

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN :
Insurance Commissioner of the :
Commonwealth of Pennsylvania, :
 :
Plaintiff :
 :

v. :
 :

RELIANCE INSURANCE COMPANY, :
 :
Defendant :
 :
No. 269 M.D. 2001

ORDER

AND NOW, this day of , 2001, upon consideration of the Petition of Rehabilitator to Supplement May 29, 2001 Order To Address Statutory Deposits, it is hereby ORDERED as follows:

1. The Petition is GRANTED;
2. The Order of May 29, 2001, is hereby supplemented as follows: "Pursuant to Section 221.15(c) of the Insurance Department Act of 1921, the Rehabilitator is specifically authorized, in her sole discretion, to enter into agreements to and otherwise take possession of the statutory deposits held by any state and to do all things necessary to manage and apply the deposits in accordance with any such agreements."

BY THE COURT:

JAMES GARDNER COLINS, Judge

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PHILADELPHIA
COMMONWEALTH COURT
OF PENNSYLVANIA
JUL 31 11 51 AM '01

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN
Insurance Commissioner of the
Commonwealth of Pennsylvania,

Plaintiff

v.

RELIANCE INSURANCE COMPANY,

Defendant

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No. 269 M.D. 2001

**PETITION OF THE REHABILITATOR TO SUPPLEMENT
MAY 29, 2001 ORDER TO ADDRESS STATUTORY DEPOSITS**

Plaintiff M. Diane Koken (the "Rehabilitator"), Insurance Commissioner of the Commonwealth of Pennsylvania in her capacity as Rehabilitator of Reliance Insurance Company ("Reliance"), hereby petitions this Court, pursuant to 40 P.S. § 221.5, for an Order declaring that, under paragraph 5 of this Court's May 29 Order and Section 221.15(c) of the Insurance Department Act of 1921, the Rehabilitator has the authority to enter into agreements with representatives of the various states to take possession of and administer statutory deposits held by those states. In support thereof, the Rehabilitator states as follows:

1. By Order dated May 29, 2001 (the "Rehabilitation Order"), this Court granted the Insurance Commissioner's Petition for Rehabilitation of Reliance, and appointed her Rehabilitator. (A copy of the Rehabilitation Order is attached as Exhibit A).

2. Under Article V of the Insurance Department Act, 40 P.S. §§ 221.1 - 221.63 (the "Act"), the Rehabilitator has full authority to operate Reliance during rehabilitation. She may "take such action as she deems necessary or expedient to correct the condition or conditions which constituted the grounds for the order of the court to rehabilitate the insurer." 40 P.S. § 221.16(b).

3. Under paragraphs 3 and 4 of the Rehabilitation Order, the Rehabilitator has authority to take such action as may be necessary to protect the interests of the policyholders, certificateholders, creditors, or the public.

4. Under paragraph 5 of the Rehabilitation Order, this Court directed the Rehabilitator "to take possession of the assets . . . of Reliance, of whatever nature and wherever located, whether held directly or indirectly." See Rehabilitation Order, ¶ 5 (emphasis added). Similarly, Section 221.15(c) of the Act charges the Rehabilitator with the duty to "take possession of the assets of the insurer" 40 P.S. § 221.16(c).

5. Reliance, as a nationwide property and casualty insurer, was required by statutes in many states in which Reliance transacted business to maintain deposits within the states for the benefit of: (1) policyholders and creditors of Reliance in general; (2) policyholders of Reliance residing or otherwise domiciled in a particular state; or (3) a particular class of Reliance policyholders, *i.e.*, holders of workers compensation policies of insurance. See, e.g., Cal. Ins. Code §§ 11690 et seq.; Mass. Gen. Law 175 § 180J. These deposits are referred to below as Reliance's "statutory deposits."

6. The purpose of statutory deposits is to pay claims of policyholders and their claimants domiciled in the state that requires and holds the deposit. Prior to rehabilitation,

Reliance ceased writing most new business and began operating in a "run-off" manner, administering claims on policies written before run-off. The Rehabilitator has continued to pay all claims for losses under insurance policies of Reliance. In order to do so, she needs large amounts of cash on a daily basis followed by the collection of reinsurance related to the paid claims. There is a time lag between paying the claims and billing and collecting the reinsurance. Access to cash assets to pay the claims is therefore of critical importance, will protect policyholders, and will thus accomplish the very purpose for which these deposits are collected.

7. The release to Reliance of the statutory deposits is essential to a rehabilitation of Reliance, particularly the Rehabilitator's ability to fund ongoing policyholder claims. The Rehabilitator has determined that, as of May 29, 2001, Reliance's domestic statutory deposits totaled \$346,982,174.

8. The Rehabilitator has requested from the insurance commissioners, directors and superintendents of the states in which the statutory deposits are being held that the statutory deposits be returned to the Rehabilitator to pay the claims of only those policyholders who are covered by the respective statutory deposits. In this manner, for example, the claims of California policyholders would be paid, in part, with the funds of Reliance deposited with the California insurance commissioner. Thus, the Rehabilitator requests to use the statutory deposits precisely for the purpose for which they are intended.

9. Shortly after the filing of the Rehabilitation Order, the Rehabilitator developed three alternative forms of agreement to be executed by the Rehabilitator and individual deposit-holding state insurance commissioners. In her cover letter to the insurance

commissioners, directors and superintendents of the deposit-holding states, the Rehabilitator explained the three alternative forms of agreement as follows:

Option One: "Agreement to Fund Each Month in Advance One Month of Claim Payments" - Under this agreement, an estimate of a month's worth of your residents' claims would be made. You will send that estimated monthly amount to a special account under my control. We will use it to pay claims in your state. You will replenish the account every month until the deposit is exhausted.

Option Two: "Agreement to Fund the Entire Deposit into a Claims Fiduciary Account" - Under this agreement, you will send the entire deposit to us immediately and it will be placed in a special account under my control. We will use money from the account only to pay claims of residents of your state until such time as the deposit is exhausted.

Option Three: "Agreement to Release Entire Deposit with a Return Provision" - Under this option, you would send the entire deposit to us on an immediate basis. Under the agreement, we would agree to return the pro rata share of any claimants' portion of the deposit that can demonstrate that they were entitled to have been covered by the deposit and did not receive any payment. This agreement is generally designed for small deposits, where the liabilities in the state far exceed the deposit.

See Letter of the Rehabilitator (dated June 8, 2001).

10. Four states, aside from Pennsylvania, have agreed to return to the Rehabilitator statutory deposits of Reliance totaling \$7,657,000. These states are Delaware, Indiana, Oklahoma and Wyoming. The statutory deposits of Reliance maintained under Pennsylvania law and released to the Rehabilitator total \$4,479,000.

11. The California Insurance Commissioner holds in excess of \$213,000,000 of statutory deposits. In his review of the request of the Rehabilitator to release the statutory deposits for California, the Commissioner questioned the Rehabilitator's authority to negotiate the release of these funds under the Rehabilitation Order. Specifically, in a letter to

the Rehabilitator, he stated, "the rehabilitation order entered on May 29, 2001, does not expressly provide for the Rehabilitator to enter into agreements regarding the management of statutory deposits held by other states, and in fact it only states that Reliance shall not post additional statutory deposits."

12. The Rehabilitator believes that the California Insurance Commissioner's interpretation of the Rehabilitation Order is incorrect. Both Section 221.15(c) of the Act and paragraph 5 of the Rehabilitation Order direct the Pennsylvania Insurance Commissioner as Rehabilitator for Reliance to take possession of all assets of Reliance. The statutory deposits, which were made wholly with the funds of Reliance, clearly constitute assets of Reliance. Nevertheless, it will assist the efforts of the Rehabilitator to obtain the statutory deposits in California and elsewhere for the Order to expressly provide for her authority in this regard.

13. The Rehabilitator's efforts to obtain possession of the statutory deposits from California, and other states, will be assisted if the Rehabilitator has specific authority to negotiate and enter into agreements, the purpose of which is to obtain the use of the statutory deposits to pay policyholder claims.

14. Other state insurance commissioners have inquired as to California's position with regard to the deposits, as California has by far the most deposit funds.

15. To assist the Rehabilitator in securing possession of the statutory deposits, to address a major concern raised by the California Insurance Commissioner, and to deter other states from taking a position similar to that of California, the Rehabilitator seeks an order from this Court supplementing the Rehabilitation Order and stating that the

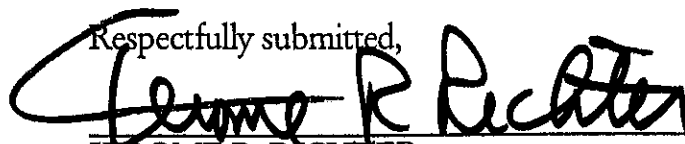
Rehabilitator has specific authority to enter into agreements with other states pertaining to the release of the statutory deposits to the Rehabilitator and to otherwise take possession of and manage and apply such deposits. See 40 P.S. §§ 221.15(c), 221.16(b).

16. Without a supplemental order, the Rehabilitator may be unable to persuade the State of California and other states to release Reliance's statutory deposits, and actions by other states may further "lessen the value of the insurer's assets [and] prejudice the rights of policyholders, creditors . . . [and] the administration of the[se] [rehabilitation] proceedings." 40 P.S. § 221.5(a). Under the Act, this Court clearly has the authority to issue the Order requested. See id.

17. As the ability of the Rehabilitator to develop an effective plan of rehabilitation for Reliance significantly depends on whether Reliance's statutory deposits will be available to fund policyholder claims, the Rehabilitator respectfully requests that the Court consider this Petition on an expedited basis.

WHEREFORE, the Rehabilitator requests an order from this Court holding that the Insurance Commissioner of the Commonwealth of Pennsylvania as Rehabilitator of Reliance Insurance Company has the authority pursuant to the Rehabilitation Order and Section 221.15(c) of the Pennsylvania Insurance Department Act of 1921, in her sole discretion to enter into agreements to and otherwise take possession of statutory deposits held by other states and to do all things necessary to manage and apply the deposits in accordance with any such agreements.

Respectfully submitted,



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Counsel for Petitioner,
M. DIANE KOKEN, Insurance Commissioner of the
Commonwealth of Pennsylvania in her capacity as
Rehabilitator of RELIANCE INSURANCE
COMPANY

Of Counsel:

DAVID F. SIMON
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THE COMMONWEALTH OF PENNSYLVANIA
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(717) 787-6009

Dated: July 31, 2001

EXHIBIT A

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

Plaintiff

v.

Reliance Insurance Company,

Defendant

Docket No. 269 MD 2001

ORDER

AND NOW, this 29th day of May, 2001, upon consideration of the Petition for Rehabilitation ("Petition") filed by the Insurance Commissioner of the Commonwealth of Pennsylvania ("Commissioner"), the Court hereby finds that it is in the best interest of Reliance Insurance Company ("Reliance"), its policyholders, certificateholders and creditors, and the public, that Reliance be placed into Rehabilitation in accordance with provisions of Article V of the Insurance Department Act of 1921, Act of May 17, 1921, P.L. 789, as amended, 40 P.S. §§221.1-221.63, and that sufficient grounds exist for the entry of an Order of Rehabilitation ("Order"), based on Reliance's consent to rehabilitation under 40 P.S. §221.14(12). All references to "Reliance" hereinafter shall include the former subsidiaries which were previously merged into Reliance by approval of the Commissioner: Reliance National Indemnity Company, Reliance National Insurance Company, United Pacific Insurance Company, Reliance Direct Company,

Reliance Surety Company, Reliance Universal Insurance Company, United Pacific Insurance Company of New York and Reliance Insurance Company of Illinois.

NOW, therefore, it is hereby ORDERED, JUDGED AND DECREED that:

1. The Petition for Rehabilitation filed by the Commissioner is granted.
2. Reliance is hereby placed in rehabilitation pursuant to the provisions of Article V of the Insurance Department Act, supra.
3. M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, is, and her successors in office are, hereby appointed Rehabilitator of Reliance, directed to take immediate possession of its property, business and affairs as Rehabilitator pursuant to the provisions of Article V of the Insurance Department Act, supra, and to take such action as the nature of this case and the interests of the policyholders, certificateholders, creditors, or the public may require.
4. The Rehabilitator shall have full powers and authority given the Rehabilitator under Article V of the Insurance Department Act, supra, and under provisions of all other applicable laws, as are reasonable and necessary to fulfill the duties and responsibilities of the Rehabilitator under Article V of the Insurance Department Act, supra, and under this Order.

ASSETS OF THE ESTATE

5. As provided in Section 515(c) of Article V of the Insurance Department Act, supra, as Rehabilitator, the Commissioner is hereby directed to take possession of the assets (including the assets of Reliance Lloyds), contracts and rights of action of Reliance, of whatever nature and wherever located, whether held directly or indirectly. According to Section 515(c), supra, "the filing or recording of this Order with the clerk of the Commonwealth Court or recorder of deeds of the county in which the principal business of Reliance is conducted, or the county in which its principal office or place of business is located, shall impart the same notice as a deed, bill of sale or other evidence of title duly filed or recorded with that recorder of deeds would have imparted."

6. All banks, investment bankers, or other companies, entities, or persons having in their possession assets which are, or may be, the property of Reliance are hereby ordered to advise the Rehabilitator, any agents and attorneys for the Rehabilitator (collectively, the "Rehabilitator") immediately of such assets and to identify such assets for the Rehabilitator, and are further ordered not to disburse, convey, transfer, pledge, assign, hypothecate, encumber or in any manner dispose of such assets without the prior written consent of, or unless directed in writing by, the Rehabilitator. Any checks or other payments which have, as of the date of this Order, been actually mailed or actually delivered to the payee will, provided same are otherwise proper and in compliance with relevant law, be honored without prejudice to the rights of the Rehabilitator regarding recoupment from the recipient. Such persons and entities, and all other persons and

entities, are enjoined from disposing of or destroying any records pertaining to any business transactions between Reliance and banks, brokerage houses or other persons or companies having done business with Reliance or having in their possession assets, which are, or were, the property of Reliance.

7. All insurance agents, brokers or other persons having sold policies of insurance and/or collected premiums on behalf of Reliance shall account for all earned premiums and commissions and shall account for and pay all premiums and commissions unearned due to policies canceled in the normal course of business, directly to the Rehabilitator at the offices of Reliance within 30 days of the date of this Order, or the date of receipt, whichever is later, or appear before this Court to show good cause as to why they should not be required to account to the Rehabilitator. No insurance agent, broker, or other person shall use premium monies owed to Reliance for refund of unearned premiums or for any purpose other than payment to the Rehabilitator. Such insurance agents, brokers or other persons may be held in contempt of Court for violation of the provisions of this Order.

8. At the request of the Rehabilitator, all attorneys employed or retained by Reliance as of the date of this Order shall, within 30 days of such request, report to the Rehabilitator the name, company claim number, if applicable, and status of each case or matter they are handling on behalf of Reliance.

9. At the request by the Rehabilitator, any company providing telephone service to Reliance shall provide new telephone numbers and refer calls from the numbers presently assigned to Reliance to any such new numbers and perform any other changes necessary to the conduct of the Rehabilitation of Reliance.

10. Any premium finance company which has entered into a contract to finance a policy which has been issued by Reliance shall pay the premium owed to Reliance directly to the Rehabilitator at the Offices of Reliance.

11. The United States Postal Service is requested to provide any information requested regarding Reliance and to handle future deliveries of Reliance mail, as directed by the Rehabilitator.

12. Any entity furnishing water, electric, sewage, garbage or trash removal services to Reliance shall maintain such services and transfer any such accounts to the Rehabilitator as of the date of this Order, unless instructed to the contrary by the Rehabilitator.

13. Any outside entity which has custody or control of any data processing information and records including, but not limited to, source documents, all types of electronically stored information, master tapes or any other recorded information relating to Reliance, shall transfer, at the request of the Rehabilitator, custody and control of such records to the Rehabilitator.

14. At the request of the Rehabilitator, Reliance, its officers, directors, trustees, employees, agents and attorneys are hereby ordered to deliver to the Rehabilitator keys or access codes to the premises where Reliance conducts its business and to any safe deposit boxes, and to advise the Rehabilitator of the combinations or access codes of any safes or safe keeping devices of Reliance.

15. Reliance, its officers, directors, trustees, employees, agents and attorneys are hereby ordered to identify for the Rehabilitator all of the assets, books, records, files, credit cards, or other property of Reliance, to tender or make readily available to the Rehabilitator, at the Rehabilitator's request, all of the foregoing, and to advise and cooperate with the Rehabilitator in identifying and locating any of Reliance's assets.

16. Except for policies and contracts of insurance, the Rehabilitator, in her discretion, may affirm or disavow any executory contracts to which Reliance is a party. The entry of this Order of Rehabilitation shall not constitute an anticipatory breach of any such contracts.

EXPENSES, POLICYHOLDER AND CERTIFICATEHOLDER CLAIMS,

OTHER PAYMENTS AND LAWSUITS

17. The Rehabilitator may, in her discretion, pay expenses incurred in the ordinary course of Reliance's business in rehabilitation and may, in her discretion, pay

the actual, reasonable, and necessary costs of preserving or recovering the assets of Reliance and the costs of goods and services provided to Reliance's estate. Such costs shall include but not be limited to: (a) reasonable professional fees for accountants, actuaries, attorneys and consultants with other expertise retained by the Commonwealth of Pennsylvania Insurance Department ("Department"), the Commissioner or the Rehabilitator to perform services relating to the Rehabilitation of Reliance or the preparation, implementation, or operation of a rehabilitation plan; (b) compensation and other costs related to representatives and employees of Reliance; and (c) a reasonable allocation of costs and expenses associated with time spent by Department personnel in connection with the rehabilitation of Reliance.

18. The Rehabilitator may, in her discretion, pay claims for losses under policies and contracts of insurance and loss adjustment expenses as identified in Section 544(b) of the Insurance Department Act, supra, 40 P.S. §221.44(b). Such discretion of the Rehabilitator shall include the discretion not to pay bad faith claims or claims for extra-contractual damages.

19. No payments of any type shall be made to any claimant of Reliance as identified in Section 544 (c) through (i) of the Insurance Department Act of 1921, supra, 40 P.S. §221.44 (c) through (i), except in the discretion of the Rehabilitator

20. All persons, in the Commonwealth or elsewhere, are enjoined and restrained from: (a) instituting or further prosecuting any action in law or equity against Reliance or the Rehabilitator; (b) obtaining preferences, judgments, attachments, garnishments or liens, including obtaining collateral in any litigation, mediation, or arbitration involving Reliance, the Rehabilitator, or Reliance's assets and property; (c) levying any execution process against Reliance, the Rehabilitator or Reliance's assets and property in the Commonwealth of Pennsylvania or elsewhere; and (d) making any assessments or indirectly collecting such assessments by setting them off against amounts otherwise payable to Reliance.

21. Reliance shall not post additional statutory security deposits in any state.

22. All actions currently pending against Reliance in the Courts of the Commonwealth of Pennsylvania or elsewhere are hereby stayed. All actions currently pending in the Courts of the Commonwealth of Pennsylvania or elsewhere against an insured of Reliance are stayed for 60 days or such additional time as the Rehabilitator may request. This Order shall not preclude any action from proceeding prior to the expiration of 60 days provided that the Rehabilitator and the parties to any such pending actions have so agreed to proceed.

23. No judgment or order against Reliance or an insured of Reliance entered after the date of filing of the Petition for Rehabilitation and no judgment or order against

Reliance or an insured of Reliance entered at any time by default or by collusion need be considered as evidence of liability or quantum of damages by the Rehabilitator.

REINSURANCE

24. The amounts recoverable by the Rehabilitator from any reinsurer of Reliance shall not be reduced as a result of this rehabilitation proceeding or by reason of any partial payment or distribution on a reinsured policy, contract or claim, and each such reinsurer of Reliance is without first obtaining leave of Court, hereby enjoined and restrained from terminating, canceling, failing to extend or renew, or reducing or changing coverage under any reinsurance policy or contract with Reliance. The Rehabilitator may terminate or rescind any contract with a reinsurer or reinsurers that is contrary to the best interests of the estate in rehabilitation.

NEW OR RENEWAL BUSINESS

25. The Rehabilitator is authorized to accept or reject new or renewal business.

INJUNCTION AGAINST INTERFERING WITH REHABILITATION

26. Until further order of this Court, all persons, corporations, partnerships, associations, custodians, and all other entities, wherever located, are hereby enjoined and

restrained from interfering in any manner with the Rehabilitator's possession, title and rights to the assets and property of Reliance and from interfering in any manner with the conduct of the rehabilitation of Reliance. Those persons, corporations, partnerships, associations, custodians, and all other entities are hereby enjoined and restrained from wasting, transferring, selling, concealing, terminating, canceling, destroying, disbursing, disposing of, or assigning any assets, contracts, causes of action, funds, records or other property of any nature of Reliance.

INJUNCTION AGAINST ACTIONS BY SECURED CREDITORS

27. All secured creditors or parties, pledgees, lienholders, collateral holders or other person claiming secured, priority or preferred interests in any property or assets of Reliance are hereby enjoined from taking any steps whatsoever to transfer, sell, assign, encumber, attach, dispose of, or exercise, purported rights in or against any property or assets of Reliance.

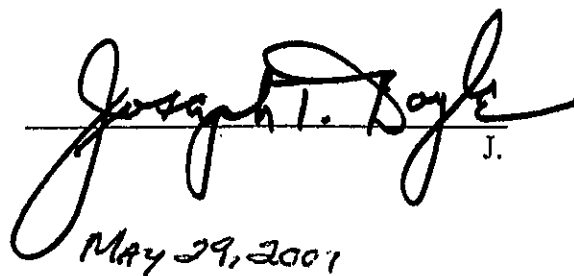
NOT A DECLARATION OF INSOLVENCY

28. This Order shall not be deemed a finding or declaration of insolvency such as would activate the provisions of the Pennsylvania Property and Casualty Insurance Guaranty Association Act, 40 P.S. §§991.1801-991.1820, or the Pennsylvania Life and Health Insurance Guaranty Association Act, 40 P.S. §§991.1701-991.1718, or the provisions of similar acts of any other state.

JURISDICTION

29. This Court shall retain jurisdiction for all purposes necessary to effectuate and enforce this Order.

BY THE COURT,


J.
May 29, 2001

Certified from the Record

MAY 29 2001
and Order Exit

VERIFICATION

I, William S. Taylor, am the authorized agent and employee of the Statutory Rehabilitator in this action and hereby verify that the statements made in the foregoing Emergency Petition of the Rehabilitator to Supplement May 29, 2001 Order to Address Statutory Deposits are true and correct to the best of my knowledge, information and belief.

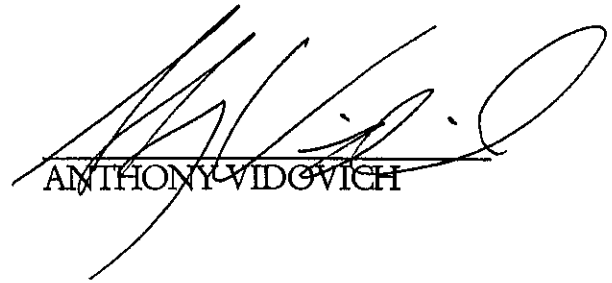
I understand that the statements in said Emergency Petition are made subject to the penalties of 18 Pa. C.S. § 4904 relating to unsworn falsification to authorities.

Date: 7-31-01

William S. Taylor
William S. Taylor
Deputy Insurance Commissioner
Pennsylvania Insurance Department
Office of Liquidations, Rehabilitations and
Special Funds

CERTIFICATE OF SERVICE

I, Anthony Vidovich, hereby certify that there are no parties upon whom service of the foregoing Petition to Supplement May 29, 2001 Order to Address Statutory Deposits is required.



ANTHONY VIDOVICH