

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 13, 2005

APPLICATION OF

RECIPROCAL OF AMERICA and
THE RECIPROCAL GROUP

CASE NO. INS-2004-00244

For Approval of Agreement to Stay
Proceedings and Tolling Agreement

FINAL ORDER

On July 20, 2004, the Deputy Receiver of Reciprocal of America¹ filed with the State Corporation Commission ("Commission") an Application for Approval of Agreement to Stay Proceedings and Tolling Agreement ("Application") in Case No. INS-2003-00092.² Therein, the Deputy Receiver of ROA sought an Order from the Commission that: (i) approves the Tolling

¹ Reciprocal of America and The Reciprocal Group are collectively referred to herein as "ROA."

² *In re: Joint Petition of Special Deputy Receivers of Doctors Insurance Reciprocal, Risk Retention Group, In Receivership, American National Lawyers Insurance Reciprocal, Risk Retention Group, In Receivership, and The Reciprocal Alliance, Risk Retention Group, In Receivership*, Case No. INS-2003-00092 (the "Joint Petition Proceeding"). In the Joint Petition Proceeding, the Special Deputy Receivers ("SDRs") of Doctors Insurance Reciprocal ("DIR"), Risk Retention Group ("RRG"), American National Lawyers Insurance Reciprocal ("ANLIR"), RRG, and The Reciprocal Alliance ("TRA"), RRG, (DIR, ANLIR, and TRA will collectively be referred to herein as the "Tennessee RRGs") filed a Joint Petition for Expedited Review of Claims and Deputy Receiver's Determination of Appeal and Brief in Support of Joint Petition ("Joint Petition") on April 24, 2003. The Joint Petition seeks, *inter alia*, to have the policyholders and claimants of the Tennessee RRGs treated with the same priority as ROA policyholders and claimants. On April 30, 2003, the Deputy Receiver of ROA issued his Fifth Directive Regarding a Discontinuance of Policy Payments and Discontinuance of Other Claim Payments ("Fifth Directive"), in which he directed the discontinuance of most payments, including those to policyholders, subscribers, and third-party claimants for claims under insurance policies of ROA. On June 10, 2003, the Commission entered an Order Cancelling Hearing, in which it, *inter alia*, directed that the Deputy Receiver of ROA not revoke, cancel, or amend the Fifth Directive without at first providing at least ten business days' written notice to certain entities. The Commission referred the Joint Petition Proceeding to a Hearing Examiner on July 14, 2003. The Agreement to Stay Proceedings and Tolling Agreement ("Tolling Agreement") between ROA and the Tennessee RRGs was filed on October 10, 2003, and the Hearing Examiner approved the Tolling Agreement the same day. The litigation in the Joint Petition Proceeding was suspended, so that the Deputy Receiver of ROA and the SDRs of the Tennessee RRGs could jointly pursue asset recovery litigation against third parties.

Agreement³ entered into by the Deputy Receiver of ROA and the Receiver of the Tennessee RRGs; (ii) approves payment by the Deputy Receiver of ROA claims at 17%, the payment percentage mutually agreed upon by the Deputy Receiver of ROA and the Receiver of the Tennessee RRGs, regardless of whether the Tolling Agreement is subsequently terminated; (iii) approves that ROA's claim payments, as described in the Application, will not exceed approximately \$77,511,000, without further order of the Commission; (iv) affirms that the payments approved in the Application to guaranty associations be considered payments for early access in Case No. INS-2003-00267;⁴ and (v) approves modification or cancellation of the Fifth Directive so as to allow the Deputy Receiver of ROA to proceed with partial payment of ROA claims.⁵

On July 30, 2004, the Kentucky Hospitals⁶ and Coastal Region Board of Directors and Alabama Subscribers ("Coastal") filed the Intervenor's Partial Objection to the Deputy Receiver's

³ The Tolling Agreement was amended on August 23, 2004. References to the Tolling Agreement herein shall include both the Tolling Agreement and the Amendment and Clarification of "Agreement to Stay Proceedings and Tolling Agreement." The Deputy Receiver of ROA filed a Notification of Amendment on September 1, 2004.

⁴ *Application of Virginia Property and Casualty Insurance Guaranty Association, For Disbursement of Assets*, Case No. INS-2003-00267 (the "Early Access Proceeding"). On December 15, 2003, the Virginia Property and Casualty Insurance Guaranty Association ("VPCIGA") filed the Application of Virginia Property and Casualty Insurance Guaranty Association for Disbursement of Assets. VPCIGA seeks an early access distribution of available assets to guaranty associations, pursuant to § 38.2-1509 of the Code of Virginia. The VPCIGA Application requests that the Commission adopt a plan for disbursement of assets, direct the Deputy Receiver of ROA to enter into an early access agreement with multiple state guaranty associations and direct the Deputy Receiver of ROA to make distributions of ROA assets to the associations. On January 9, 2004, the Commission entered an Order Establishing Proceeding, in which it, *inter alia*, docketed the case, assigned it to a Hearing Examiner, and set a deadline for interested parties to file a notice of participation. The parties to the Early Access Proceeding have been unable to reach agreement on the terms of an early access distribution.

⁵ Application at 10.

⁶ The "Kentucky Hospitals" include Appalachian Regional Healthcare, Caverna Memorial Hospital, Clinton County Hospital, Crittenden Health System, Cumberland County Hospital, Gateway Regional Medical Center, Hardin Memorial Hospital, Highlands Regional Medical Center, Jane Todd Crawford Hospital, Livingston Hospital & Healthcare Service, Marcum & Wallace Memorial Hospital, Marshall County Hospital, Monroe County Medical Center, Murray-Calloway County Hospital, Ohio County Hospital, Owensboro Mercy Health System, Pattie A. Clay Hospital, Pineville Community Hospital, Regional Medical Center/Trover Clinic Foundation, Rockcastle Hospital, St. Claire Medical Center, T.J. Samson Community Hospital, Twin Lakes Regional Medical Center, and Westlake Regional Hospital.

Application for Approval of Agreement to Stay Proceedings and Tolling Agreement ("Partial Objection"). The Kentucky Hospitals and Coastal assert that they have previously filed objections to the Tolling Agreement to reserve their right to appeal to the Commission at the time the Commission considers any motion to approve the Tolling Agreement. The Kentucky Hospitals and Coastal further contend that "implementation of the [Tolling Agreement] without change will postpone indefinitely" the resolution of the issues underlying the Joint Petition. The Kentucky Hospitals and Coastal request that a hearing be scheduled as expeditiously as may be practicable in order to address the issues raised in the Partial Objection. Alternatively, the Kentucky Hospitals and Coastal request that the Hearing Examiner set a definite hearing date for the adjudication of the issues in the Joint Petition Proceeding.

On August 4, 2004, the Guaranty Associations⁷ filed a Notice of Participation and the Guaranty Associations' Response to Deputy Receiver's Application for Approval of Agreement to Stay Proceedings and Tolling Agreement. Therein, the Guaranty Associations seek to ensure that no action taken in this proceeding, including but not limited to the Deputy Receiver of ROA's proposed 17% payment of ROA claims, prejudices or adversely affects the Guaranty Associations' rights to seek and obtain both early access disbursements and regular disbursements from the ROA estate as a policyholder-level claimant. The Guaranty Associations object to certain terms and conditions contained in the Application that the Deputy Receiver of ROA seeks to impose on his 17% payment of ROA claims. Among others, the Guaranty Associations object to treating the 17% payment to them as an early access payment under

⁷ The "Guaranty Associations" include the Alabama Insurance Guaranty Association, the Kansas Insurance Guaranty Association, the Indiana Insurance Guaranty Association, the Louisiana Insurance Guaranty Association, the Mississippi Insurance Guaranty Association, the Missouri Property & Casualty Insurance Guaranty Association, and the Tennessee Insurance Guaranty Association.

§ 38.2-1509 of the Code of Virginia.⁸ Instead, the Guaranty Associations maintain that the 17% payment requested in the Application should be considered an outright, interim distribution, not an early access payment. The Guaranty Associations further contend that certain issues are being determined in the Early Access Proceeding and should not be decided in this case. The Guaranty Associations also request that they be permitted sufficient time to conduct discovery and prepare for a hearing on this matter.

On August 16, 2004, the Deputy Receiver of ROA filed his Reply to Guaranty Associations' Response to Deputy Receiver's Application for Approval of Agreement to Stay Proceedings and Tolling Agreement. The Deputy Receiver of ROA objects to certain requests made by the Guaranty Associations and requests that they be denied by the Commission. The Deputy Receiver of ROA requests, *inter alia*, that the Commission overrule the objections asserted by the Guaranty Associations, direct that any matters regarding early access payments to the Guaranty Associations be presented in the Early Access Proceeding, deny the Guaranty Associations' request for discovery, and schedule a hearing on the Application.

The Commission entered an Order Establishing a Proceeding on August 26, 2004, in this case in which it docketed the Application, assigned the matter to a Hearing Examiner, directed the Deputy Receiver of ROA to serve a copy of the Application on certain persons, and required any person desiring to participate in this proceeding as a respondent to file a Notice of Participation on or before September 17, 2004.⁹

⁸ All statutory references herein are to the Code of Virginia.

⁹ The SDRs of the Tennessee RRGs, the Guaranty Associations, the Kentucky Hospitals, and Coastal were deemed parties to this proceeding.

Notices of Participation were filed timely by PhyAmerica Physicians Group, Inc. and The Children's Hospital of Alabama, which, however, did not otherwise actively participate in this proceeding.

An evidentiary hearing was convened on February 23, 2005. The Deputy Receiver of ROA, the Guaranty Associations, the Kentucky Hospitals, the SDRs of the RRGs, Coastal, the VPCIGA, and the Bureau of Insurance all appeared at the hearing and participated in one form or another.

On September 23, 2005, the Hearing Examiner filed his report ("Report"). The Report contains a thorough summary of the record in this proceeding, as well as the Hearing Examiner's discussion of the legal issues involved in this case, along with his findings and recommendations.

The Hearing Examiner made the following findings and recommendations:

- (1) The Tolling Agreement is in the best interests of the parties and should be approved by the Commission;
- (2) The Guaranty Associations' concerns about an unlawful preference relating to the amount of the 17% payment percentage distribution are unfounded;
- (3) The 17% payment percentage distribution is reasonable and will not result in a preference among similarly situated policyholder-level creditors of the ROA estate;
- (4) The Commission should cap the 17% payment percentage distribution from the ROA estate at \$77,511,000, and require the Deputy Receiver of ROA to file an application to make any further monetary distributions from the estate;
- (5) The 17% payment percentage distribution to guaranty associations should be characterized as a partial "covered claim" payment;
- (6) The 17% payment percentage distribution to the guaranty associations moots any requirement for an early access distribution; and

- (7) The Commission should authorize the Deputy Receiver of ROA to modify his Fifth Directive to permit the 17% payment percentage distribution to policyholder-level claimants.¹⁰

The Hearing Examiner recommends that the Commission adopt the findings of his Report and approve the Application as modified by his recommendations.

On October 12, 2005, Coastal and the Kentucky Hospitals filed comments on the Report. Therein, Coastal and the Kentucky Hospitals support findings (2), (3), (5), (6), and (7), but disagree with findings (1) and (4). Coastal and the Kentucky Hospitals assert that the proposed 17% payment could be increased to 40% if the \$107.7 million that the Deputy Receiver of ROA proposes to reserve for the Tennessee RRG claims is made available immediately for the payment of ROA policyholder claims. They further contend that if the payment percentage was increased from 17% to 40%, Coastal and the Kentucky Hospitals would receive \$17 million more than they will receive if the Hearing Examiner's findings and recommendations are adopted. Coastal and the Kentucky Hospitals thus request that the Commission provide them with some assurance that, notwithstanding the Tolling Agreement, they will be permitted to petition the Commission at some reasonable time in the future for a final decision in the Joint Petition Proceeding.

The Guaranty Associations filed the Objections and Responses of Certain Guaranty Associations to Report of Michael D. Thomas, Hearing Examiner, Dated September 23, 2005, on October 13, 2005. The Guaranty Associations do not object to a 17% distribution provided that the Commission confirms that all covered claims paid by guaranty associations are entitled to a 17% distribution and that a guaranty association cannot be required to return such distribution. Among other things, the Guaranty Associations object to the Hearing Examiner's determination that the 17% distribution moots the Early Access Proceeding. The Guaranty Associations

¹⁰ Report at 30.

request that the Commission adopt and approve the Hearing Examiner's ruling that § 38.2-1509 cannot be used in a manner such that a guaranty association would receive less on a percentage basis for its claims under § 38.2-1509 B 1 (ii) than other claimants having claims at such level.

The Deputy Receiver of ROA filed comments on October 14, 2005. Therein, the Deputy Receiver of ROA agrees with the majority of the Hearing Examiner's findings, including that the Tolling Agreement is in the best interest of the parties and that the Tolling Agreement and proposed 17% payout should be approved. The Deputy Receiver of ROA disagrees with the Hearing Examiner's observation that the only guaranty association claims entitled to priority status other than that of "other creditors" under § 38.2-1509 B 1 (v) are "covered claims."¹¹ Instead, the Deputy Receiver of ROA points out that § 38.2-1609 B provides that the expenses of the associations "incurred in handling claims" shall be accorded the same priority as the liquidator's expenses.¹² The Deputy Receiver of ROA also seeks certain clarifications as to early access disbursements and certain factual statements in the Report. The Deputy Receiver requests the Commission enter an Order that adopts findings 1-5 and 7 of the Report and clarifies finding 6 as described in his comments.

On October 14, 2005, the SDRs of the Tennessee RRGs submitted their comments on the Report. The SDRs of the Tennessee RRGs request that the Commission adopt the recommendations of the Report and proceed to allow modification of the Fifth Directive in accordance therewith.

NOW THE COMMISSION, having considered the evidence and arguments of the parties, the pleadings, the Report and the comments thereto, and the applicable law, finds as follows.

¹¹ Report at 28-29.

¹² The Guaranty Associations agree with the Deputy Receiver of ROA as to this point.

We agree with the majority of the Hearing Examiner's findings, recommendations and analysis. We accept with one modification finding (1), and we also accept findings (2), (3), (4), (5), and (7). We reject finding (6) and direct the Hearing Examiner to complete the Early Access Proceeding.

Discussion

Despite ordering the liquidation of ROA in June of 2003, very little money has so far been returned to policyholders. We are pleased to now be able to direct an initial distribution to ROA policyholders. We now address more specifically the Hearing Examiner's findings and recommendations.

Tolling Agreement

We agree that the Tolling Agreement should be approved. We incorporate one modification herein that will require the Deputy Receiver of ROA to file semi-annual reports¹³ with the Commission that provide: (i) the status of the MDL Proceeding in the United States District Court for the Western District of Tennessee;¹⁴ (ii) any projection by the Deputy Receiver of ROA as to when the MDL Proceeding shall conclude; and, (iii) the status of the bankruptcy proceeding pending before the Eastern District of Virginia.¹⁵ We will permit any party to this case to submit within ten days following the Deputy Receiver of ROA's submittal of the aforementioned semi-annual report a response thereto, as well as the impact on such party from the continued stay of the Joint Petition Proceeding. The Deputy Receiver of ROA may file a reply thereto within seven (7) days.

¹³ The reports shall be filed in this case and in Case No. INS-2003-00092 on or before January 1 and on or before July 1. The first report shall be filed on or before July 1, 2006.

¹⁴ *In re: Reciprocal of America (ROA) Sales Practices Litigation*, Master File No. 04-MD-1551 (W.D. Tenn.) ("MDL Proceeding").

¹⁵ *In re: Petition of Malcolm L. Butterfield and Michael W. Morrison as Joint Provisional Liquidators of First Virginia Reinsurance, Ltd. ("FVR")*, Case No. 03-40202 (DOT) (E.D. Va. Bankr.).

We believe that, at this time, joint pursuit of asset recovery efforts by the SDRs of the Tennessee RRGs and the Deputy Receiver of ROA is preferable to forcing the parties to the Tolling Agreement to expend scarce resources litigating against each other at the Commission. However, we are also sympathetic to the plight of affected ROA policyholders, such as those represented by Coastal and the Kentucky Hospitals. We understand that the delay in resolving whether the RRG insureds are entitled to be treated as ROA insureds has a substantial impact on the amount of money that can be distributed from the ROA estate. Our required reporting from the Deputy Receiver of ROA will enable us to consider twice yearly whether it continues to be in the best interests of policyholders, creditors, and the public for the litigation to be stayed in the Joint Petition Proceeding. If we determine that the Tolling Agreement should be terminated as a result of these filings, we will notify the parties. Hence, we adopt Hearing Examiner finding (1) as modified herein.

17% Distribution

We also agree with the Hearing Examiner that the Guaranty Associations' concerns about an unlawful preference resulting from approval of the 17% payment percentage are unfounded.¹⁶ We also find that the 17% payment percentage is reasonable and will not result in a preference among similarly situated policyholder-level creditors of the ROA estate. Thus, we also adopt Hearing Examiner findings (2) and (3).

We further agree that the 17% payment percentage distribution from the ROA estate pursuant to the Application should be capped at \$77,511,000, and we will require the Deputy Receiver of ROA to file an application to make any further monetary distributions from the

¹⁶ The Guaranty Associations' chief concern in this case, that any disbursement to them be characterized as a partial liquidating distribution, rather than an early access payment subject to "claw-back" under § 38.2-1509 B 3, has apparently been satisfied by the Hearing Examiner's Report. Moreover, the Deputy Receiver of ROA apparently has abandoned his contention that any distribution to the Guaranty Associations in this case should be subject to a "claw-back" condition.

estate. Any such application shall be made in accordance with our Order Cancelling Hearing entered on June 10, 2003, in the Joint Petition Proceeding. We note that, at the time of the hearing in this matter, ROA had approximately \$706.2 million in total losses and only \$128.2 million in available assets.¹⁷ We thus also adopt finding (4).

We agree with the Hearing Examiner that the 17% payment percentage distribution to guaranty associations should be characterized as a partial "covered claim" payment. Such distribution is not subject to any "claw-back" arrangement pursuant to § 38.2-1509 B 3. Hence, we also adopt finding (5).

Early Access Proceeding

We disagree with the Hearing Examiner that the Early Access Proceeding is mooted by our approval of the Tolling Agreement and 17% distribution in this case. The Hearing Examiner found that the "17% Payment Percentage distribution in this case moots any requirement for an early access distribution from the ROA estate. Simply stated, § 38.2-1509 of the Code of Virginia requires an early access distribution only when there are "available assets." The record in this case established that once the \$77,511,000 has been distributed, there are no other assets in the ROA estate available at this time for distribution to anyone."¹⁸ We cannot accept this

¹⁷ Of this amount, the Hearing Examiner found, based on the evidence, that \$427,059,000 constitute ROA policyholder losses and \$279,117,000 constitute losses of Tennessee RRG policyholders. Based on this approximately 60% to 40% allocation of losses between the ROA policyholders and the Tennessee RRG policyholders, the Deputy Receiver of ROA proposed to pay not more than \$77,511,000 to ROA policyholders and he would reserve approximately \$50,661,000 for the Tennessee RRG policyholder claims. Report at 25.

¹⁸ Report at 30.

finding, as it appears possible that there are additional assets available for distribution.¹⁹ Other issues raised by the parties in this matter should be decided in the Early Access Proceeding.²⁰ Accordingly, we reject finding (6).

Fifth Directive

We agree with the Hearing Examiner that the Deputy Receiver of ROA should be authorized to modify his Fifth Directive to permit the 17% payment percentage distribution to policyholder-level claimants. Thus, we adopt finding (7) and, in accordance with the Order Cancelling Hearing dated June 10, 2003, in Case No. INS-2003-00092, hereby authorize the Deputy Receiver of ROA to modify the Fifth Directive to make the 17% payment authorized herein.

Conclusion

We adopt the Hearing Examiner's findings as follows: we accept with one modification finding (1), and we also accept findings (2), (3), (4), (5), and (7). We reject finding (6) and direct the Hearing Examiner to complete the Early Access Proceeding.

Accordingly, IT IS ORDERED THAT:

(1) The Application of the Deputy Receiver of ROA is APPROVED, except as modified herein.

¹⁹ For example, the Hearing Examiner acknowledges that our decision in Case No. INS-2003-00239, *Application of Reciprocal of America and The Reciprocal Group, For a Determination Whether Certain Workers' Compensation Insurance Policy Payments May be Made to Claimants Formerly Covered by SITs and GSIA's*, in which a Final Order was entered on August 24, 2005, may free up approximately \$29 million for distribution. Report at 25. Additionally, not all of the \$77,511,000 is proposed to be immediately distributed. This also may add to the list of "available assets." We do not decide those issues here, but direct the Hearing Examiner to proceed with the Early Access Proceeding.

²⁰ Those issues include, but are not limited to, the proper interpretation of § 38.2-1509 C pertaining to "payments made or to be made," the priority levels of guaranty association expenses, the use of the "claw-back" arrangement for any asset distribution in that case, and any other issues yet to be determined in that proceeding.

(2) The Tolling Agreement is APPROVED, subject to the reporting requirements required herein.

(3) The 17% payment percentage distribution from the ROA estate, capped at \$77,511,000 in this proceeding, is hereby APPROVED.

(4) The 17% payment percentage distribution to ROA policyholders and the appropriate guaranty associations constitutes a partial liquidating distribution and is not subject to any "claw-back" arrangement pursuant to § 38.2-1509 B 3.

(5) The Hearing Examiner shall proceed with the Early Access Proceeding.

(6) The Deputy Receiver of ROA is hereby authorized to modify the Fifth Directive to permit the 17% payment percentage distribution to policyholder-level claimants.

(7) This matter is closed and the papers herein be passed to the file for ended causes.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter and in Case Nos. INS-2003-00024, INS-2003-00239, and INS-2003-00092. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, Virginia 23219.