

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN, :
Insurance Commissioner of the :
Commonwealth of Pennsylvania, :
 :
Plaintiff, :
 :
v. :
 :
RELIANCE INSURANCE CO., :
 :
Defendant. :
_____ :

No. 269 M.D. 2001

RECEIVED AND FILED
PHILADELPHIA
COMMONWEALTH COURT
OF PENNSYLVANIA
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**RESPONSE OF REHABILITATOR TO PETITIONERS' ANSWER TO
PRELIMINARY OBJECTIONS AND SUR-REPLY TO PETITION FOR THE
APPOINTMENT OF A COMMITTEE OF POLICYHOLDERS**

M. Diane Koken, Commissioner of Insurance of the Commonwealth of Pennsylvania, in her capacity as statutory Rehabilitator (hereinafter "Rehabilitator") of the Reliance Insurance Company (hereinafter "Reliance"), respectfully submits this Response to Petitioners' Answer to Preliminary Objections and Sur-reply to the Petition for the Appointment of a Committee of Policyholders, filed May 30, 2001. The Petition should be denied.

**SUR-REPLY IN OPPOSITION TO PETITION FOR THE APPOINTMENT
OF A COMMITTEE OF POLICYHOLDERS**

**Petitioners' Memorandum of Law is Inaccurate and Misconstrues the
Insurance Department Act**

1. The Act Confers Broad Discretion Upon the Insurance Commissioner

In their Memorandum of Law, Petitioners wrongly frame the issue as whether the Court or the Insurance Commissioner is authorized by the Insurance Department Act of 1921 (hereinafter, the "Act") to appoint a policyholder committee during the rehabilitation of Reliance. See Petitioners' Memorandum of Law in Support of Petition for Appointment of Committee of Policyholders (filed Jun. 26, 2001) at 4 (hereinafter, "Petitioners' Brief"). But the Rehabilitator's opposition does not rest on any lack of authority on her part. Rather, the Rehabilitator has the authority, as well as the discretion, to consider the appointment of a policyholder committee. See Pa. Con. Stat. §§ 221.1(c), 221.14, 221.15. As a result, for the reasons stated below as well as those reasons contained in the Rehabilitator's Response to the Petition for the Appointment of a Committee of Policyholders ("Response"), the Rehabilitator opposes the appointment of a policyholder committee in this proceeding.

As both this Court and the Supreme Court of Pennsylvania have recognized, under the Act, the Rehabilitator is afforded "broad supervisory powers to regulate the insurance business in the Commonwealth, [and] . . . the power to protect the interests

of insureds, creditors, and the public generally.” Foster v. Mutual Fire, Marine and Inland Ins. Co., 531 Pa. 598, 608; 614 A.2d 1086, 1091 (1992) (internal quotations and citations omitted) (citing 40 Pa. Cons. Stat. § 221.1(c)); see also 40 Pa. Cons. Stat. §§ 221.14-221.15. The Commonwealth Court in Grode v. Mutual Fire, Marine and Inland Ins. Co. described the interrelated roles of the Insurance Commissioner and the Court, as follows:

[W]e perceive that the Rehabilitator’s broad powers in [rehabilitation] proceedings are circumscribed by this Court’s mandate to act as a check on potential discretionary abuse and to insure equitable apportionment of loss.

132 Pa. Cmwlth. 196, 209; 572 A.2d 798, 804 (1990). The Supreme Court in Foster added that “this great deference in favor of the Insurance Commissioner and the resulting narrow scope of review for the courts are in recognition of the expertise of the administrative agency or individual officer assigned the task of regulating [the insurance] industry.” Foster, 614 A.2d at 1093 (citations omitted).

The appointment of policyholder committees during the statutory rehabilitations of Mutual Fire, Marine and Inland Insurance Company (hereinafter, “Mutual Fire”) and The Fidelity Mutual Life Insurance Company (“FML”) is beside the point. Nothing about the fact that these committees existed in two unrelated rehabilitations requires their existence here. The circumstances here are entirely different.

For instance, in *Mutual Fire*, the appointment of a policyholder committee followed the Court's observation that the Rehabilitator of *Mutual Fire* had not notified all policyholders of the impact of the original plan of rehabilitation on their interests. See Grode, 572 A.2d at 801. Here, no plan has been filed and Petitioners have made no allegation that the Rehabilitator has abused her discretion in any way. Indeed, Petitioners admit that they "do not contend, and have no reason to believe, that the Commissioner as statutory rehabilitator will act in any way improperly." See Petitioners' Brief at 7. By conceding that the Insurance Commissioner (1) has not abused her discretion; (2) has given Petitioners no reason to believe that she will abuse her discretion; and (3) has not taken any action requiring this Court to exercise its equitable powers to safeguard the interests of policyholders, Petitioners must concede that there is no basis for interfering with the Rehabilitator's discretion to reject the appointment of a policyholder committee. See Grode, 572 A.2d at 804; see also Foster, 614 A.2d at 1093.

In *FML*, the Rehabilitator chose not to oppose the appointment of a policyholder committee. The Commissioner's decision was influenced, in part, by the circumstances of the *FML* rehabilitation, circumstances which are absent from the rehabilitation of *Reliance*. For example, the *FML* rehabilitation involved a mutual life insurance company and policyholders with certain rights to the cash value of their policies and an ownership or membership interest in the insurer's estate. See

Response, ¶¶ 25-26. The policyholder/insurer relationship at issue in the rehabilitation of Reliance, a property/casualty insurer, is completely different. See, generally, Response.

Accordingly, neither the FML nor the Mutual Fire cases provides a basis for a policyholder committee here.

2. The Rehabilitator's Interests Are *Not* Separate and Distinct from the Interests of Policyholders

Disregarding the explicit terms of the Act, Petitioners contend that “[t]he interests . . . of policyholders are separate and distinct from the interests . . . of Reliance, the Commissioner, [and] the Insurance Department” See Petitioners’ Brief at 6. This assertion simply restates Petitioners’ previous incorrect statement that policyholders would be left un-represented without the appointment of a committee. See Petition for the Appointment of a Committee of Policyholders, ¶ 8. Petitioners are wrong. See Response, ¶ 13. Both this Court and the Supreme Court have recognized that it is the “statutorily charged duty of the Rehabilitator to protect the interests of . . . insureds.” Foster, 614 A.2d at 1104; Grode, 572 A.2d at 811.

Far from serving as a basis for the appointment of a policyholder committee, it is precisely because of the possibility that “policyholders . . . are most likely victims of the poor business judgments made by Reliance, are geographically diverse, unsophisticated in the insurance industry, and lack the concentrated resources of other

major categories of interested parties,” see Petitioners’ Brief at 6, that the Pennsylvania legislature has charged an arm of the Commonwealth, the Insurance Department, with the duty to safeguard the interests of all policyholders. See 40 Pa. Cons. Stat. §§ 221.1, 221.14, 221.15. Nor does the possibility of future liquidation proceedings and the resort to Guaranty Associations demonstrate that the Insurance Commissioner’s interests conflict with those of policyholders. See Petitioners’ Brief at 7. First, Petitioners’ concern is wholly speculative. As this Court noted in Vickodil v. Commonwealth 126 Pa. Cmwlth. 390, 559 A.2d 1010 (1989), it is because difficult decisions affecting the competing interests of policyholders will need to be made that the regulation of insolvent insurers is entrusted to a public, rather than a private entity. In Vickodil, this Court stated:

We conclude that the statute imposes the duty to act with a broader view toward minimizing inevitable financial harm to all policyholders, creditors and the general public. Implicit is the realization that when an insurance company is under threat of insolvency, or in a financially “hazardous” condition, individual interests may need to be compromised in order to avoid greater harm to a broader spectrum of policyholders and the public.

Vickodil, 559 A.2d at 1013. The Act confers this duty upon the Insurance Commissioner, not a committee of private policyholders, whose motivation may prevent the broader view of policyholder interests required by the Act to be considered by the Insurance Commissioner.

There being no divergence of interests between policyholders and the

Rehabilitator, the appointment of a policyholder committee is unwarranted in this matter, and Petitioners' petition should be denied.¹

3. Petitioners Seek to Usurp the Role of the Court

Petitioners next contend that, in the absence of a policyholder committee, "there can be no redress or relief from the consequences of a completed act [taken by the Rehabilitator] even if it is determined that the Rehabilitator abused her discretion or otherwise proceeded improperly." See Petitioners' Brief at 8. That is clearly wrong. This Court has the statutory "authority to oversee rehabilitation proceedings in this Commonwealth[,]" Grode, 572 A.2d at 804, and the power to remedy an abuse of the Rehabilitator's discretion. The Pennsylvania Supreme Court explained:

The Commonwealth Court is empowered by the General Assembly to supervise and review the activities and proposals of the Insurance Commissioner while she undertakes the rehabilitation of an insolvent insurer. In overseeing the course of rehabilitation to check any abuse of discretion by the Commissioner, the Commonwealth Court is authorized to approve or disapprove the plan of rehabilitation proposed, or may modify it and approve it as modified. If it is approved, the rehabilitator shall carry out the plan. Therefore, in order for [a plan] to warrant the Commonwealth Court's imprimatur it must be found to be free from any abuse of the Rehabilitator's discretion.

Foster, 614 A.2d at 1091 (internal citations, quotations and alterations omitted, emphasis added); see Grode, 572 A.2d at 804. Thus, even without the appointment of

1 Ironically, shortly after contending that the Commissioner is incapable of protecting the interests of all policyholders, Petitioners contend that a policyholder committee will have no problem representing the admittedly divergent interests of the policyholders as a class. See Petitioners' Brief at 8-9. The legislature, in enacting the Insurance Department Act has determined, contrary to Petitioners' position, that the Insurance Commissioner, charged with protecting the public welfare, is better situated to protect the interests of this divergent group of policyholders.

a policyholder committee, any potential abuse of discretion by the Rehabilitator may be reviewed and redressed by this Court.

4. **The Appointment of Policyholder Committee Will Not Aid Judicial Economy or the Efficient Resolution of this Rehabilitation**

Petitioners contend that “judicial economy [is] best served if policyholder issues are advocated by a single voice.” See Petitioners’ Brief at 6. The Rehabilitator agrees, but the voice chosen by the legislature is that of the Insurance Commissioner. See 40 Pa. Cons. Stat. §§ 221.1, 221.14, 221.15.

Petitioners further contend that “[e]stablishment of a committee of policyholders, the costs of which would be charged to the estate of Reliance as an expense of administration, is the most equitable and efficient procedure for providing policyholder representation and for fairly allocating the necessary cost of policyholder participation.” See id. at 9. This contention is wholly unsupported by the recent history of the appointment of policyholder committees by this Court. In the rehabilitation of Mutual Fire, the Pennsylvania Supreme Court noted that the policyholder committee impeded efficient administration and judicial economy. Foster, 614 A.2d at 1104 n.14. The Foster court stated that “in view of the testimony offered regarding the Committee’s numerous attempts to interfere with the Plan [of rehabilitation], ignore Orders of the Court and bill the estate of [the insurer] millions of dollars in expenses and fees, its continued presence may be an unacceptable financial

detriment.” Id. The Insurance Commissioner’s further experience in the rehabilitation of FML prompted her decision that, barring exceptional circumstances not presented here, the appointment of a policyholder committee is not in the best interests of Reliance’s policyholders, creditors or the general public. See 40 Pa. Cons. Stat. §§ 221.1, 221.14, 221.15.

Petitioners also contend that the appointment of a policyholder committee will aid in the dissemination of information to individual policyholders. See Petitioners’ Brief at 9. However, in the rehabilitation of FML, the Policyholder Committee has had no role in mass communication with the policyholders. Its only interaction with individual policyholders occurs when it is contacted through a letter or telephone call about a specific situation. All mass communication with FML policyholders concerning the status of the rehabilitation has been made by the Rehabilitator.

If the Court believes that some matters brought to it by the Rehabilitator require inquiry or analysis by a third party, the Rehabilitator suggests that limited participation by a court appointed special master may be a more efficient alternative. This Court of course has the authority to follow this alternative procedure, if it believes it is required. See, e.g., In re 322 Boulevard Associates, 143 Pa. Cmwlth. 618, 622, 600 A.2d 630, 632 (1991) (stating that the Commonwealth Court has the authority to appoint masters to assist the Court in carrying out various functions). The Judicial Code, 42 Pa. Cons. Stat. § 101 et seq., specifically provides that the

Commonwealth Court “shall have the power to issue, under its judicial seal, every lawful writ and process necessary and suitable for the exercise of its jurisdiction and for the enforcement of any order which it may make,” including the appointment of masters and other “appointive judicial officers.” See 42 Pa. Cons. Stat. §§ 102, 562. Courts in other jurisdictions have appointed masters to assist in various aspects of insurance insolvency proceedings. See, e.g., In the matter of the Liquidation of Integrity Ins. Co., 598 A.2d 940 (N.J. Sup. Ct. 1991) (referring 26,000 claims against insolvent insurer’s estate to special masters for hearing and decision); Bolton v. Progressive General Ins. Co., 228 N.E.2d 146 (Ill. App. 1967) (issue of whether facts existed to support appointment of state insurance commissioner as rehabilitator for domestic insurance company referred to master for report); Clark v. Preferred Accident Ins. Co. of New York, 97 S.E. 2d 498 (S.C. 1957) (in insolvency proceeding, referring claims against insolvent insurer’s estate to master); In re International Re-Insurance Corp., 86 A.2d 647 (Del. 1952) (same).

In the Order of Appointment, this Court has the authority to define the powers and duties of a master. This approach would avoid the expense, delay and encroachments on the Insurance Commissioner’s broad discretion that have arisen where policyholder committees have been appointed in other rehabilitations.

REHABILITATOR'S RESPONSE TO PETITIONERS' ANSWER TO
PRELIMINARY OBJECTIONS

First Preliminary Objection

1. Petitioners wrongly argue that the Rehabilitator waived her objections to their failure to verify the Petition by filing a substantive answer to the Petition for the Appointment of a Committee of Policyholders. Petitioners' failure to properly verify the Petition, as well as their failure to submit a verified Answer to Preliminary Objections, violates Pa. R. App. P. 123(c).

2. Rule 123(c) provides, in relevant part:

An application or answer which sets forth facts which do not already appear of record shall be verified by some person having knowledge of the facts, except that the court upon presentation of such an application or answer without a verified statement, may defer action pending the filing of a verified statement or it may in its discretion act upon it in the absence of a verified statement if the interests of justice so require.

See Pa. R. App. P. 123(c). First, both the Petition and Petitioners' Answer to the Rehabilitator's Preliminary Objections are unverified, notwithstanding the fact that both filings "set forth facts which do not already appear of record." See id.

3. Petitioners made no attempt to remedy their failure to comply with the rules governing this Commonwealth Court proceeding. Rule 123(c) permits Petitioners to file a curative verified statement. Petitioners continue to ignore the Rules of Procedure, filing an Answer in response to the Preliminary Objections which

is also unverified. Under Rule 123(c), this Court should refrain from considering Petitioners' request for relief until Petitioners provide a verification. See Pa. R. App. P. 123(c).

4. Finally, Petitioners have also provided no reasonable explanation why the "interests of justice" require that this Court decide the instant Petition on the basis of unverified factual allegations. Accordingly, the Petition must be dismissed pursuant to Rules 1028 and 206.3 of the Pennsylvania Rules of Civil Procedure and Rule 123 of the Pennsylvania Rules of Appellate Procedure.

Second and Third Preliminary Objections

5. Petitioners' Answer to the second and third Preliminary Objections does not explain how they satisfy the standing requirement. Standing requires a party to demonstrate that it is aggrieved. See Pennsylvania Game Comm'n v. Pennsylvania Dept. of Environmental Resources, 512 Pa. 121, 127 (1987). Petitioners appear to argue that the entry of the Order of Rehabilitation on May 29 rendered them "aggrieved." See Petitioners' Answer at 4 (contending that "it is the entry of the order of rehabilitation which triggers the right participate . . ."). But the Insurance Department Act clearly provides that the entry of an order of rehabilitation protects and does not harm the rights of policyholders. See 40 Pa. Cons. Stat. §§ 221.1, 221.14, 221.15. Petitioners have identified not one action of the Rehabilitator that would support a contention that they are "aggrieved." Accordingly, the Petition should be

dismissed pursuant to Rule 1028(a)(3) and (5) of the Pennsylvania Rules of Civil Procedure.

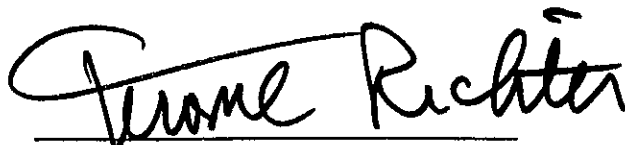
Fourth Preliminary Objection

6. The Petition is legally insufficient for the reasons set forth in the Preliminary Objections of the Rehabilitator of the Reliance Insurance Company to Petition for the Appointment of a Committee of Policyholders, or in the Alternative, Motion to Strike.

CONCLUSION

M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania as Rehabilitator of Reliance Insurance Company respectfully requests that the Petition for Appointment of a Committee of Policyholders be denied.

Respectfully submitted,



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Dated: July 17, 2001

CERTIFICATE OF SERVICE

I, Anthony Vidovich, Esquire, hereby certify that on July 17, 2001, I served a true and correct copy of the foregoing Response of Rehabilitator to Petitioners' Answer to Preliminary Objections and Sur-Reply to Petition for the Appointment of a Committee of Policyholders, via hand-delivery, on:

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