

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

M. DIANE KOKEN	:	CIVIL ACTION
INS. COMM’R OF PA, IN HER	:	NO. 04-4342
OFFICIAL CAPACITY AS	:	
LIQUIDATOR OF RELIANCE INS.	:	
CO.,	:	
	:	
Plaintiff	:	
	:	
v.	:	
	:	
PENSION BENEFIT GUARANTY	:	
CORP. (PBGC),	:	
	:	
Defendant	:	

REPORT OF PATRICK CANTILO

I. DOCUMENTS REVIEWED

- A. 2001-05-29 Rehabilitation Order**
- B. 2001-10-03 Petition for Liquidation**
- C. 2001-10-03 Liquidation Order**
- D. 2002-01-22 Order re Subsidiaries**
- E. 2004-08-25 Declaratory Judgment action**
- F. 2005-07-14 Memorandum Opinion of Judge Robreno**
- G. 2005-08-08 Memorandum Opinion of Judge Robreno**

II. ASSUMPTIONS AND OBSERVATIONS

- A. PBGC claims that it has obtained after the date of the Rehabilitation Order a lien upon the assets of a wholly owned subsidiary of Reliance.**
- B. PBGC provided no new consideration in exchange for this lien.**
- C. PBGC also asserts a lien upon other assets held directly by Reliance.**
- D. It is undisputed that current U.S. law applies to this matter so that the claims of reliance’s policyholders hold a higher priority than**

that of PBGC in the distribution of Reliance's assets.

E. The subsidiary in question was reported among the assets of Reliance.

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- F. ~~I have reviewed t~~The October 3, 2001, Liquidation Order for Reliance Insurance Company ~~and find that it~~ contains at pages 2 and 3 typical provisions vesting in the Commonwealth Court jurisdiction over Reliance's assets, including subsidiaries.
- G. Similarly, the Liquidation Order (as did the May 29, 2001, Rehabilitation Order), among other things, enjoins the placement or enforcement of liens on Reliance's assets.

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III. RELEVANT EXPERIENCE

A. Attached is my Curriculum Vitae.

- B. I have worked in the area of insurance insolvency since 1980 and have been involved in the rehabilitation or liquidation of more than 50 insurers and insurance related entities. I have served as Special Deputy Receiver, Deputy Liquidator or Special Deputy Commissioner in many of these cases, and as counsel to the receiver or deputy receiver in most of the others.
- C. Among these matters, in those instances in which the insurer owned all or part of an operating subsidiary, we have treated that subsidiary (especially when wholly owned) as an asset of the insurer, to be sold if possible. Invariably, the proceeds of such sales were then included among the assets of the insolvent and distributed to policyholders and creditors under the applicable priority scheme.
- D. In every state in which I have been so involved, a court supervising the liquidation of an insurer (the "receivership court"), typically possesses and exercises *in rem* jurisdiction over all assets of the insolvent insurer, whether held directly or indirectly, including those held through subsidiaries.

IV. OPINIONS - IN MY EXPERIENCE:

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- A. Receivership courts, such as the Commonwealth Court in this case, generally treat ~~the value of~~ subsidiaries as the property and assets of the insurer in liquidation, whether or not the subsidiaries are themselves engaged in the business of insurance, whether or not they are incorporated separately, and independent of whether they are direct (“first tier”) subsidiaries or themselves owned by other subsidiaries (and thus “lower tier” subsidiaries).
- B. The determination of value for a subsidiary typically takes into account a comparison of its assets and liabilities, and that value is then attributed to the parent in proportion to the parent’s ownership interest.
- C. In determining the value of a subsidiary as an asset of the insolvent insurer, the liabilities of the insurer (that are not the liabilities of the subsidiary) are not taken into account, regardless of the manner in which they arose.
- D. A lien placed on a subsidiary, or upon the assets of the subsidiary, generally would impair or bar the ability of the receiver to sell the subsidiary, or would reduce the proceeds of any such sale.
- E. The effect of permitting a creditor of the insolvent insurer to place such a lien on the assets of a subsidiary would be to enable the lienholder to circumvent the injunction in the receivership order against imposition of such liens upon the assets of the insurer.
- F. In that sense, such a subsidiary lien would enable its holder to obtain a position preferential to the position of policyholders and other creditors with respect to the assets of the subsidiary, and distributions from the parent insolvent insurer.
- G. In the absence of such liens, the value of the subsidiary, as an asset of the insurer, would be distributed pro-rata in accordance with the applicable priority scheme, which typically places policyholders and insureds above governmental agencies, taxing authorities, and other

creditors.

- H.** **The Reliance Rehabilitation Order expressly enjoins any person from obtaining liens upon, or encumbering, the assets of Reliance. Based on my experience, liens imposed in derogation of such injunctions are disregarded.**

- I.** **In this matter, the effect of disregarding PBGC's purported lien on the assets of the subsidiary is to place PBGC in the position of a creditor of Reliance, whose claim will be paid in accordance with the statutory priorities and other applicable law.**