

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

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RECEIVED
COMMONWEALTH COURT OF PENNSYLVANIA

**RESPONSE OF LIQUIDATOR TO OBJECTION OF
CITICORP NORTH AMERICA, INC. TO STATUTORY
LIQUIDATOR'S NOTICE OF DETERMINATION**

Pursuant to the Order of this Court dated September 9, 2002, M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania, in her official capacity as Liquidator of Reliance Insurance Company ("Liquidator"), hereby responds to the Objection of Citicorp North America, Inc. ("Citicorp") to the Notice of Determination issued on or around December 5, 2003, by the Liquidator with respect to Proof of Claim No. 2025727 (the "Claim") filed by Citicorp.

INTRODUCTION

Citicorp wrongly seeks administrative priority for the full rent, electricity and other costs and expenses on four floors of a New York City high rise office building, notwithstanding that (1) Reliance only occupied and used one of the four floors; and (2) Reliance vacated that one floor promptly (within 10 weeks) after the Order of Rehabilitation was entered by this Court. While the Liquidator recognizes that Citicorp is entitled to reasonable rent at class (a) priority for

the space actually occupied and used by Reliance for that 10-week period, the remainder of Citicorp's claim is properly characterized as a class (e) general creditor claim.

RESPONSE TO OBJECTIONS

1. On May 29, 2001, this Court entered an Order of Rehabilitation (the "Rehabilitation Order") placing Reliance Insurance Company ("Reliance") into rehabilitation in accordance with the 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 (the "Act").

2. The Rehabilitation Order appointed the Statutory Rehabilitator of Reliance and ordered her to take immediate possession of the property, business and affairs of Reliance, and to take such action as was required to protect the interests of the public and Reliance policyholders and creditors.

3. The Liquidator denies the averments of paragraph 3 as this paragraph summarizes the contents of this Court's Order, which speaks for itself.

4. For some time prior to and on May 29, 2001, Reliance and Citicorp were parties to certain Subleases, pursuant to which Reliance leased from Citicorp all or portions of the 7th, 8th, 9th and 19th floors of an office building located at 77 Water Street, New York, New York (the "Leased Premises"). However, for some time prior to May 29, 2001 and on May 29, 2001 through August 10, 2001, Reliance occupied only one floor of 77 Water Street, New York, New York and the other three floors were vacant.

5. The agreements governing Reliance and Citicorp prior to Rehabilitation provided that the monthly rental payments for the entire four floors in the applicable time period were \$233,200 and further provided that Reliance would pay certain electricity charges relating to the Leased Premises.

6. At the date of Rehabilitation and until August 10, 2001, the date upon which the Rehabilitator disavowed the lease, however, and for some time before that date, Reliance occupied only one of the four floors of the Leased Premises. The other three floors were, and had been, vacant for some time.

7. Citicorp seeks amounts it claims are due from Reliance to Citicorp from June 1, 2001 through to and including August 10, 2001, as well as, in addition to interest, attorney's fees and costs incurred in connection with the Claim as provided for by the Lease and asserts that the full amount is entitled to administrative priority, thus giving Citicorp priority over policyholders for that amount. However, the Liquidator denies that Citicorp's claim of administrative priority for the full amount sought has merit. Administrative priority is reserved for only the actual, reasonable, and necessary costs and expenses incurred to preserve and protect the assets of the estate.

8. In the Notice of Determination, the Liquidator classified the entire Claim as a Priority Level (e) claim, which includes, among others, claims of general creditors.

9. Citicorp objected to the classification of the Claim, asserting instead that the entire amount of the Claim constitutes costs and expenses of administration of Reliance's estate while in rehabilitation and, therefore, should be classified as a Priority Level (a) claim.

Only A Fraction Of The Claim Constitutes an Administrative Expense of the Estate

10. The Act establishes the order of priority and distribution of claims relating to an insolvent insurer. See 40 P.S. § 221.44.

11. Claims afforded Priority Level (a), the highest priority, are claims involving the costs and expenses of administration of the insolvent insurer's estate, including, but not limited to, the actual and necessary costs of preserving or recovering the assets of the insurer, and compensation for all services rendered in the liquidation. Id.

12. The Order entered by this Court on July 2, 2001, provides that “actual, reasonable and necessary costs of preserving or recovering the assets of Reliance” during the period of rehabilitation constitute “costs and expenses of administration” pursuant to 40 P.S. § 221.44. See Rehabilitation Order (Supplement), Paragraph 2.

13. Citicorp's critical concession that Reliance occupied "a portion" of the leased premises is key to resolution of this objection. In fact, Reliance occupied and used only one of the four floors of the Leased Premises from May 29, 2001 until August 10, 2001 and on August 10, 2001, Reliance vacated that floor, disavowed the Sublease and returned the floor, to Citicorp. The other three floors had been vacant for some time and Reliance had sought to return them previously, with no success. It is specifically denied that the Liquidator acknowledged liability for rent and other charges due to Citicorp under the Lease through to and including August 10, 2001. See Exhibit “B.” On the contrary, the letter dated August 10, 2001, simply stated that the Rehabilitator “hereby disavows and terminates the above-referenced Sublease and forfeits to Citicorp and immediately returns to Citicorp the space. Accordingly, no further rent or other charges will be paid at this time pursuant to the above-referenced Sublease.” Nothing in that letter acknowledged liability for anything.

14. The Liquidator denies the characterizations of Reliance’s activities at 77 Water Street from May 29, 2001 to August 10, 2001 contained in paragraph 14 of the Objection. Reliance staff and staff engaged by the Rehabilitator operated and conducted business relating to the Rehabilitation from one of the four floors comprising the Leased Premises. No business activities were conducted on the other three floors, nor had such floors been occupied for some period prior to the Rehabilitation Order.

15. Citicorp is entitled to a claim as an administrative expense (i.e., class (a) priority) no more than the fair market value of the space Reliance actually occupied from May 29, 2001 to August 10, 2001. See, e.g., In re Braniff Airways, Inc., 783 F.2d 1283, 1285 (5th Cir. 1986); In re Equipment Lessors of PA, Inc., 2002 U.S. Dist. LEXIS 23994 (E.D. Pa. 2002). The Court of Appeals in Braniff explained that the lessor is entitled to the contract rental rate "adjusted downward or upward to reflect the extent to which the debtor actually used the demised premises." Id. (Emphasis added). Judge Yohn in Equipment Lessors, likewise recognized that under the analogous but not identical federal bankruptcy law, "the lessor is entitled to collect the fair rental value of the leased premises so long as the debtor is occupying the leased property and using it to help preserve the estate." Id. at *18, quoting In re F.A. Potts & Co., Inc., 137 B.R. 13, 17 (E.D. Pa. 1992); Zagata Fabricators, Inc. v. Superior Air Products, Inc., 893 F.2d 624, 627 (3d Cir. 1990).¹ Here, Reliance was only occupying and using one-quarter of the property. Therefore, at most, one-quarter of the total rent may be properly characterized as an administrative expense. While Citicorp has a claim for the remainder of the rent, it rises no higher than the claims of other creditors, with class (e) priority.

16. While electrical service was provided and used at the premises, there is a factual issue with respect to the cost being charged the Liquidator given the fractional use of the property.

17. Only the costs incurred in connection with the provision of electricity service to the portion of the premises that were actually used by Reliance could conceivably fall within administrative priority.

¹ The Bankruptcy Code contains special provisions dealing with rent which are not included in the Act, including § 365(d) dealing with the amount of rent that must be paid prior to rejection. No such statutory provisions appear in the Act. Under the Act, administrative priority may extend no further than to the actual, reasonable and necessary costs incurred.

18. Citicorp has conceded that Reliance and the Rehabilitator's staff occupied and used only a portion of the premises. Accordingly, given that only one out of four floors was occupied and used, Citicorp is entitled to no more than 25% of the claim for rent and electricity as an administrative expense. No other components of the claim can remotely qualify as administrative priority, including but not limited to interest, attorney's fees and "costs incurred in connection with the Claim."

WHEREFORE, the Liquidator respectfully requests that this Court overrule the Objection of Citicorp, except that the Liquidator hereby amends the Notice of Determination to classify as administrative priority 25% of the rent and electricity charges sought by Citicorp. The remainder of the Citicorp claim is properly classified as Class (e).

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M. Diane Koken, Insurance Commissioner
of the Commonwealth of Pennsylvania, in her official
capacity as Statutory Liquidator of
Reliance Insurance Company

Dated: March 3, 2004

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VERIFICATION

I, Terry Hasset, Claims Specialist of Reliance Insurance Company (In Liquidation), hereby state that I am authorized to file this Response to Objection on behalf the Statutory Liquidator of Reliance Insurance Company . The facts set forth in the foregoing Response of the Liquidator to the Objection of Citicorp North America, Inc. to the Notice of Determination on Proof of Claim Number 2025727 are true and correct to the best of my knowledge, information and belief.

I understand that this Verification is made subject to the penalties of 18 P.S. § 4904 relating to unsworn falsification to authorities.

Dated: March 3, 2004


Terry Hasset
Claims Specialist

Reliance Insurance Company (In Liquidation)
Three Parkway
Philadelphia, PA 19102
On behalf of the Statutory Liquidator of
Reliance Insurance Company

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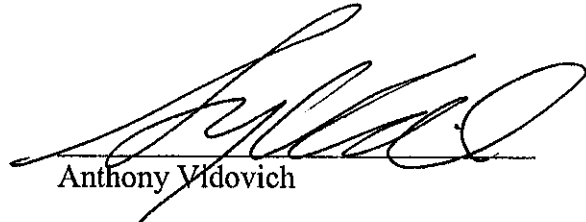
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CERTIFICATE OF SERVICE

I, Anthony Vidovich, hereby certify that this day a true and correct copy of the foregoing
Response was served on the following by U.S. Mail, postage prepaid.

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Dated: March 3, 2004


Anthony Vidovich