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July 19, 2004

VIA OVERNIGHT DELIVERY

The Honorable Joel H. Peck, Clerk
State Corporation Commission
Tyler Building - 1st Floor
1300 East Main Street
Richmond, Virginia 23219

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DOCUMENT CONTROL

ATTN.: DOCUMENT CONTROL CENTER

Re: In Re Joint Petition of Special Receivers of Doctors Insurance Reciprocal, RRG, in Receivership, American National Lawyers Insurance Reciprocal, RRG, in Receivership, and The Reciprocal Alliance, RRG, in Receivership; Case No. Our File No. 65000-203

Dear Mr. Peck:

INS-2004-00244

On behalf of the Deputy Receiver of Reciprocal of America and The Reciprocal Group, please find enclosed for filing an original and 16 copies of the following pleading:

**Deputy Receiver's Application for Approval of Agreement
to Stay Proceedings and Tolling Agreement**

Please date stamp the extra copy and return to us in the enclosed self-addressed, stamped envelope. Thank you for your kind assistance in regard to this matter. Please let us know if you have any questions.

Respectfully submitted,



Susan E. Salch
Counsel to the Deputy Receiver

SES:dkd
Enclosures

cc: All Parties of Record

Background

1. On April 25, 2003, the Special Deputy Receivers (“SDRs”) of ANLIR, DIR, and TRA 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”) with the State Corporation Commission (the “Commission”). The SDRs sought a finding by the Commission that the insureds of the RRGs are entitled to be treated in the same manner and with the same priority as ROA’s insureds. The SDRs also sought to have the claims of the RRGs’ insureds, and those of third-party claimants under the RRGs’ policies, paid by the Companies. Additionally, the SDRs asserted claims regarding approximately \$57 million in certain funds (the “FVR Recovery”) obtained by the Deputy Receiver from a trust account established by First Virginia Reinsurance, Ltd. (“FVR”).

2. On April 30, 2003, the Deputy Receiver 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 all payments, including those to policyholders, subscribers, and third-party claimants for claims under insurance policies of ROA. However, partial or total disability payments arising under ROA workers’ compensation insurance policies, and medical and recurring partial or total disability payments made thereunder (“Disability Payments”), were directed to continue until such time as they could be resumed by guaranty associations. The Fifth Directive also directed for continuing payment of administrative expenses and secured claims against the Companies.

3. Also on April 30, 2003, the Commission entered a Scheduling Order and Temporary Injunction (“Temporary Injunction”), enjoining the Deputy Receiver from making any further

payments to ROA's policyholders, subscribers, or third-party claimants, with the exception of Disability Payments, until further order of the Commission.

4. Following additional proceedings, on June 10, 2003, the Commission entered an Order Canceling Hearing that, *inter alia*: (1) dissolved the Temporary Injunction issued on April 30, 2003, and (2) directed that the Deputy Receiver not revoke, cancel, or amend the Fifth Directive without first providing at least ten business days' written notice thereof to the SDRs, the Commission, and to any other person who has, as of the date of such notice, made an appearance herein. Additionally, the Order required that such notice specifically state the nature and reason for the proposed action, and the total amount of monies involved if the action requires monetary payments.

5. On July 14, 2003, the Commission referred this matter to Hearing Examiner Michael D. Thomas (the "Hearing Examiner"). Mr. Thomas issued a Hearing Examiner's Ruling on August 6, 2003, establishing a schedule for this matter, culminating in an evidentiary hearing scheduled to commence on December 8, 2003.

6. There have been a number of filings and proceedings since this matter was referred to the Hearing Examiner, including the addition of a number of parties, though limited in scope of participation.

Agreement to Stay Proceedings and Tolling Agreement

7. On October 10, 2003, the Deputy Receiver and the Tennessee Receiver (collectively, the "Parties") entered into the Tolling Agreement, a copy of which is attached hereto as Exhibit A and incorporated herein by reference.

8. In sum, under the Tolling Agreement the Parties agreed to the following: (1) to request that the Hearing Examiner stay further proceedings in the litigation while the Parties seek the Commission's approval of the Tolling Agreement, (2) assuming approval of the Tolling Agreement by the Commission, to stay this proceeding until September 30, 2004, such term being automatically extendable in six-month increments, (3) to permit payment by the Deputy Receiver of claims of ROA direct policyholders and insureds ("ROA Claims," singularly referred to as "ROA Claim") in an amount calculated not to create a preference in the event that subsequent proceedings herein result in rulings favorable to the SDRs as to their claim to the FVR Recovery, and their claim to elevated priority on the distribution of ROA and TRG assets, and (4) to attempt to negotiate a Common Interest Agreement.

9. The payment of ROA Claims pursuant to the Tolling Agreement would be at a percentage (the "Payment Percentage") no higher than that which the Companies' actuaries and accountants reasonably believe will be ultimately available to pay all ROA Claims (including approved claims of the state guaranty associations), even assuming (for the purpose of this calculation only) that the RRGs' policyholders and insureds are to be treated with the same priority as ROA's insureds. Additionally, only for the purposes of determining the Payment Percentage, the FVR Recovery will not be considered an ROA asset, and the RRG claims will be reduced by a corresponding amount. The Tolling Agreement also provides that once the Payment Percentage is agreed upon, the RRGs shall not later claim that payments made using that percentage constitute an illegal preference among similarly situated creditors under VA. CODE ANN. § 38.2-1509 (B)(1).

10. By ruling dated October 10, 2003, the Hearing Examiner: (1) approved the Tolling Agreement, (2) suspended the discovery deadline, (3) ruled that the Deputy Receiver's motion for

summary judgment shall remain pending until further ruling of the Examiner, and (4) suspended the hearing on the merits scheduled for December 8, 2003.

**Effect of Approving the Agreement to Stay Proceedings and Tolling Agreement
and the Mutually Agreed Upon Payment Percentage**

11. Approval of the Tolling Agreement would allow the Parties to preserve and further marshal the assets of their respective receivership estates, possibly share beneficial information through a Common Interest Agreement, and resume at least partial payment of ROA Claims.

12. We also seek approval of the mutually agreed Payment Percentage independent of the continued existence of the Tolling Agreement. The conservative methodology employed to derive the payment percentage for ROA Claims provides for a safe payment percentage. Even assuming that it is ultimately determined that the claims of the RRGs' policyholders and insureds are to be treated with the same priority as ROA Claims, the Payment Percentage still results in the availability of sufficient funds for the payment of the claims of the RRGs' policyholders and insureds at the same percentage as that of ROA Claims of the same priority. As such, there is no preference of creditors or harm arising from the approval of the Payment Percentage regardless of whether the Tolling Agreement subsequently is terminated between the Parties.

13. The Deputy Receiver has been advised by his professional advisors that, based upon current information, he may pay 17% of ROA Claims without creating a preference of creditors. Under this payment analysis, the Deputy Receiver determined that ROA had total approximate direct policy losses of \$462,052,000 available for the percentage payout and total approximate assets of \$77,511,000 available for the payment of such direct policy losses. Additionally, the Deputy Receiver's outside experts have estimated that the liability for Disability Payments for all of the

Assumed Claims may be as high as \$35,000,000, and the Deputy Receiver reduced the estimate of available assets to include a reserve for the Assumed Claim liabilities in case the Commission orders the payment of such Assumed Claims¹. In the event the Commission orders the payment of the Assumed Claims, the Deputy Receiver has further determined that the aggregate of 17% payments on ROA Claims, together with the Assumed Claims payments will not exceed approximately \$112,511,000.

14. The payment determination analysis makes a number of conservative assumptions. For example, the Deputy Receiver's advisors assumed that ROA will not receive any investment income from its invested assets. The Deputy Receiver's advisors further assumed that ROA will not receive any reinsurance recoveries from General Reinsurance Corporation. Next, as a hypothetical assumption, the Deputy Receiver's advisors assumed that the RRGs' direct policy claims would receive the same priority and payment as ROA's direct policy claims. Finally, the payment determination analysis includes another hypothetical assumption, that the FVR Recovery is unavailable for claim payments (*i.e.*, the FVR recovery is not an asset of ROA, but instead, is an asset of the RRGs). The aggregate liability of the RRGs, for which ROA would be responsible as a reinsurer, is reduced by the same amount as the FVR recovery. Thus, the payment determination analysis assumes that the FVR Recovery will satisfy a like amount of the RRGs' claims. Ultimately, the payment determination analysis assumes that the RRGs prevailed on their claims against ROA, and, as such, there should be no preference of creditors if the conservative payment percentage of 17% is adopted by the Commission. Therefore, payment of the 17% amount on ROA Claims should

¹ The Assumed Claims are discussed further in paragraphs 16 and 17 of this Application.

not prejudice the interests of the RRGs and their insureds. The Deputy Receiver's advisors have also incorporated a risk margin of approximately \$42 million into the recommended payment determination, and this risk margin will be an additional cushion against unforeseen or unanticipated liabilities that may arise in the future.

15. Accordingly, the Deputy Receiver estimates, based upon the payment determination analysis, that total 17% payments of no more than approximately \$77,511,000 will be made on ROA Claims in the future. In the future, if the Deputy Receiver believes that ROA's direct policy or other claims may be paid at a higher percentage without preference, he will re-apply to the Commission for authority to make such additional claim payments. The RRGs have agreed to the proposed Payment Percentage of 17% for ROA Claims. In addition, administrative expenses and secured creditor claims of ROA will be paid at 100% in the future.

16. In accordance with VA. CODE ANN. §38.2-1509(B)(1), the guaranty associations will also receive reimbursement at 17% for actual claims payments they have made, and for settlements that have been approved and finalized, though for which payment may not yet have been issued. However, the Deputy Receiver will not provide payment to the guaranty associations for reserves attributable to claims that have not yet been paid, and as to which a settlement has not been fully finalized and approved. Payments to the guaranty associations hereunder are to be recognized as payment under the requests for early access by those guaranty associations in Commission Case No. INS-2003-00267.

17. There are workers' compensation claims that ROA assumed as a result of assumption reinsurance or similar transactions with several Self-Insured Trusts (SITs) in Alabama, Arkansas, Kentucky, and Missouri, and Group Self-Insurance Associations (GSIAAs) in Mississippi, North

Carolina, Tennessee, and Virginia² ("Assumed Claims"), which the Deputy Receiver believes constitute direct policyholder claims. The issue of payment of Disability Payments for the Assumed Claims has been presented before the Commission in INS-2003-00024.³

18. This Application does not seek to change or modify the Commission's January 8 Order. In accordance with that Order, the Deputy Receiver is currently allowed to make wage replacement and indemnity payments for the Assumed Claims. However, pursuant to the

² The SITs were the Healthcare Workers Compensation Self-Insured Fund (Alabama), Arkansas Hospital Association Workers' Compensation Self-Insured Trust, Compensation Hospital Association Trust (Kentucky), and MHA/MSA Compensation Trust (Missouri). The GSAs were MHA Private Workers' Compensation Group (Mississippi), MHA Public Workers' Compensation Group (Mississippi), SunHealth Self-Insurance Association of North Carolina, THA Workers' Compensation Group (Tennessee), and Virginia Healthcare Providers Group.

³ On July 11, 2003, the Deputy Receiver filed his Application for Order Authorizing the Continuation of Workers' Compensation Disability Payments by Reciprocal of America and The Reciprocal Group for Workers' Compensation Claims Denied Coverage by State Guaranty Associations ("Disability Payment Application"). Responses were filed by the SDRs and various guaranty associations, and the proceedings culminated in a hearing held before the Commission on September 17, 2003. By request of the Commission, briefs were filed by September 29, 2003, in support of positions argued. On November 12, 2003, the Commission approved the Disability Payment Application with certain modifications ("November 12 Order"). On December 1, 2003, certain guaranty associations filed a Petition for Suspension of Order Pending Appeal and a Petition for Rehearing or Reconsideration. On December 2, 2003, the Commission entered an Order granting the Petition for Rehearing or Reconsideration for the purpose of receiving responses thereto. On January 8, 2004, the Commission entered an Order on Reconsideration which denied the guaranty associations' Petition for Suspension of Order Pending Appeal, denied their Petition for Rehearing or Reconsideration, and reinstated the November 12 Order ("January 8 Order"). The November 12 Order also assigned the determination of whether the SITs and GSAs or employers thereof constitute "other policyholders arising out of insurance contracts" pursuant to VA. CODE ANN. § 38.2-1509(B)(1). In addition, by Order on January 29, 2004, the Commission has permitted the Hearing Examiner to make this determination for two SITs with liability Assumed Claims, the Alabama Hospital Association Trust and the Kentucky Hospital Association Trust. There is currently a September 22, 2004, hearing date set for these proceedings.

Commission's November 12 Order, the Deputy Receiver is pursuing diligently alternative avenues of payment. See November 12 Order at 16.

19. At present, the Deputy Receiver is prevented from making any payments to policyholders and insureds (other than Disability Payments) by his own Fifth Directive and the Commission's Order dated June 10, 2003, which prevents cancellation or modification of the Fifth Directive without prior approval of the Commission. Accordingly, the Deputy Receiver also seeks herein an order of the Commission authorizing the Deputy Receiver to cancel or modify the Fifth Directive so as to permit the proposed payments. By way of notice, in accordance with the Order dated June 10, 2003, a copy of this Application is being served upon all parties of record in this proceeding contemporaneous with its filing. The Application satisfies the requirements regarding the content of the notice contemplated in the Order dated June 10, 2003, in that it specifically states the nature and reason for the proposed payments, as well as the monies involved. However, so that he may comply fully with the requirements of the Order dated June 10, 2003, the Deputy Receiver respectfully requests that the Commission not hold a hearing or rule upon this Application for at least ten (10) business days, so that any interested party may express its views on the matters at issue.

20. Additionally, the Deputy Receiver respectfully requests that the Commission's order setting hearing require that any interested party who objects to this Application, or any portion thereof, be required to file with the Commission and serve on the Deputy Receiver a written statement of objection, detailing the legal and/or factual bases for the objection no later than ten (10) business days prior to the hearing.

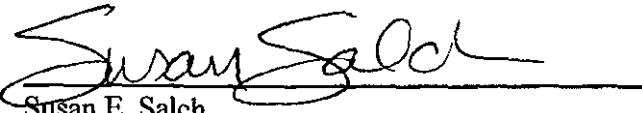
WHEREFORE, PREMISES CONSIDERED, the Deputy Receiver respectfully requests an order:

- a. approving the Tolling Agreement entered into by the Deputy Receiver and the Tennessee Receiver on October 10, 2003;
- b. approving payment by the Deputy Receiver of ROA Claims at 17% as the Payment Percentage mutually agreed upon by the Parties, regardless of whether the Tolling Agreement subsequently is terminated between the Parties;
- c. approving that all 17% ROA Claim payments, as described in this Application, will not exceed approximately \$77,511,000 without further order of the Commission;
- d. approving that the payments hereunder to guaranty associations are payments to be recognized as payments under requests for early access in Commission Case No. INS-2003-00267;
- e. approving modification or cancellation of the Fifth Directive so as to allow the Deputy Receiver to proceed with partial payment of ROA Claims; and
- f. granting such other and general relief as the Commission deems proper under the circumstances.

Respectfully submitted,

Alfred W. Gross, Commissioner of Insurance, State
Corporation Commission, Bureau of Insurance, as Deputy
Receiver of Reciprocal of America and The Reciprocal Group

By:


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CERTIFICATE OF SERVICE

I hereby certify that on July 19, 2004, the original and 15 copies of the foregoing document was sent via overnight delivery to:

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