

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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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  
SEP 31 3 48 PM '01

ORDER

AND NOW, this \_\_\_\_\_ day of \_\_\_\_\_, 2001, upon  
consideration of the Answer to the Rule to Show Cause dated September 28, 2001, and  
hearing held, it is hereby **ORDERED** and **DECREED** that said Rule is hereby  
**DISCHARGED**.

BY THE COURT:

\_\_\_\_\_  
James Gardner Colins, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

M. DIANE KOKEN,  
Insurance Commissioner of the  
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Plaintiff,

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ANSWER IN RESPONSE TO RULE TO SHOW CAUSE

M. Diane Koken, Commissioner of Insurance of the Commonwealth of Pennsylvania, in her capacity as statutory Rehabilitator (hereinafter "Rehabilitator") of Reliance Insurance Company (hereinafter "Reliance") and her counsel, David F. Simon, Esquire, submit this Answer and the accompanying affidavit of Arthur W. Mullin ("Mullin Aff."), and Verification of William S. Taylor, sworn to October 1, 2001, in response to the Rule to Show Cause of this Court dated September 28, 2001 (the "Rule to Show Cause").

I. **FACTUAL BACKGROUND**

A. Reliance's Petition For Secured Credit Facility

On August 8, 2001, the Rehabilitator petitioned this Court to approve the negotiation, execution and performance of a one-year secured credit facility in an amount of up to \$75,000,000 between Reliance and Bear Stearns on terms substantially similar to those detailed in the Petition. Mullin Aff. ¶ 4.

Bear Stearns required that Reliance obtain court approval before it would proceed with the negotiations, based upon its concerns about the treatment of any potential claims it might have against Reliance if Reliance were subject to a liquidation order. Mullin Aff. ¶5.

B. August 13, 2001 Court Order

By order dated August 13 Order (the "August 13 Order"), this Court granted the Petition and specifically provided that "the Rehabilitator is authorized to negotiate, execute and perform a secured credit facility . . . on terms substantially similar to those set forth in paragraph 15 of the Petition." *Id.* ¶ 6.

Material Term D in paragraph 15 provided that:

The borrowings would be secured by a pledge to Bear Stearns of shares of Symbol stock owned by Reliance. Inasmuch as Reliance owns approximately 11.3 million shares of Symbol stock, the maximum number of shares of Symbol stock that could be pledged under the Proposed Facility is approximately 11.3 million shares.

Material Term F in paragraph 15 provided that:

Under the Proposed Facility, for a term of one year, Reliance would be permitted to make draw downs as frequently as daily, in minimum increments of \$1,000,000, with repayments due one year from the date of each draw down.

Additionally, the August 13 Order provided the assurances Bear Stearns required in order to proceed with its transaction with Reliance. Mullin Aff. ¶ 5.

C. Rehabilitator's Negotiation of Secured Credit Facility on Terms Substantially Similar to Those in Paragraph 15 of the Petition

Since the issuance of the August 13 Order, Reliance and the rehabilitation staff, through their advisors and consultants, have negotiated the terms of the secured credit facility with Bear Stearns. The Rehabilitator has sought to formulate an acceptable credit

facility that complies with the August 13 Order. Id. ¶ 11. To this end, various meetings have occurred between members of the Rehabilitator's team. Id. ¶¶ 11-12. Additionally, drafts of the proposed terms of the complex credit facility agreements have been reviewed, circulated, discussed and revised. Id.

The Rehabilitator's efforts to conclude and execute an agreement have been impeded by Bear Stearn's proposal of terms for the credit facility agreements that are unacceptable and that do not comport with the August 13 Order. Id. ¶¶ 12-17. It has taken some time and discussion to attempt to resolve these conflicts. For example, Bear Stearns proposed terms providing that:

- the loan would be payable on demand instead of for a term of one year as required by Material Term F; and
- draws would be in \$5,000,000 increments rather than \$1,000,000 increments as required by Material Term F.
- Bear Stearns would decline to accept collateral on margin
- Bear Stearns could unilaterally modify the terms of the credit facility agreement at anytime
- the Symbol stock collateral would cross-collateralize all other obligations of Reliance to Bear Stearns, beyond the loan contemplated by the Court Order (if any exist); and
- an arbitration clause and choice of law clause providing respectively for submission of disputes to mandatory arbitration and New York as the governing law.

While progress has been made on these issues, as of September 26 it was clear that it would take at least two weeks to consummate the financing. However, the finalization of

the transaction continues to be pursued, and the Rehabilitator's team fully expects to execute and perform the credit facility once the agreements are finalized. Id. ¶¶ 14-17.

D. Intervening Cash Crisis Requiring Sale of Symbol Stock.

Meanwhile, Reliance's cash crisis intensified during the week of September 24, 2001. Reliance required cash urgently to fund both its internal operations, including payroll, claims administration expenses, lease payments, and claims payments. Having been unable to conclude the Bear Stearns facility on acceptable terms, the Rehabilitation Team determined on the morning of September 26 at the internal weekly cash management meeting, to sell a small portion (less than 10%) of Reliance's holdings in Symbol Technology common stock to meet Reliance's most pressing and immediate cash requirements. Id. ¶¶ 17-21. Neither David Simon,<sup>1</sup> nor M. Diane Koken were involved in or informed of that decision, although they learned of it midday on September 27, 2001, after entry of this Court's Order of the afternoon of September 26. The Rehabilitation Team believed that selling a limited portion of Reliance's Symbol holdings was in the best interests of Reliance's policyholders, employees, creditors and the public, and would cause no harm to any constituencies. Id. ¶ 23.<sup>2</sup>

In addition, the sale of a portion of the Symbol common stock was not inconsistent with the proposed credit facility approved by this Court on August 13. In the Petition, the Rehabilitator sought to pledge "up to 11.3 million shares" of Symbol stock owned by

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<sup>1</sup> Mr. Simon is Chief Counsel of the Insurance Department and in that role is counsel to the Insurance Commissioner. However, he is employed by the Office of General Counsel, reports to the General Counsel of the Commonwealth, and is assigned to and resident at the Insurance Department. Accordingly, he is not a member of the Reliance Rehabilitation Team and has no operational responsibilities for the rehabilitation.

<sup>2</sup> For a more detailed account of Reliance's cash crisis, see Rehabilitator's Emergency Petition for Approval of Sale of Real Estate Assets and Securities dated September 28, 2001.

Reliance as collateral. The Rehabilitator neither intended to nor represented to the Court that she intended to pledge Reliance's entire holding of Symbol stock. Indeed, Material Term D expressly stated that "the maximum number of shares of Symbol's stock that could (not would) be pledged" under the secured credit facility agreement is approximately 11.3 shares. (Emphasis added.) Id. ¶ 25. Nothing in the explicit terms of the Order prohibited Reliance from selling some portion of its Symbol common stock holdings, even had it earlier concluded the credit facility.

## II. LEGAL STANDARD

Reliance's sale of a portion of its Symbol common stock during its negotiations for an acceptable credit facility with Bear Stearns did not violate this Court's August 13 Order and therefore cannot form the basis for a finding of civil contempt.

A civil contempt order should be entered only where the petitioner demonstrates, by a preponderance of the evidence, that: (1) the respondent had notice of the specific order or decree which was disobeyed; (2) the act constituting the violation was volitional; and (3) the respondent acted with wrongful intent. See Marian Shop, Inc. v. Baird, 448 Pa. Super. 52, 55-56, 670 A.2d 671, 673 (1996) (citing Fenstamaker v. Fenstamaker, 337 Pa. Super 410, 415-16, 487 A.2d 11, 14 (1985)).

It is well settled that a party must "violate" a court order to be punished for civil contempt. Marian Shop, Inc. v. Baird, 448 Pa. Super. 52, 56, 670 A.2d 671, 673 (1996) (citing C.R. By Dunn v. The Travelers, 426 Pa. Super. 92, 100, 626 A.2d 588, 592 (1993)), Woods v. Peckish, 463 Pa. 274, 280, 344 A.2d 828, 832 (1975) (citing cases). "However, a

mere showing of noncompliance with a court order, or even misconduct, is never sufficient alone to prove civil contempt.” Lachat v. Hinchliffe, 769 A.2d 481, 488 (2001)(citing Marian Shop, 448 Pa. Super. at 56, 670 A.2d at 673). Rather, “[t]o be punished for civil contempt, a party must not only have violated a court order, but that order must have been ‘definite, clear and specific -- leaving no doubt or uncertainty in the mind of the contemnor of the prohibited conduct.’” Lachat, 769 A.2d at 488-89 (quoting Marian Shop, 448 Pa. Super. at 56, 670 A.2d at 673). To support a contempt finding, the Court must find that the party acted “volitionally” and with “wrongful intent” to violate the Order. Marian Shop, 448 Pa. Super. at 55-56, 670 A.2d at 673.

Indeed, contempt is a harsh remedy not to be handed out in the absence of a party’s clear violation of a court order that is ‘definite, clear and specific -- leaving no doubt or uncertainty in the mind of the contemnor of the prohibited conduct.’” See Lachat, 769 A.2d at 488-89 (quoting Marian Shop, 448 Pa. Super. at 56, 670 A.2d at 673). The circumstances here do not warrant holding the Rehabilitator or her counsel in contempt.

### III. DISCUSSION

The Rule to Show Cause directs the Rehabilitator to show cause why an order for civil contempt should not be issued against the Rehabilitator for “failing to create [a secured] credit facility after having petitioned and been ordered by the Court to create said credit facility; and by further seeking to dispose of the designated collateral of said credit facility without having petitioned the Court for a modification or amendment of its August 13, 2001 order.” For the reasons set forth below, this Court should not hold the Rehabilitator or her counsel in contempt of court.

A. A Finding of Contempt is Not Warranted in these Circumstances

1. The Rehabilitator Complied with the August 13 Order

The Rehabilitator complied and continues to comply with the August 13 Order under which she was “authorized to negotiate, execute and perform a secured credit facility . . . on terms substantially similar to those set forth in paragraph 15 of the Petition.” See Order ¶ 2. While the Rule to Show Cause seeks to hold the Rehabilitator liable for “failing to create a secured credit facility,” the terms of the August 13 Order provide that the creation of a secured credit facility is authorized, not mandated. The August 13 Order expressly granted the Rehabilitator the “authority to” negotiate, execute and perform the secured credit facility.

Since the issuance of the August 13 Order, the Rehabilitator has proceeded to negotiate the complex terms of the secured credit facility. Mullin Aff. ¶¶ 11-17. After entry of the Order, Bear Stearns proposed certain terms that were unacceptable and were not consistent with the August 13 Order. *Id.* These included that the note be payable on demand, that the collateral secure all other obligations owed by Reliance to Bear Stearns, that the loan draw-downs be in increments different from those specified in the Court’s Order, that the terms be modifiable unilaterally by Bear Stearns and that disputes be subject to arbitration under New York law. These terms were neither acceptable to Reliance as a matter of business practice, nor did they comply with the August 13 Order. Consequently, the Rehabilitator complied with, and certainly did not contravene, the August 13 Order by continuing to negotiate until the terms were acceptable and consistent with the approval granted by this Court. *Id.*

The Rehabilitator's failure to execute and perform a secured credit facility, especially in light of the difficulties experienced, does not warrant a finding of contempt. Indeed, had the Reliance entered into the credit facility in the form proposed by Bear Stearns, it would indeed have run afoul of the August 13 Order, as the terms proposed were not "substantially similar" to the terms approved in this Court's Order.

2. The Sale Was A Lawful Exercise of the Rehabilitator's Powers

As reported to this Court in prior filings by the Rehabilitator, Reliance has immense weekly cash requirements simply to pay routine (excluding large exposure cases in litigation) claims, including routine but voluminous workers compensation and pip claims. The delays in its receipt of reinsurance proceeds, exacerbated by the destruction of the World Trade Center, has precipitated a growing cash crisis. That crisis became particularly severe during the week of September 24. In response, Reliance placed an order on September 26 with Bear Stearns to sell a small portion (less than 10%) of its holdings in Symbol Technology to generate cash to assist in funding its weekly operations, including payroll expenses and claims payments – a decision that was made to further the interests of Reliance and its policyholders and employees. *Mullin Aff.* ¶¶ 17-20. Due to the exigencies of this particular situation, neither M. Diane Koken nor David Simon were involved in this decision or its implementation, or even made aware of it until the next day, after this Court entered its Order of September 26, 2001 requiring prior court approval of asset sales. *Id.* At ¶ 21.

The August 13 Order neither expressly nor implicitly prohibited the sale of the Symbol stock. Although the Rehabilitator sought in the Petition to pledge up to 11.3 million shares of Symbol stock owned by Reliance as collateral, the Rehabilitator neither intended to

nor represented to the Court that she would pledge Reliance's entire holding of Symbol stock.. Indeed, Material Term D as approved by the August 13 Order expressly stated that "the maximum number of shares of Symbols stock that could (not would) be pledged" under the secured credit facility agreement is approximately 11.3 million shares. (Emphasis added.) The credit facility, as described and authorized, provided for the pledge of "up to 11.3 million shares." At no time, did the Rehabilitator commit to pledge Reliance's entire holdings of Symbol stock, and never did Reliance forego its inherent right to sell the stock, if required.

The Supreme Court of Pennsylvania declared in Foster v. Mutual Fire Marine and Inland Ins. Co., 531 Pa. 598, 614 A.2d 1086 (1992), that the Pennsylvania legislature granted the Insurance Commissioner "freedom of action in the over-all management of the [financially troubled insurance] company which will permit [her] to knowledgeably evaluate, plan, devise and implement a program which in [her] best judgment and in keeping with [her] expertise in the field of insurance accomplish the objective of [rehabilitation]." Id. at 612, 614 A.2d at 1093 (citations omitted). Absent specific orders to the contrary, a Rehabilitator is required to take possession of an insurer's assets and has all the powers of its directors and officers to direct, manage and deal with the property and business of the insurer. See 40 P.S. §§ 221.15(c), 221.16(b). Therefore, the sale of Symbol stock to safeguard the interests of Reliance, its policyholders, employees, creditors and the general public is a lawful exercise of her powers.

"Any ambiguity or omission in the order forming the basis for the civil contempt proceeding must be construed in favor of the [alleged contemnor]." C.R. By Dunn, 426 Pa.

Super. at 100, 626 A.2d at 592 (citing Carborundum Co. v. Combustion Engineering Inc., 263 Pa. super. 1, 396 A.2d 1346 (1979)). “Where . . . the specific terms of the order have not been violated, there is no contempt.” C.R. By Dunn, 426 Pa. Super. at 100, 626 A.2d at 592 (citing cases).

Because the August 13 Order authorized the negotiation and execution of a credit facility, it did not specify that no stock could be sold before the credit facility was completed and it did not purport to require the pledge of all of the stock. Accordingly, the sale of this stock cannot suffice for a finding of contempt. It is well settled that “[a] mere showing of noncompliance with a court order, or even misconduct, is never sufficient alone to prove civil contempt.” See Lachat, 769 A.2d at 488 (2001) (citation omitted). Rather, “[t]o be punished for civil contempt, a party must not only have violated a court order, but that order must have been ‘definite, clear and specific—leaving no doubt or uncertainty in the mind of the contemnor of the prohibited conduct.’” See Lachat, 769 A.2d at 488-890. There must further be a specific finding of “wrongful intent” to violate the order. Marian Shop, 448 Pa. Super. at 55-56, 670 A.2d at 673. None of these standards can be met here.

**B. The Rehabilitator Should be Accorded Deference Unless She has Abused Her Discretion, Which She Clearly Has Not**


The Pennsylvania Supreme Court has held that “our courts will not disturb [the Insurance Commissioner’s] administrative discretion in interpreting legislation within [the Insurance Department’s] own sphere of expertise absent fraud, bad faith, abuse of discretion or clearly arbitrary action.” Winslow-Quattlebaum v. Maryland Ins. Group, 561 Pa. 629, 636, 752 A.2d 878, 881 (2000); see Foster, 531 Pa. at 612, 614 A.2d at 1093; accord Alpha Auto Sales, Inc. v. Dept. of State, Bureau of Professional and Occupational Affairs, 537 Pa.

353, 357, 644 A.2d 153, 155 (1994) (stating that “[w]e have long held that contemporaneous construction of a statute by those charged with its execution and application . . . is entitled great weight . . . .”); In re Insurance Stacking Litigation, 754 A.2d 702, 706 (Pa. Super. 2000) (stating that “[c]ourts traditionally accord an interpretation of a statutory provision by an administrative agency charged with administering that statute . . . deference” (citations omitted)); cf. Armstrong Communications, Inc. v. Pennsylvania Public Utility Comm., 768 A.2d 1230, 1232 (Pa. Cmwlth. Ct. 2001) (Colins, J.) (stating that “[a]n agency’s interpretation should not be disregarded unless it is shown to be clearly erroneous”). Similarly, here, the actions of the Rehabilitator in dealing with the secured credit facility and disposing of the Symbol stock should be accorded deference and upheld by this Court.

#### IV. CONCLUSION

For all of the foregoing reasons, this Court should not hold the Rehabilitator and her counsel in contempt of court.

Respectfully submitted,



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Dated: October 1, 2001

VERIFICATION

I, William S. Taylor, Deputy Insurance Commissioner of the Pennsylvania Insurance Department, Office of Liquidations, Rehabilitations and Special Funds, hereby verify that the facts set forth in the foregoing Answer to the Rule To Show Cause are true and correct to the best of my knowledge, information and belief.

I understand that the facts stated in the Petition are made subject to the penalties of 18 P.S. §4904 relating to unsworn falsification to authorities.

Date: October 1, 2001

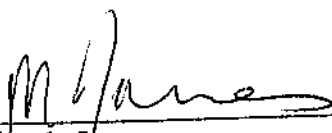
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William S. Taylor

## CERTIFICATE OF SERVICE

I, Mojirade James, hereby certify that this day a true and correct copy of the foregoing Answer in Response to Rule to Show Cause and Affidavit of Arthur W. Mullin in Support of Answer was served on all persons listed on the attached Master Service List by facsimile and U.S. Mail, postage prepaid.

Dated: October 1, 2001

  
\_\_\_\_\_  
Mojirade James

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No. 269 M.D. 2001 (Commonwealth Court of Pennsylvania)

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