

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN
Insurance Commissioner of the
Commonwealth of Pennsylvania,
in her official capacity as Liquidator of
RELIANCE INSURANCE COMPANY,

Plaintiff,

v.

RELIANCE INSURANCE COMPANY,

Defendant.

DOCKET NO. 269 M.D. 2001

ORDER

AND NOW, this _____ day of _____ 2004, upon consideration of the
Petition to Approve Sale of Reliance National Asia Re Pte Limited, it is hereby ORDERED and
DECREED that the Petition is GRANTED and the sale of Reliance National Asia Re Pte
Limited on the terms set forth in the Agreement attached to the Petition as Exhibit A is
APPROVED.

JAMES GARDNER COLINS
PRESIDENT JUDGE

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

v.

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Defendant.

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**PETITION TO APPROVE SALE OF RELIANCE
NATIONAL ASIA RE PTE LIMITED**

Pursuant to the Court's Orders of November 30, 2001, regarding the administration of assets and January 22, 2002, regarding guidelines for subsidiary transactions, Petitioner M. Diane Koken, Insurance Commissioner of Pennsylvania (the "Liquidator"), in her official capacity as Liquidator of Reliance Insurance Company ("Reliance"), respectfully requests that the Court enter an Order approving the Agreement dated February 10, 2004 ("Agreement") relating to the Sale and Purchase of the Entire Issued Share Capital of Reliance National Asia Re Pte Limited ("RNA"). In accordance with the terms of the Agreement, the Liquidator respectfully requests that this Petition be granted as soon as possible before March 31, 2004.

In support of this Petition, the Liquidator avers the following:

BACKGROUND

1. On October 3, 2001, this Court found Reliance insolvent and appointed the Commissioner as Liquidator pursuant to Article V of the Insurance Department Act of 1921, 40 P.S. § 221.1 et seq. (the "Act").

2. The Act confers broad powers on the Liquidator to dispose of the assets of Reliance in order to maximize the value of the insolvent insurer's estate for eventual distribution to its policyholders and creditors. See 40 P.S. § 221.23.

3. On January 22, 2002, the Court entered an Order approving guidelines for subsidiary transactions. In that Order, the Court required the Liquidator to obtain advance Court approval of (among other things) sales of any direct subsidiary.

4. RNA is a wholly owned subsidiary of Reliance. The Liquidator herein seeks approval of the Agreement for Reliance to sell the entire issued share capital of RNA to Omni Whittington Investments (Guernsey) Limited ("Omni"). A copy of the Agreement is attached hereto as Exhibit A.

5. Under the Agreement, Omni is to pay RNA in Singapore dollars ("S\$"). As of February 26, 2004, according to information published in the Wall Street Journal, one Singapore dollar is worth approximately \$0.5871. The amount to be paid by Omni is S\$1,000,000 at "Completion" (closing) plus the following deferred consideration:

(a) 90 percent of the first S\$5,000,000 (in the aggregate) of the liquidating dividends and/or distributions paid by RNA after closing;

(b) 80 percent of the second S\$5,000,000 (in the aggregate) of the liquidating dividends and/or distributions paid by RNA after closing;

(c) 75 percent of any liquidating dividends and/or distributions paid by RNA thereafter.

BUSINESS AND FINANCIAL CONDITION OF RNA

6. RNA is licensed in Singapore and Malaysia to underwrite reinsurance business.

7. RNA's principal broker from 1998 to 2000 for two of its most substantial lines of business was Collard & Partners Limited ("Collard"), an independent Lloyd's insurance broker. Collard is now in Administrative proceedings in the United Kingdom. During the course of its relationship with RNA, due to what was eventually determined to be its ineffective information dissemination process, Collard delayed in relaying information to RNA concerning certain risks, premiums and claims on the lines of business it had brokered. As a result Reliance's books did not reflect such information.

8. Attached as Exhibit B is a one page summary of income and balance sheet information excerpted from RNA's audited financial statements for the years 2000 through 2002 and from unaudited information for December 31, 2003, followed by copies of the audited income statement and balance sheet for 2001 and 2002. The summary shows RNA lost a significant amount of money during its last full year of operations, which was 2000. In 2001 claims continued to mount and despite strong investment income and foreign exchange gains, RNA lost S\$11.6 million.¹ In 2002 losses were reduced to S\$7.1 million, a still substantial sum and a difficult environment in which to be attempting to sell the company. A significant portion of the loss was attributable to the difficulties being experienced by Collard. As a result of the uncertainties arising from the Collard accounting issues, the Singapore Monetary Authority required RNA to post both additional bad debt reserves and loss reserves. Finally in 2003 operations stabilized and losses were almost eliminated. Reliance now believes that is feasible to

¹ The S\$11.6 million amount is larger than the sum of the component amounts which make up the net loss due to rounding of the components

realize 80% or more of the remaining equity if the accelerated runoff planned by Omni is implemented upon closure of this proposed sale.

9. As shown in Exhibit B total assets of RNA were S\$55.5 million in 2000, and total equity was S\$29.9 million. Beginning in 2000, substantial losses emerged and materially eroded the retained earnings and equity in the company. In April 2001, RNA voluntarily ceased writing new policies and formally entered runoff.

10. From a financial soundness perspective, as of December 31, 2000, RNA's equity was 54% of its total assets and 117% of its outstanding liabilities. As of December 31, 2003, its equity was only 40% of its total assets and 67% of its outstanding liabilities. RNA has value, but it has declined rapidly.² The decline in both of these ratios over this time period is a cause for serious concern.

EFFORTS BY THE LIQUIDATOR TO SELL RNA

11. In view of the long time it would take to run-off RNA and in view of the fact that RNA had value for the Reliance Estate but which value was deteriorating, on May 10, 2002, Reliance appointed PricewaterhouseCoopers Corporate Finance Pte Ltd (PwCCF) to provide financial advice and services in connection with the proposed sale of RNA.

12. PricewaterhouseCoopers Corporate Finance Pte Ltd is a limited liability company incorporated in Singapore, which is licensed as an "Investment Adviser" by the Monetary Authority of Singapore, the regulatory authority in Singapore. It is part of PricewaterhouseCoopers, which refers to the network of member firms of

² The equity as a percentage of total assets calculation provides an analyst with the amount of dilution to asset values that can be withstood before there would be an inability to pay all liabilities. The equity as a percentage of outstanding liabilities calculation provides an analyst with the amount of cushion that exists to absorb worsening liabilities, an important factor to regulators.

PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. PwCCF is authorized to engage in certain financial advisory activities, and provides advice and assistance to clients on a range of corporate finance matters.

13. Specifically, PwCCF was retained to assist Reliance in: (a) preparing, on the basis of information provided by Reliance, an information memorandum summarizing RNA's business and affairs; (b) soliciting from potential bidders interest in acquiring RNA; (c) assisting Reliance in identifying and contacting potential bidders; (d) distributing the information memorandum and supplemental information to potential bidders on Reliance's behalf; (e) organizing and administering the due diligence process; and (f) analyzing and negotiating the terms of expressions of interest and offers received by Reliance.

14. As is more fully set forth in Exhibit C hereto, a letter from PwCCF dated February 27, 2004 describing the process and the reason for it, PwCCF advised RNA to sell RNA through a "controlled auction process." As is stated in that letter, the controlled auction methodology was selected to help ensure that RNA, despite its financial difficulties, could make appropriate disclosures of its financial condition and still be in a position to maintain bargaining power with potential buyers.

15. In May 2002, PwCCF and Reliance compiled a "long" list of forty three (43) potential purchasers. The list included companies that specialized in run-off situations and also global reinsurers and regional reinsurers and insurers. PwCCF advised that four of the parties on the long list were considered to be unlikely buyers based on funding constraints and/or lack of strategic fit and were excluded from the "short list" of thirty nine (39) potential purchasers who were initially solicited.

16. First Phase of the Auction Process (beginning August 2002). Of the 39 potential purchasers initially solicited to bid for RNA, six (6) requested further information with a view to submitting an offer. Each of those entities was provided with an information memorandum. Each was also asked to provide specific criteria in its bid, including, among other matters, proposed price, method of funding and key terms of purchase; details of the bidder's financial standing and capitalization; and a description of its insurance business. Of the six, four (4) parties, all with experience in operating companies in run-off mode, by September 2002 had submitted detailed expressions of interest, each subject to due diligence and other conditions. The four parties indicated that, subject to their performing due diligence, they would be potentially willing to submit bids, expressed in terms of Singapore dollars, ranging from as low as S\$4 million to as high as S\$12 million. Of those four, the highest potential bidder, Omni, indicated interest at a potential level of S\$10-12 million. According to publicly available information, in September 2002 the Singapore dollar traded at an average of approximately 1.76 Singapore dollars to the US dollar. Such an Omni bid would therefore have been worth between \$5.7 and \$6.8 million.

17. Second Phase of the Auction Process (beginning in October 2002). Two of the four first round interested parties were asked to resubmit their bid proposals because their bids were lower than the other two. These two lower bidders, however, decided not to resubmit their proposals. The two remaining higher bidders were invited to proceed with a data room visit as part of due diligence to be followed by the submission of a firm and final bid offer. One of the two, Omni, proceeded with its due diligence and a question and answer session with RNA management facilitated by PwCCF. The remaining bidder could not proceed with due diligence because of staff constraints, requested the deferral of a data room visit until the first quarter of

2003 and then continued to cite staff constraints as a basis for refraining from complying with PwCCF repeated requests to proceed. That bidder never followed through.

18. After completing its due diligence, Omni was still willing to make a bid, but did so with a bid to purchase for a fixed aggregate price at closing both RNA and another Reliance affiliated entity, Reliance National Insurance Company (Europe) Limited ("RNICE"). When asked to break out the portion of its aggregate price which it would be willing to offer for only RNA, Omni in November 2002 advised that the price, in pounds sterling (£), would be in the range of £1 - 1.25 million. According to publicly available exchange rate information, in November 2002, the pound sterling traded at an average price of \$1.56 to the pound. The Omni bid therefore equated in US dollars to approximately \$1.56 to \$1.95 million and in Singapore dollars to approximately S\$2.75 - S\$3.4 million.

19. Reliance rejected that bid as unacceptable, and concluded instead that before further dealing with Omni respecting RNA, it would pursue a final agreement with Omni for the sale of RNICE. During the period January - October 2003, further action on the effort to sell RNA was suspended due to the lack of acceptable bids and the pendency of the RNICE negotiation. Reliance did not want that negotiation to adversely impact upon the amount it might realize for the sale of RNA, and the suspension of negotiations left open the possibility that in the interim either another bidder or one of the earlier potential bidders would express interest in RNA.

20. Third Phase of the Auction Process (beginning in August 2003). The sale of RNICE was agreed upon in October 2003 and with the consideration being paid in the form of an initial payment plus deferred consideration to be paid based on distribution and/or dividends after completion. The sale was approved by this Court in an Order dated October 6, 2003.

21. Without specifying amounts for the various payment levels, known as tranches, Omni had in August 2003 suggested that it would be willing to offer a similar payment structure for a purchase for RNA. Thereafter, rather than simply accept or negotiate with Omni on the proposal that had been made, PwCCF in August 2003 again contacted the three previously interested parties and provided them with further information about RNA, including an actuary's report on its estimated claims reserves and further details on its financial position. PwCCF advised those parties that a deferred consideration payment structure would be considered. Despite repeated efforts by PwCCF, none of the three previously interested parties made formal bids. This was considered to be attributable to a combination of factors, including the uncertainty of the reconciliation process of RNA's principal broker, Collard, by UK Administrators who had taken over Collard, staff constraints at the contacted parties and lack of serious interest in pursuing the opportunity.

22. As a result of dealing with Omni in the RNICE transaction Reliance personnel had developed a high degree of comfort with the Omni management and their competence and integrity. Reliance personnel had made numerous inquiries within the industry about Omni, its experience and the competence and integrity of its management. The responses to those inquiries were uniformly positive.

23. During the period between Omni's submission of its first bid in August 2002 and the conclusion of the RNICE agreement in October 2003, RNA's financial situation continued to deteriorate. Omni had made its August 2002 bid predicated in part upon RNA's financials as of December 31, 2001, which showed equity in the company at about S\$18.4 million. When the 2002 year-end financials became available in early 2003, equity had declined to S\$11.9 million.

24. Final Negotiations (Beginning in December 2003). In December 2003, Omni negotiated with Reliance and agreed to final transaction terms, pursuant to which, similar to the Omni purchase of RNICE, it would pay an initial consideration (in this case S\$1million) plus deferred consideration payable per a formula based on dividends and/or distributions made by RNA after completion. Based on the fact that there were no other bids, Reliance's confidence in Omni's integrity which led to the negotiation of a deferred consideration arrangement for the sale of RNICE and that Omni's previously rejected fixed price bid was no longer available, PwCCF agreed with Reliance's decision to accept the deferred consideration arrangement. Completion was subject to the approval by March 31, 2004 of the Monetary Authority of Singapore and of this Court.

25. Under the deferred consideration arrangement, if Omni distributes or dividends just S\$5 million, Reliance would receive S\$5.5 million [S\$1 million + .9 (S\$5.0 million)]. That is more than S\$2.5 million higher than the upper range of the fixed price indication of interest expressed by Omni in November 2002. As higher levels of distribution are achieved, Reliance will receive larger amounts as shown by the following chart:

<u>Distributed Amount</u>	<u>RNA Share</u>	<u>Initial Payment</u>	<u>Total To Be Received By RNA</u>
	(in Millions of S\$)		
5	4.5	1.0	5.5
10	8.5	1.0	9.5
15	12.25	1.0	13.25

26. Both Reliance and Omni believe that it is feasible to realize 80% or more of Reliance's remaining equity (S\$11.8 million as of December 31, 2003 on an unaudited basis) if

Omni carries out its plan for accelerated runoff upon closing on this proposed sale. Even only an 80% realization would produce consideration to Reliance of approximately \$9.05 million

VALUATION OF RNA

27. As demonstrated above, valuation of RNA is not a simple task. Valuation in such a circumstance is simply an educated estimate as to what an asset will bring upon reasonable exposure to the marketplace. Given the complexities, the Reliance team, together with PwCCF, determined that given the numerous uncertainties in any valuation of RNA,³ the best way to proceed would be to determine value through the prolonged and extensive exposure to the market.

THE TRANSACTION IS IN THE BEST INTEREST OF THE ESTATE

28. The Liquidator has taken the necessary steps to determine whether the proposed sale of RNA pursuant to the terms in the Agreement constitutes fair value to Reliance. *See* 40 P.S. § 221.23(7), (9) (authorizing the Liquidator to sell all assets of the insurer on fair and reasonable terms).

29. The Liquidator further believes that the terms of the stock sale transaction to Omni are fair and reasonable to Reliance and in the best interests of the insurer's estate, its policyholders, claimants, and the general public. *See* 40 P.S. § 221.1(c). *See also* 40 P.S. §

³ As was proved by the extensive marketing program undertaken by Reliance and PwCCF and the history of negotiations as set forth herein and in Exhibit C the uncertainties that everyone confronted in the bid process concerning RNA's value would have made the validity of any valuation questionable. Some of the significant uncertainties included:

- 1) How to determine amounts which would be owed to or payable by RNA in connection with its relationship with its principal broker, Collard, given Collard's deficiencies in disseminating information about risks, premiums and claims and given that it is in Administrative proceedings;
- 2) Whether additional losses develop that are greater than the reserves established;
- 3) Whether the investment income will be greater than the operating expenses each year going forward; and
- 4) The impact of foreign exchange rates on net realizable value.

221.23(7) (authorizing the Liquidator to "conduct public and private sales of property of the insurer" and "sell, transfer . . . or otherwise dispose of or deal with any property of the insurer at its market value or upon terms and conditions as are fair and reasonable").

30. As recited above and in Exhibit C the proposed sale of RNA to Omni is the result of a lengthy process of exposing RNA for sale to the marketplace in an effort to obtain the best possible return to the Estate.

31. Omni has incentive and is in a position to produce for the Estate the best possible result from the RNA business in run off. It has significant experience in run-off of insurance businesses. Further, it has the ability to place RNA through a "solvent scheme of arrangement" under Singapore law which has the advantage of expediting the claims resolution process, and minimizing the time (and expenses of) the run off. This should assist in increasing the distribution from RNA's business.

32. The proposed sale is structured so that Reliance gets nearly all of the first distributions and Omni only reaps substantial profits if it is successful in administering the run off. The Reliance negotiating team believes RNA will obtain, in addition to the initial S\$1 million, at least another S\$8.5 million in distributions by year 2008.

33. To the extent possible under the circumstances, given the goal of maximizing the sale price for the benefit of the estate, the Liquidator has complied with the Court's Orders of November 30, 2001 (approving guidelines for the administration of Reliance's assets) and January 22, 2002 (governing, among other things, sales of subsidiaries). The transaction was negotiated at arms-length with the only party that made an offer after performing due diligence. It was obtained after a substantial marketing effort. Reliance believes that the offer now

accepted will prove to be substantially more beneficial than the November 2002 offer by the same party which was rejected.

34. As is evidenced by Exhibit C, PwCCF which assisted throughout the extensive sale process has opined that, from a financial point of view, the proposed sale is a "fair and reasonable result of a reasonable sale process."

35. Accordingly, the Liquidator respectfully requests that this Court enter an order authorizing the Liquidator to enter into the Agreement attached hereto to sell RNA.

WHEREFORE, the Liquidator respectfully requests that this Court grant this Petition, approve the Agreement attached hereto for the sale of the RNA stock, enter an Order in the form attached hereto, and enter such other relief as this Court deems necessary and appropriate.

Wolf Block Schorr and Solis-Cohen LLP

By: 

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Koken, Insurance Commissioner of the
Commonwealth of Pennsylvania, in her
capacity as Liquidator of Reliance
Insurance Company

Dated: March 2, 2004

VERIFICATION

I, ARTHUR W. MULLIN, verify that: 1) I am President of Mullin Management Consultants LLC and have been engaged by M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania in her official capacity as Liquidator of Reliance Insurance Company as a special consultant to oversee the divestiture of certain assets; 2) I am authorized to take this verification on behalf of the Liquidator; and 3) the facts set forth in the foregoing Petition to Approve Sale of Reliance National Asia Re Pte Limited are true and correct to the best of my knowledge, information and belief.

I understand that the statements herein are subject to the penalties of 18 Pa. C.S.A. § 4904 relating to unsworn falsification to authorities.

Arthur W. Mullin

ARTHUR W. MULLIN

Dated: 2/27/2004