposal (described in basic terms):

The central element of the Restructuring is the transfer of ownership from Reorganized RFS to four Guaranty Association creditors [GAs] of Reliance . . . which will result in an ownership change, but one which will qualify for the bankruptcy exception under [Section] 382(l)(5) of the Code, thereby preserving the NOLs of Reliance for future use. The GAs will receive no preference as to their claims against Reliance due to their new ownership status, and each of the GAs will, in fact, cancel \$1000 of qualified indebtedness (as defined in [Section] 382(l)(5)(E) of the Code) in exchange for receiving the Reliance stock. . . .

The first step in the proposed Restructuring is that Reliance will execute a reverse stock split to reduce the total number of existing shares of

common stock from over 44 million to 100. All subsequent actions relating to the Restructuring will occur at the date designated for implementing the Restructuring (“Closing Date”), expected to occur on or prior to December 31, 2016.

On the Closing Date, Reliance will redeem 100 percent of the outstanding Reliance common stock (100 shares) from Reorganized RFS for \$1. Reliance will also issue an amended RGF [Notice of Determination (NOD)] to recognize the right of RGH to equity benefits [R]eliance agreed to pay the actual, reasonable and necessary operating expenses of Reorganized RFS for its continued existence (approximately 15 months) for the limited purpose of implementing the Restructuring.
. . .

Also on the Closing Date, Reliance will issue 25 shares of [restricted] Reliance common stock to each of the GAs, comprised of the Connecticut Insurance Guaranty Association, the Georgia Insurers Insolvency Pool, the Illinois Insurance Guaranty Fund and the Massachusetts Insurers Insolvency Fund, in exchange for the satisfaction and cancellation of indebtedness totaling \$1,000 by each GA. . . . Additionally, Reliance will indemnify and hold the GAs harmless from any liability associated with the Restructuring as set forth in the Indemnification Agreement Reliance has also agreed to pay the reasonable expenses of the GAs in evaluating and implementing the Restructuring, and such expenses are estimated to be under \$350,000.

The Restructuring was conditional upon receiving a favorable private letter ruling from the Internal Revenue Service holding that the GAs would be treated as receiving the Reliance stock in their capacity as creditors of Reliance for purposes of [Section] 382(l)(5)(A)(ii) and [Section] 1.382-9(b)(2) of the Code and that the GAs would be treated as owning Reliance stock which meets the

requirements of [Section] 1504(a)(2) under [Section] 382(l)(5)(A)(ii) of the Code. The necessary ruling was received on August 24, 2016.

...

Application, ¶¶ 8-12. Attached to the Application for approval are the Redemption Agreement among Reorganized RFS, the RGH Trust² and Reliance,³ the Guaranty Associations Shareholders' Agreement pertaining to the issuance of shares of Reliance common stock (restricted) to the GAs, and the Indemnification Agreement, whereby Reliance agrees to indemnify and hold the GAs harmless from any liability associated with the restructuring.

Pursuant to Article V of the Insurance Department Act of 1921 (Act),⁴ the Liquidator has broad discretion to take action that is necessary to conserve or protect the Estate assets and property. *See* Section 523, 40 P.S. § 221.23. The Court will defer to the Liquidator's authority and discretion in administering the Estate unless there is an abuse of discretion. *Koken v. Colonial Assurance Co.*, 885 A.2d 1078, 1095 (Pa. Cmwlth. 2005) (single judge op.). As described in the Application, the Liquidator's restructuring proposal and her averments regarding its purpose and necessity demonstrate an exercise of sound discretion. Accordingly, the Court grants the Application.

NOW, November 22, 2016, the Court hereby orders as follows:

1. The Application is granted.

² Following bankruptcy, RGH converted to a liquidating trust.

³ The Redemption Agreement includes the Amended NOD to RGH Liquidating Trust.

⁴ The Act of May 17, 1921, P.L. 789, *as amended*. Article V was added by the Act of December 14, 1977, P.L. 280, *as amended*, 40 P.S. §§ 221.1 – 221.63.

2. The following documents are approved as necessary to implement the Restructuring:

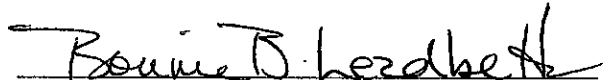
a. the Redemption Agreement attached as Exhibit A to the Application as well as the Amended NOD to RGH Liquidating Trust;

b. the Guaranty Associations Shareholders' Agreement attached as Exhibit B to the Application; and

c. the Indemnification Agreement attached as Exhibit D to the Application.

3. The reduction in the debt owed by Reliance to the Guaranty Associations in the amounts and for the claims set forth in Exhibit C to the Application is hereby approved.

4. Further, the Liquidator is authorized to take all action necessary to execute, deliver, perform and implement all agreements set forth above and to take any additional action necessary to implement the Restructuring.


BONNIE BRIGANCE LEADBETTER,
Senior Judge

Certified from the Record