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April 24, 2008

VIA OVERNIGHT DELIVERY

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

2008 APR 25 P 12:55

ATTN.: DOCUMENT CONTROL CENTER

Re: Commonwealth of Virginia ex rel. State Corporation Commission v. Reciprocal of America and The Reciprocal Group; Case No. INS-2003-00024; Our File No. 65000-002

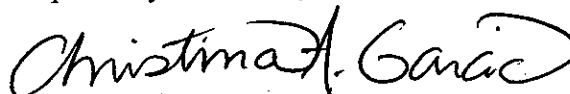
Dear Mr. Peck:

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:

APPLICATION FOR AUTHORITY TO EXECUTE CLOSING 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,



Christina A. Garcia
Counsel to the Deputy Receiver

CAG:vc
Enclosures

cc: All Parties of Record

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA *ex rel.*
STATE CORPORATION COMMISSION,

Applicant,

v.

RECIPROCAL OF AMERICA and
THE RECIPROCAL GROUP,

Respondents.

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Case No. INS-2003-00024

APPLICATION FOR AUTHORITY TO EXECUTE CLOSING AGREEMENT

TO THE HONORABLE JUDGES OF THE COMMISSION:

Alfred W. Gross, Commissioner of Insurance, Bureau of Insurance, State Corporation Commission of the Commonwealth of Virginia (the "Commission"), in his capacity as Deputy Receiver (the "Deputy Receiver") of Reciprocal of America ("ROA") and The Reciprocal Group ("TRG") (collectively, "Companies"), in receivership for liquidation, by counsel, respectfully makes this his Application for Authority to Execute Closing Agreement (the "Application").

BACKGROUND

1. Effective July 17, 1981, TRG established The Reciprocal Group Retirement Income Plan/002 (the "Plan") to provide retirement benefits for its employees. The Plan was an employee pension benefit plan to which 29 U.S.C. §1321(a) applied and was covered by title IV of the Employee Retirement Income Security Act.

2. On January 29, 2003, pursuant to title 38.2, chapters 12 and 15 of the Virginia Code and other applicable Virginia law, the circuit court for the City of Richmond issued its Final Order Appointing Receiver for Rehabilitation or Liquidation (the "Receivership Order") which appointed

the Commission as Receiver, Alfred W. Gross, the Commissioner of Insurance of the Commonwealth of Virginia as Deputy Receiver, and Melvin J. Dillon as Special Deputy Receiver,¹ and authorized and directed them to administer the business and affairs of the Companies and to do all acts necessary or appropriate for the rehabilitation or liquidation of the Companies.

3. In the Receivership Order, the court found that ROA and TRG (as ROA's attorney-in-fact) were insurers for purposes of title 38.2, chapter 15, of the Virginia Code. The court also found that ROA and TRG (as ROA's attorney-in-fact) were engaged in the business of issuing reciprocal insurance as reciprocal insurance is defined by Virginia Code section 38.2-1201, entering into reinsurance agreements with respect to same, and were engaged in the business of insurance as defined by Virginia Code section 38.2-100.

4. In the Receivership Order, the court found that ROA and TRG (as ROA's attorney-in-fact) were in a condition where any further transaction of business would be hazardous to the policyholders, creditors, members, subscribers, and the public.

5. As a result of the Receivership Order, the affairs and business of the Companies are administered by the Receiver, the Deputy Receiver, and the Special Deputy Receiver, who are vested, *inter alia*, with all the powers and authority expressed or implied under the provisions of title 38.2, chapters 12 and 15 of the Virginia Code.

¹ Melvin J. Dillon served as Special Deputy Receiver of the Companies from the date of the Receivership Order until January 14, 2005. On that date, the management of the receivership operations transferred to Mike R. Parker, formerly Director of Reinsurance and Accounting, as Receivership Operations Manager. Effective June 1, 2005, Mike R. Parker was appointed as Special Deputy Receiver of the Companies by the Seventh Directive of the Deputy Receiver Appointing Special Deputy Receiver.

6. On April 30, 2003, the Deputy Receiver of the Companies filed an Application for Orders Setting Hearing on Liquidation of ROA and TRG, Establishing Response Dates, Ordering Liquidation, Approving Claims Bar Dates, and Related Matters (“Liquidation Application”). The Liquidation Application discussed the events that precipitated its filing, the proposed plan of liquidation devised by the Deputy Receiver, and the Deputy Receiver’s request that the Commission schedule two hearings for consideration of the Liquidation Application, which were held on May 2, 2003, and June 19, 2003.

7. On June 20, 2003, the Commission entered an Order of Liquidation with a Finding of Insolvency and Directing the Cancellation of Direct Insurance Policies (“Liquidation Order”). The order: (1) declared ROA and TRG to be insolvent; (2) directed the Deputy Receiver to proceed with the liquidation of ROA and TRG in accordance with provisions of title 38.2, chapter 15, of the Virginia Code, other applicable Virginia law, and the Orders of the Commission, and all subject to further orders of the Commission; (3) pending further Orders of the Commission, the Deputy Receiver was authorized to continue making Disability Payments arising under ROA workers’ compensation insurance policies until such time as such Disability Payments can be made by guaranty associations; and (4) the Deputy Receiver was also authorized to cancel all direct insurance policies issued by ROA, such cancellation to be effective on or before the last date for which claims arising thereunder would be covered by the applicable insurance guaranty association.

8. On October 28, 2003, the Commission entered an Order Setting Final Bar Date and Granting Deputy Receiver Continuing Authority to Liquidate Companies, setting a Final Bar Date of September 30, 2004. The Final Bar Date was the date by which all claims, unless exempt from

the Final Bar Date,² were to be filed. Claims filed after the Final Bar Date are considered late-filed claims and receive payment only after claims filed by the Final Bar Date and late-filed claims of higher priority have been paid in full.

9. In response, there have been various Proofs of Claim (“POCs”) filed against TRG or the Companies. For example, there have been claims regarding the lease of the premises which TRG occupied, a claim on a Subordinated Promissory Note, claims filed by former officers, directors, and other TRG employees, and claims for equity funds and contributions.

10. Additionally, in light of TRG’s financial condition, the Pension Benefit Guaranty Corporation (“PBGC”) determined that the Plan did not meet the minimum funding standard required under 26 U.S.C. § 412 and would be unable to pay benefits when due and further determined that the Plan must be terminated to protect the interest of the Plan participants. The Plan was terminated as of January 30, 2004, and the PBGC filed POCs against the Companies for unfunded benefit liabilities, minimum funding contributions, premiums, penalties, and interest.

11. The Commissioner of Internal Revenue (“Commissioner”), on behalf of the Internal Revenue Service (“IRS”), seeks to assess excise taxes under section 4971³ and related penalties against TRG totaling \$1,033,172 (\$93,925 under section 4971(a) and \$939,247 under section 4971(b)) because of the funding deficiency that was reported on the Plan’s form 5500 for the Plan year ended March 31, 2003. Although the Commissioner has asserted a claim, he has not filed a POC.

² The two categories of exempt claims are claims arising under direct policies of insurance already properly submitted by the date of the Order and proper administrative expense claims.

³ Section references are to the Internal Revenue Code, Title 26 of the United States Code, unless otherwise noted.

12. The Commissioner and Deputy Receiver seek a final disposition of the issues with respect to potential excise taxes and penalties for the funding deficiency through the execution of a Closing Agreement (“Agreement”). A copy of the proposed Agreement is attached hereto as Exhibit A.

The Agreement

13. The parties wish to execute an Agreement outlining terms of settlement of the claim described above. Specifically, to compromise the claim, the parties agree that, notwithstanding the Final Bar Date, the Deputy Receiver would consent to the assessment and collection of excise tax under section 4971(a) from TRG in a settlement amount of \$93,925. The exact settlement sum will accrue interest until paid under the Internal Revenue Code (“IRC”) guidelines, but the final settlement amount, as and when paid, will be approved as a percentage of the original excise tax claim.⁴

14. Further, the Commissioner would waive any right to the collection of excise taxes imposed under section 4971(b), applicable statutory interest thereon as provided under section 6601, and penalties against TRG or any other entity with respect to the Plan related to the funding deficiency. No other federal income or excise taxes or penalties of any other kind under the IRC (other than those computed under the Agreement) would be due or payable as related to the Plan funding deficiency.

⁴ TRG would pay a total of approximately \$124,263, including \$30,338 in interest, through February 29, 2008, to settle the claim. After February 29, 2008, pursuant to IRC guidelines, interest will continue to accrue on these amounts at a rate of 7% compounded daily or approximately \$24 a day.

15. Given that execution of such an Agreement does not occur in the normal course of business for TRG, the Deputy Receiver respectfully requests authority from the Commission to do so.

DISCUSSION

16. The Deputy Receiver avers that execution of the Agreement and payment to the IRS are in the best interest of TRG given that the Commissioner has agreed to settle his claim for substantially less than the total that might ultimately be owed if the matter were fully litigated. Nevertheless, several issues warrant additional discussion.

POC Deadline

17. The Final Bar Date by which to file a POC against the Companies was September 30, 2004. Since the Commissioner has not filed a POC against TRG, his claim could arguably be characterized as a late-filed claim lower in priority than timely-filed claims against TRG, prohibiting payment of the settlement.

18. In general, claims of the United States government or federal claims take priority in an insolvency context pursuant to 31 U.S.C. § 3713 and the Supremacy Clause, U.S. CONST. art VI, cl. 2. A claim made by the United States against an insolvent company indebted to the government is to be paid first when an act of bankruptcy is committed. 31 U.S.C. § 3713(a)(1)(A)(iii) (2006). However, federal claim priority may be preempted when the application of the McCarran-Ferguson Act, 15 U.S.C. § 1012, is appropriate. The McCarran-Ferguson Act provides that “No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.” 15 U.S.C. § 1012(b) (2006). Laws

“regulating the business of insurance” have been defined as “[s]tatutes aimed at protecting or regulating this relationship [between insurer and insured], directly or indirectly.” United States Dep’t of Treasury v. Fabe, 508 U.S. 491, 501 (1993) (quoting SEC v. Nat’l Sec. Inc., 393 U.S. 453, 460 (1969)).

19. Nevertheless, case law is unsettled on the issue of whether the POC deadline would even apply to a federal claim because courts considering the matter differ on whether such a deadline regulates the business of insurance or protects policyholder interests. For example, in Ruthardt v. United States, upholding its ruling in a similar case, the court found that an early bar date did not apply to the United States claims because it did not regulate the business of insurance through protecting policyholder interests. Ruthardt v. United States, 303 F.3d 375 (1st Cir. 2002). The court elaborated that “[a]n early bar date for United States claims has only limited effect on policyholders – who have priority anyway [under the state priority statute] – and equally or primarily helps other general creditors.” Id. at 385. While on the other hand, in Clark v. Blue Cross Blue Shield of West Virginia, Inc., the court found “the West Virginia priority scheme for late-filed claims . . . does not exceed state power, and furthermore, under the McCarran Ferguson Act, . . . reverse preempts the federal priority statute asserted by the United States.” Clark v. Blue Cross Blue Shield of West Virginia, Inc., 510 S.E.2d 764, 768 (W. Va. 1998).

20. In addition to the applicability of the POC deadline being unsettled, TRG, as the attorney-in-fact for ROA, does not have policyholders of its own whose interests must be protected. Moreover, the settlement payment would be issued from the TRG estate and not the ROA estate, thus not affecting ROA policyholders. Therefore, the premise for preemption by the McCarran-

Ferguson Act arguably does not apply in these circumstances and federal claim priority would prevail.

21. Under the circumstances, the Deputy Receiver submits respectfully that it is in the best interest of the TRG estate to waive the untimely filing defense and settle the claim as agreed by the Commissioner, as an unfavorable decision (if litigation were pursued) would likely result in a much greater loss.

Claim Priority

22. As discussed above, federal claim priority may be preempted by state law through application of the McCarran-Ferguson Act when the law in question is enacted for the purpose of regulating the business of insurance. The Virginia priority scheme outlined in Virginia Code Annotated section 38.2-1509(B) would qualify as such, and other creditors of TRG might assert that the Commissioner's claim does not have priority and the settlement amount should not be paid.

23. As previously noted, since TRG does not have its own policyholders, it is arguable whether the McCarran-Ferguson Act would provide for state statute preemption of federal claim priority. In this connection, it may be argued that the Virginia priority statute does not "regulate the business of insurance" under the McCarran-Ferguson Act, as the priority statute may not regulate or protect a relationship between TRG and insureds. TRG does not have any policyholder claims, and on a related note, it does not have any unsatisfied secured creditor claims.

24. While the PBGC and former TRG officers and directors have asserted claims for administrative expense priority,⁵ ultimately, this is a settlement (at a substantial discount of the

⁵ The Deputy Receiver has not made any claim determination on these matters, and does not do so for purposes of this Application.

original balance) of a disputed claim that will benefit all creditors of the TRG estate. There are material and unresolved legal issues as to whether the Virginia priority statute would be enforceable against the Commissioner's claim. Additionally, the failure to pay federal priority claims may result in personal liability for the Deputy Receiver. Thus, given the potential loss to the TRG estate (and all its creditors) if additional litigation of the claim was unsuccessful, the settlement is clearly in the best interest of all concerned, even for those creditors that have asserted administrative expense priority in the TRG receivership.

CONCLUSION

25. The Commissioner has agreed to settle his claim for excise tax and penalties for approximately 9% of the amount which might actually be owed. As noted above, this is a very favorable settlement, and all of TRG's creditors will benefit because the alternative outcome may not be as favorable.

26. Even though the Commissioner has not filed a POC, asserting a late-filed claim defense would place the Deputy Receiver and TRG on uncertain footing given that the result of an appeal by the Commissioner might be that TRG is held liable for full payment of the claim, diminishing available assets for all other claims against TRG. Where upheld, the rationale for using the claims bar date as a defense is protection of policyholders. However, because TRG has no policyholders of its own, that policy argument supporting the application of the Final Bar Date may not apply. This is particularly true because the funds which will be used to pay the settlement amount are those of TRG only, not ROA, whose policyholders might otherwise be affected adversely by the Agreement.

27. TRG's creditors and other interested parties will receive notice of this Application and the Deputy Receiver respectfully requests a procedural schedule which provides time for them to respond. However, time is of the essence because the settlement amount increases daily pursuant to the Agreement, increasing the cost (albeit minimally) to the TRG estate with each passing day. Accordingly, if objections are filed the Deputy Receiver requests an expedited procedural schedule.

28. In the event that no objection to this application is timely filed by a party with a legitimate interest, the Deputy Receiver requests that the Commission grant the Application without hearing.

29. In sum, the settlement amount is favorable to the TRG estate, all other creditors and interested parties will receive notice of the Application and have an opportunity to be heard should they object to the IRS settlement, and the Application should be approved to the benefit of all creditors.

WHEREFORE, PREMISES CONSIDERED, the Deputy Receiver respectfully requests that the Commission issue an Order:

- a. Approving this Application without hearing if no objection is timely filed by a party with a legitimate interest;
- b. If objections are filed, establishing an expedited procedural schedule for consideration of the Application;
- c. Approve the Application authorizing the Deputy Receiver to execute the Agreement to settle the claim and pay the IRS as provided therein; and
- d. Providing such other and further relief as the Commission deems appropriate 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: Christina A. Garcia
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Counsel to the Deputy Receiver

CERTIFICATE OF SERVICE

I hereby certify that on April 24, 2008, the original and 15 copies of the foregoing document were sent via overnight delivery to:

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Clerk of the Commission
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joel.peck@scc.virginia.gov

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Christina A. Garcia

Closing Agreement on Final Determination Covering Specific Matters

Under section 7121 of the Internal Revenue Code

The Reciprocal Group (in Receivership) ("Taxpayer"), 54-1027624

(Taxpayer's name, address, and identifying number)

4200 Innlake Drive, Glen Allen, Virginia 23060

and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS, effective July 17, 1981, Taxpayer established The Reciprocal Group Retirement Income Plan/002 ("Plan") to provide retirement benefits for its employees;

WHEREAS, the Plan was an employee pension benefit plan to which 29 U.S.C. Section 1321(a) applied and was covered by Title IV of the Employee Retirement Income Security Act (ERISA);

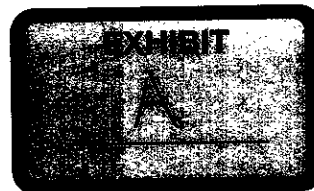
WHEREAS, on January 29, 2003, the Circuit Court of the City of Richmond found Taxpayer, along with Reciprocal of America ("ROA"), to be a single insurance business enterprise "in a condition ... where any further transaction of business will be hazardous to the policyholders, creditors, members, subscribers, and the public," and placed Taxpayer in receivership;

WHEREAS, on June 20, 2003, the court entered an Order of Liquidation with a Finding of Insolvency and Directing the Cancellation of Direct Insurance Policies, which declared Taxpayer to be insolvent and ordered it to be liquidated;

WHEREAS, on October 28, 2003, the court entered an Order Setting Final Bar Date and Granting Deputy Receiver Continuing Authority to Liquidate Companies, which set dates for creditors to make claims against the receivership;

WHEREAS, the Commissioner has not yet filed a claim for unpaid taxes against the receivership;

WHEREAS, in light of Taxpayer's financial condition, the Pension Benefit Guaranty Corporation ("PBGC") determined that the Plan did not meet the minimum funding standard required under Section 412 and would be unable to pay benefits



when due and further determined that the Plan must be terminated to protect the interests of the Plan participants;

WHEREAS, the Commissioner seeks to assess excise taxes under Section 4971 and related penalties because of a funding deficiency in the amount of \$939,247 that was reported on the Plan's Form 5500 for the plan year ended March 31, 2003; and

WHEREAS, the parties wish to determine with finality the issues with respect to potential excise taxes and penalties for any funding deficiency.

NOW IT IS HEREBY DETERMINED AND AGREED FOR FEDERAL INCOME TAX PURPOSES THAT:

1. Notwithstanding the Final (claim) Bar Date, Taxpayer agrees to the assessment and collection of excise tax in the amount of \$93,925 under Section 4971(a) plus statutory interest as provided under the provisions of Section 6601 on the assessed amount, for plan year ended March 31, 2003;
2. The Commissioner will not assess or be entitled to collect any excise taxes imposed under Section 4971(b), applicable statutory interest under Section 6601 or penalties against Taxpayer or any other entity with respect to the Plan related to this funding deficiency;
3. This Agreement constitutes a resolution under the Code of the specific matters discussed herein. There are no other federal income or excise taxes or penalties or taxes of any other kind under the Code (other than interest computed on the taxes under this Agreement) due or payable with respect to the minimum funding deficiencies herein discussed. No inference shall be made as to the application of the Code under any facts and circumstances outside this agreement. No inference shall be made with respect to whether this resolution satisfies any other federal laws, including Title I of the Employee Retirement Income Security Act of 1974. This Agreement is binding only on the Internal Revenue Service and not on any other agency of the United States;
4. This agreement does not constitute a ruling by the Service and may not be cited or relied on as precedent in the disposition of any other matter; and
5. No party to this agreement shall endeavor by litigation or other means to attack the validity of this agreement.

This agreement is final and conclusive except:

- (1) the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of material fact;
- (2) it is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for Code section 7122) notwithstanding any other law or rule of law; and
- (3) if it relates to a tax period ending after the date of this agreement, it is subject to any law, enacted after the agreement date, that applies to that tax period.

By signing, the above parties certify that they have read and agreed to the terms of this document.

Your signature _____ Date Signed _____

Spouse's signature (if a joint return was filed) _____ Date Signed _____

Taxpayer's representative Mr. Peter H. Winslow _____ Date Signed _____

Taxpayer (other than individual) _____

By _____ Date Signed _____

Title _____

Commissioner of Internal Revenue

By _____ Date Signed _____

Title _____

Instructions

This agreement must be signed and filed in triplicate. (All copies must have original signatures.)

The original and copies of the agreement must be identical.

The name of the taxpayer must be stated accurately.

The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement. If the agreement is made for a year when a joint income tax return was filed by a husband and wife, it should be signed by or for both spouses. One spouse may sign as agent for the other if the document (or a copy) specifically authorizing that spouse to sign is attached to the agreement.

If the fiduciary signs the agreement for a decedent or an estate, an attested copy of the letters testamentary or the court order authorizing the fiduciary to sign, and a certificate of recent date that the authority remains in full force and effect must be attached to the agreement. If a trustee signs, a certified copy of the trust instrument or a certified copy of extracts from that instrument must be attached showing:

- (1) the date of the instrument;
- (2) that it is or is not of record in any court;
- (3) the names of the beneficiaries;
- (4) the appointment of the trustee, the authority granted, and other information necessary to show that the authority extends to Federal tax matters; and
- (5) that the trust has not been terminated, and that the trustee appointed is still acting. If a fiduciary is a party, Form 56, Notice Concerning Fiduciary Relationship, is ordinarily required.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached. See 26 C.F.R. §601.504(b)(2)(ii) as to dissolved corporations.

Use additional pages if necessary, and identify them as part of this agreement.

Please see Revenue Procedure 68-16, 1968-1 C.B. page 770, for a detailed description of practices and procedures applicable to most closing agreements.

I have examined the specific matters involved and recommend the acceptance of the proposed agreement.

I have reviewed the specific matters involved and recommend approval of the proposed agreement.

Paul G. Joyce

(Receiving Officer)

(Date)

(Reviewing Officer)

(Date)

Appeals Officer

(Title)

(Title)