

AT RICHMOND, NOVEMBER 12, 2003

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

v.

CASE NO. INS-2003-00024

RECIPROCAL OF AMERICA and  
THE RECIPROCAL GROUP,  
Respondents.ORDER

On July 11, 2003, the Deputy Receiver of Reciprocal of America<sup>1</sup> filed an 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 ("Application"). Therein, the Deputy Receiver of ROA seeks a Commission Order authorizing him to continue payment of medical and recurring partial or total disability payments for workers' compensation claims that were assumed by ROA through assumption reinsurance, or similar transactions, and denied or likely to be denied coverage by the applicable state guaranty associations.<sup>2</sup>

The Deputy Receiver of ROA specifically asserts that the guaranty associations of the applicable states have refused, or likely will refuse, to make certain workers' compensation insurance policy payments for workers' compensation claims that ROA assumed from Self-Insured Trusts ("SITs") in Alabama, Arkansas, Kentucky, and Missouri and Group Self-Insurance Associations ("GSIAs") in Mississippi, North Carolina, Tennessee and Virginia (collectively referred to as the "Assumed Businesses") as a result of assumption reinsurance or

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

<sup>2</sup> Application at 1.

similar transactions ("Assumed Claims").<sup>3</sup> The Deputy Receiver of ROA notes that the Assumed Claims will likely not be paid, because the Assumed Businesses were not member insurers and/or the policies under which the claims arose were not ROA policies. These payments total approximately \$125,139 weekly.

The Deputy Receiver of ROA further asserts that the insureds of the Assumed Businesses are direct insureds of ROA and, due to the necessity for continued payment by the recipients thereof, requests authorization from the Commission to continue making such payments.<sup>4</sup> The Deputy Receiver of ROA classifies the Agreements as "assumption reinsurance."<sup>5</sup> The Deputy Receiver of ROA asserts that the livelihood of many injured workers is dependent upon continued receipt of the payments and that a discontinuation of such payments would cause the recipients to suffer a substantial hardship.<sup>6</sup> The Deputy Receiver accordingly seeks an Order from the Commission authorizing the continued payment of workers' compensation insurance policy claims assumed by ROA through assumption reinsurance or similar transactions and denied or likely to be denied coverage by the applicable state guaranty associations.<sup>7</sup>

On July 25, 2003, the SDRs<sup>8</sup> of the Tennessee Companies filed Objections to ROA/TRG Deputy Receiver Continuing to Make Certain Workers' Compensation Payments that Could be Paid from Alternative "Safety Net" Sources ("Objections"). The SDRs of the Tennessee

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<sup>3</sup> Such Assumed Claims and assets of the Assumed Businesses were purportedly assumed by ROA through merger agreements or different forms of assumption agreements ("Agreements"). Application at 4.

<sup>4</sup> Id.

<sup>5</sup> Id. at 6-7.

<sup>6</sup> Id. at 9. The Deputy Receiver of ROA states that payments to approximately 450 injured workers are at stake. Id. at 10.

<sup>7</sup> Id.

<sup>8</sup> The Special Deputy Receivers of Doctors Insurance Reciprocal ("DIR"), Risk Retention Group ("RRG"), American National Lawyers Insurance Reciprocal ("ANLIR"), RRG, and The Reciprocal Alliance ("TRA"), RRG are referred to herein as the "SDRs." DIR, ANLIR, and TRA are referred to herein collectively as the "Tennessee Companies."

Companies contend that the case for payment of the Assumed Claims is weak here, and it is unfair to create a priority for these claimants, because such claimants may be able to turn to uninsured employers funds (e.g., the Virginia Uninsured Employers Fund), self-insured guaranty funds, bonds or other surety posted by uninsured employers, and recovery from the employer against which the workers' compensation payment was awarded.<sup>9</sup> The SDRs of the Tennessee Companies state that they are not opposed generally to the payment of "hardship" workers' compensation claims that truly are "essential to the daily sustenance of the recipients." They challenge the payment of non-"hardship" medical payments to health care professionals and institutions, such as hospitals, on the grounds that these payments represent "an unfair priority payment to persons or entities who are, in general, indistinguishable from the [Tennessee Companies'] insureds and third-party claimants."<sup>10</sup>

The SDRs of the Tennessee Companies request that (i) ROA/TRG be required to make good faith efforts to obtain coverage by the applicable state guaranty association(s) for, and to resist the denial by such association(s) of, the workers' compensation claims in question, including legal action where necessary, and to report its efforts and the results of those efforts to the Commission and to any other party that has entered an appearance in this matter; (ii) the Commission hold a hearing at which ROA/TRG would bear the burden of proving that the SITs and GSIA's in question were in fact "direct insureds" of ROA/TRG; (iii) if the Commission determines that the SITs and GSIA's in question were in fact ROA/TRG "direct insureds," ROA/TRG be required to prove which of the claims in question represent "hardship" claims that are truly "disability" claims "essential to the daily sustenance of the recipients" and that ROA/TRG be permitted to continue to pay only such "hardship" claims; (iv) sufficient time be given before the requested hearing to conduct reasonable discovery on the "direct insured" and "hardship" issues; (v) to the extent recipients of the workers' compensation payments in question

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<sup>9</sup> Objections at 3.

<sup>10</sup> Id. at 8.

have access to "safety net" sources of payment, such as (1) the Virginia Uninsured Employers Fund or to a similar fund or mechanism in another state, (2) a bond or other surety posted by a self-insured employer, or (3) recovery from the employer against which the workers' compensation payments were awarded, a stay be issued prohibiting ROA/TRG from continuing to pay the workers' compensation claims in question until a final decision is made on the merits of the "direct insured" and "hardship" issues; (vi) the ROA/TRG Deputy Receiver be ordered to determine as soon as possible what such "safety net" payments exist in each affected state and to make arrangements for the workers' compensation claimants in question to seek immediate recovery in each state from that safety net, including the notification of those claimants of the availability of such payments; and (vii) the ROA/TRG Deputy Receiver be ordered to respond to the objections raised by the SDRs of the Tennessee Companies within 10 business days detailing ROA/TRG's efforts and progress (1) in securing guaranty fund payments for the former SIT and GSIA policyholders in question, (2) in obtaining alternate funding from "safety net" sources in applicable guaranty fund states, and (3) in obtaining reimbursement agreements with the applicable guaranty funds.<sup>11</sup>

The SDRs of the Tennessee Companies request that the Commission stay the continuation of workers' compensation payments until the "direct insured" and "hardship" issues are resolved on their merits.<sup>12</sup> The SDRs of the Tennessee Companies also argue that the Deputy Receiver of ROA has failed to support the Application legally and factually.<sup>13</sup>

On August 8, 2003, the Deputy Receiver of ROA filed his Response to the Tennessee Receivers' Objections to ROA/TRG Deputy Receiver Continuing to Make Certain Worker's Compensation Payments that Could be Paid from Alternative "Safety Net" Sources ("Response to Objections"). Therein, the Deputy Receiver claims that he is pursuing systematically different

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<sup>11</sup> Id. at 11-12, 24-25.

<sup>12</sup> Id. at 15.

<sup>13</sup> Id. at 16-22.

resources (aside from receivership assets) for payment of the workers' compensation insurance policy benefits, including the so-called "Safety Net," but asserts that to prevent substantial hardship to the recipients, continuation of these payments by the Deputy Receiver of ROA is necessary. He claims again that the policyholders of the SITs and the GSIA's are "direct insureds" and a direct responsibility of ROA, and he submits that the method of case-by-case segregation suggested by the SDRs of the Tennessee Companies among the recipients of those deemed to constitute true "hardship" claims would be highly subjective and impermissibly discriminate among similarly situated creditors.<sup>14</sup> The Deputy Receiver of ROA further outlines his ongoing efforts to seek reimbursement from other sources for these claims and asserts that there are potential problems with some of the proposed "Safety Net" sources.<sup>15</sup> The Deputy Receiver of ROA continues to maintain that claimants of the SITs and the GSIA's are "direct insureds" of ROA, that such payments constitute "hardship" payments, and that the Deputy Receiver of ROA proposes continued payments as an "interim measure" until reimbursement or payment from other sources can be secured.<sup>16</sup> The Deputy Receiver of ROA concludes by seeking a Commission Order that authorizes him to continue workers' compensation insurance policy benefits for claims assumed by ROA through assumption reinsurance, or similar transactions, and denied or likely to be denied coverage by the applicable state guaranty associations.<sup>17</sup>

On August 14, 2003, the Commission entered an Order Scheduling Hearing on Application and on August 18, 2003, the Commission entered an Order Clarifying Previous Order ("Orders"). In the Orders, the Commission scheduled a hearing for September 17, 2003, to determine whether the insureds of the Assumed Businesses are direct insureds of ROA and

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<sup>14</sup> Response to Objections at 6.

<sup>15</sup> *Id.* at 6-13.

<sup>16</sup> *Id.* at 13-20.

<sup>17</sup> *Id.* at 20.

therefore a direct responsibility of ROA or, if not, whether such insureds' claims should be treated as "hardship" claims. The Commission further ordered that the Deputy Receiver of ROA is not directed or authorized to make any workers' compensation insurance policy payments to claimants of the SITs or GSIA's until further Order of the Commission.

On August 14, 2003, the Virginia Property and Casualty Insurance Guaranty Association ("VPCIGA") filed the Objection of Virginia Property and Casualty Insurance Guaranty Association to Payment by Reciprocal of America and The Reciprocal Group of Workers' Compensation Claims ("VPCIGA Objection"). Therein, the VPCIGA avers that § 38.2-1509 of the Code of Virginia<sup>18</sup> addresses how the assets of the ROA estate may be distributed and that the Commission has no authority to deviate therefrom.<sup>19</sup> The VPCIGA also asserts that if workers' compensation claims under ROA insurance policies are paid now, it is likely that the claimants will receive a greater percentage of their claims than will the guaranty associations and other claimants with similar priorities.<sup>20</sup> Hence, the VPCIGA requests that the Commission not permit: (i) any payments to be made on any workers' compensation claim unless it is a claim under a policy issued by ROA; (ii) any payment of any claim under any policy of ROA other than payments under § 38.2-1509 A until it can be determined that such payments can be made without creating an improper preference; (iii) any payment on any workers' compensation claim until the Deputy Receiver of ROA provides the Commission and other parties additional information to support the Application; and (iv) any payment to any provider of medical services until it can be determined that such payments can be made without creating an improper preference.<sup>21</sup>

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<sup>18</sup> All statutory references are to the Code of Virginia.

<sup>19</sup> VPCIGA Objection at 3-4.

<sup>20</sup> Id. at 5.

<sup>21</sup> Id. at 8-9.

On August 18, 2003, the Indiana Insurance Guaranty Association, the Kansas Insurance Guaranty Association, the Mississippi Insurance Guaranty Association, the Tennessee Insurance Guaranty Association, and the Texas Property and Casualty Insurance Guaranty Association ("Guaranty Associations") filed a Notice of Participation of Certain Guaranty Funds ("Notice of Participation") and their Objection of Certain Guaranty Funds to ROA/TRG Deputy Receiver's Application to Continue to Make Certain Workers' Compensation Payments ("GA Objections"). Therein, the Guaranty Associations claim that giving special priority to workers' compensation claimants as requested in the Application would constitute an illegal preference in violation of § 38.2-1509 B. Moreover, the Guaranty Associations argue that no "hardship" exception to the order of priority of distribution exists in the Virginia insurer liquidation statute.<sup>22</sup> The Guaranty Associations also aver that the Deputy Receiver of ROA's argument that the Assumed Businesses are direct insureds of ROA is without merit.<sup>23</sup> The Guaranty Associations request that the Commission deny the Application.

On August 22, 2003, the Coastal Region Board of Directors and the Alabama Subscribers it represents ("Coastal") filed the Coastal Region Board of Directors' Motion for Clarification of Order Scheduling Hearing and Application ("Motion"), wherein Coastal requests that the Commission clarify its previous Orders as to whether the hearing to be held on September 17, 2003 will be a final determination as to whether the insureds of the Assumed Businesses are direct insureds of ROA. Coastal requests that, if the Commission so intends, it should instead limit the hearing to determining whether or not to approve the Application without any prejudice to the right of any insured to present argument and evidence with respect to its status as a policyholder entitled to the priority created by § 38.2-1509 B 1 ii.<sup>24</sup>

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<sup>22</sup> Notice of Participation at 3-4.

<sup>23</sup> GA Objections at 8.

<sup>24</sup> Motion at 3.

On August 27, 2003, the Kentucky Claimants<sup>25</sup> filed the Kentucky Claimants Joinder in Coastal Region Board of Directors' Motion for Clarification of Order Scheduling Hearing on Application ("Joinder Motion"). In their Joinder Motion, the Kentucky Claimants express the same concerns raised by Coastal as to the scope of the hearing to be held on September 17, 2003, on these issues and request that the Commission clarify what is to be determined at the aforesaid hearing and limit its scope appropriately in accordance with Coastal's Motion.

On August 28, 2003, the Deputy Receiver of ROA filed the Deputy Receiver's Response to Objection of Virginia Property and Casualty Insurance Guaranty Association to Payment by Reciprocal of America and The Reciprocal Group of Workers' Compensation Claims ("Response to VPCIGA"). Therein, the Deputy Receiver of ROA claims that the VPCIGA Objection was not timely filed. The Deputy Receiver of ROA renews his request that the Commission enter an Order authorizing him to continue making medical and recurring partial or total disability payments for certain workers' compensation claims assumed by ROA.<sup>26</sup> The Deputy Receiver of ROA expresses his willingness to provide evidence at the September 17, 2003, hearing to support the propositions that ROA treated the Assumed Business insureds as direct insureds not only by characterizing the transaction as direct insurance in financial documents but also, where applicable, by paying the premium tax and the guaranty fund assessment for the Assumed Business.<sup>27</sup>

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<sup>25</sup> Clark Regional Medical Center, T.J. Samson Community Hospital, Pineville Community Hospital, Highlands Regional Medical Center, Twin Lakes Regional Medical Center, Hardin Memorial Hospital, Gateway Regional Medical Center, Regional Medical Center/Trover Clinic Foundation, Murray-Calloway County Hospital, Owensboro Mercy Health System, Harrison Memorial Hospital, River Valley Behavioral Health Hospital, Muhlenberg Community Hospital, and Lincoln Trail Hospital were the original "Kentucky Claimants." On September 17, 2003, counsel for the Kentucky Claimants filed a Supplemental Notice of Participation. Therein, six additional Kentucky hospitals—Rockcastle Hospital, Clinton County Hospital, St. Claire Medical Center, Marcum & Wallace Memorial Hospital, Monroe County Hospital and Marshall County Hospital gave notice that they desire to join the Kentucky Claimants in so far as they desire to participate in the September 17, 2003, hearing regarding the Assumed Claims. All of the Kentucky Hospitals will be referred to hereafter as the "Kentucky Claimants."

<sup>26</sup> Response to VPCIGA at 1.

<sup>27</sup> Id. at 8.

On September 2, 2003, the Deputy Receiver of ROA filed the Deputy Receiver's Response to Objection of Certain Guaranty Funds to ROA/TRG Deputy Receiver's Application to Continue to Make Certain Workers' Compensation Payments ("Response to Guaranty Associations"). Therein, the Deputy Receiver of ROA makes similar arguments to those made in his Response to VPCIGA. The Deputy Receiver of ROA argues that the GA Objections should be overruled and that payments to, or for the benefit of, certain injured workers and their families should not be further disrupted.<sup>28</sup>

On September 4, 2003, the SDRs of the Tennessee Companies filed the Special Deputy Receivers' Motion for Clarification of Order Scheduling Hearing on Application ("Motion for Clarification"). Therein, the SDRs of the Tennessee Companies request clarification on the issues to be addressed at the September 17, 2003, hearing pertaining to the workers' compensation policy payments issues raised in the Application. The SDRs of the Tennessee Companies assert that there are three issues to be determined at the September 17, 2003, hearing for which the Deputy Receiver of ROA bears the burden of proof: (i) whether payment of the workers' compensation policy claims will create an illegal preference; (ii) whether the employers that were members of the SITs and GSIA in question became "direct insureds" of ROA and, if so, on what date, and (iii) whether the claims of the workers' compensation claimants in question are in fact "hardship" claims.<sup>29</sup>

On September 9, 2003, the Commission issued a Clarifying Order wherein it directed the parties to this case to be prepared to address at the September 17, 2003, hearing the following issues: (i) whether the payments requested to be made by the Deputy Receiver of ROA in his Application are permitted to be made in light of the provisions of § 38.2-1509; (ii) whether any or all of the SITs and GSIA or employers thereof may legally be considered direct insureds of ROA; (iii) whether the requested payments may be made under the "hardship" provisions of the

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<sup>28</sup> Response to Guaranty Associations at 2.

<sup>29</sup> Motion for Clarification at 8.

Final Order Appointing Receiver for Rehabilitation or Liquidation entered by the Circuit Court for the City of Richmond on January 29, 2003, or whether such "hardship" payments may be made pursuant to some other statutory provision; and/or (iv) what criteria should govern the determination of what constitutes a "hardship" claim.

The Commission heard this matter on September 17, 2003. Present and represented by counsel at the hearing were the Deputy Receiver of ROA, the Bureau of Insurance, Children's Hospital of Alabama, the VPCIGA, the Guaranty Associations, the Kentucky Claimants, the SDRs of the Tennessee Companies, Coastal, and PhyAmerica Physician Group, Inc. At the conclusion of the hearing, the Commission requested that parties file briefs to address the legal issues raised in this case.<sup>30</sup>

In their brief, the Deputy Receiver of ROA asserts that the Commission may authorize him to pay the Assumed Claims and deduct the amount of those payments from sums subsequently payable to the guaranty associations.<sup>31</sup>

The Guaranty Associations filed a Supplemental Memorandum of the Indiana Insurance Guaranty Association, the Kansas Insurance Guaranty Association, the Mississippi Insurance Guaranty Association, the Tennessee Insurance Guaranty Association and the Texas Property and Casualty Insurance Guaranty Association in Support of the Guaranty Associations' Objection to the Deputy Receiver's Proposed Disbursement of Estate Assets to Pay Certain Workers' Compensation Claims ("Memorandum"). Therein, the Guaranty Associations assert that § 38.2-1509 provides the exclusive authority for disbursements of the assets of ROA.<sup>32</sup> The Guaranty Associations further contend that the Commission simply has no authority to alter the priority

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<sup>30</sup> Transcript at 318-322.

<sup>31</sup> Deputy Receiver's Brief in Support of the Application for Order Authorizing the Continuation of Workers' Compensation Disability Payments at 5.

<sup>32</sup> Memorandum at 2. The Guaranty Associations also filed a Supplemental Memorandum of Certain Guaranty Associations in Support of Their Objection to ROA/TRG Deputy Receiver's Application to Continue to Make Certain Workers' Compensation Payments on September 17, 2003, in which they advance similar arguments in urging the Commission to reject the Application.

scheme established by the General Assembly.<sup>33</sup> They further argue that, even assuming that the SITs and GSIA's or employers thereof are considered policyholders by the Commission, such determination does not mean that the obligations thereunder would constitute "covered claims" under § 38.2-1603, nor does the Commission have the authority to determine whether such obligations are "covered claims."<sup>34</sup>

The VPCIGA filed its Brief of Virginia Property and Casualty Insurance Guaranty Association in Opposition to the Payment by the Deputy Receiver of Reciprocal of America and The Reciprocal Group at this Time of Any Claims that Arose Under Workers' Compensation Coverage Provided by Group Self-Insurance Associations and Self-Insured Trusts ("VPCIGA Brief"). Therein, the VPCIGA also argues that § 38.2-1509 does not permit the Commission to authorize the Deputy Receiver of ROA to make the payments requested in the Application.<sup>35</sup> The VPCIGA further contends that the provisions of § 38.2-1509 are not ambiguous and the Commission may not deviate therefrom in disbursing the assets of ROA.<sup>36</sup>

On September 29, 2003, Coastal filed the Coastal Region Board of Directors' Memorandum in Support of Deputy Receiver's Authority to Make Worker's Compensation Payments ("Coastal Brief"). Therein, Coastal supports the arguments of the Deputy Receiver of ROA and requests the Commission to follow the purpose and substance of § 38.2-1509 by approving the Deputy Receiver of ROA's request to make the Disability Payments. By doing this, the Commission will avoid continuing a preference that has been created by the Guaranty Associations' failure to pay the Assumed Claims.<sup>37</sup>

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<sup>33</sup> Memorandum at 3.

<sup>34</sup> *Id.* at 12-15.

<sup>35</sup> VPCIGA Brief at 2.

<sup>36</sup> *Id.* at 13.

<sup>37</sup> Coastal Brief at 2, 4.

The Kentucky Claimants filed their Joinder in Coastal Region Board of Directors' Memorandum in Support of Deputy Receiver's Authority to Make Worker's Compensation Payments. The Kentucky Claimants join in the Coastal Brief and support the Deputy Receiver's Application.

On September 29, 2003, the Virginia Workers' Compensation Commission ("VWCC") filed a Memorandum of Law in Support of Continued Payment by ROA of Certain Contested Claims ("VWCC Brief").<sup>38</sup> The VWCC supports the efforts of the Deputy Receiver of ROA to make the Disability Payments and submits that Commission approval of the Application will prevent a preference, rather than create one.<sup>39</sup> The VWCC also contends that it is possible that the injured workers will not have access to any "safety net" sources of payment.<sup>40</sup>

NOW THE COMMISSION, having considered the evidence and arguments of the parties, the pleadings, and the applicable law, finds as follows. We direct the Deputy Receiver of ROA to pay the Assumed Claims as requested in the Application as limited herein. We hereby direct payments to claimants, whether weekly or monthly in frequency, that are indemnity or wage-replacement payments. We do not authorize the Deputy Receiver of ROA to make physician, hospital, or other health care facility payments at this time. We also refer to a Hearing Examiner the question of whether the SITs and GSIA's or employers thereof constitute "claims of other policyholders arising out of insurance contracts" as that term is used in § 38.2-1509 B 1 ii.

Section 38.2-1509 B 1 ii provides, in pertinent part, that

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<sup>38</sup> On September 17, 2003, the VWCC filed a Motion to Intervene. Therein, the VWCC asserts that the Uninsured Employers' Fund ("UEF"), which is administered by the VWCC, may become a significant creditor of ROA. On October 2, 2003, counsel for the VWCC and UEF filed a letter in which he stated that the VWCC's pleadings in this case were filed for the VWCC solely in its capacity as the administrator of the UEF, and not in its role as an adjudicative body. He further intends to submit future pleadings on behalf of the UEF, rather than the VWCC. The Commission received no objection to the Motion to Intervene filed by the VWCC. The Commission granted the Motion to Intervene on October 16, 2003.

<sup>39</sup> VWCC Brief at 2.

<sup>40</sup> *Id.* at 6.

The Commission shall disburse the assets of an insolvent insurer as they become available in the following manner: . . . (ii) claims of the associations for "covered claims" and "contractual obligations" as defined in §§ 38.2-1603 and 38.2-1701 and claims of other policyholders arising out of insurance contracts apportioned without preference.

This section makes clear that the assets of the insolvent insurer are to be disbursed "as they become available" and that the assets are to be "apportioned without preference."

First, we must note that this Commission has not yet determined that any claims of any entities are either "covered claims" or "claims of other policyholders arising out of insurance contracts," including those currently being paid by the guaranty associations. Nor have we found that any claims are not within one of these two categories.

The Commission is faced with the potential of two competing preferences. The Commission could direct the Deputy Receiver of ROA to pay the Assumed Claims now. If it is later determined that the claims are neither "covered claims" nor "claims of other policyholders arising out of insurance contracts," the payments might result in these claimants receiving more than they should.<sup>41</sup> This, of course, would amount to a preference.

On the other hand, if the Commission denies payment of the Assumed Claims at this time, and it is later determined that any of these claims constitute "covered claims" or "claims of other policyholders arising out of insurance contracts," then the Commission will have permitted an ongoing preference. Currently a number of workers' compensation claimants are being paid their full workers' compensation entitlements, first by the Deputy Receiver and now by various guaranty associations that may be reimbursed by the Deputy Receiver. If other workers' compensation claimants who are not currently being paid are later determined to have either "covered claims" or "claims of other policyholders arising out of insurance contracts," then there

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<sup>41</sup> In order for this to occur, the Commission would have to determine ultimately that the Assumed Claims are not "covered claims" or "claims of other policyholders arising out of insurance contracts." We make no such determination at this time; instead, we refer that question to a Hearing Examiner to take evidence and file a Report with the Commission. If that question is ultimately decided adversely to the Deputy Receiver of ROA, then a preference would exist only if the Deputy Receiver of ROA is unable to recover the funds paid and there is less money left in the estate to pay general creditors than the recipients of the Assumed Claims had already received.

will have been a preference. Simply paying a claimant a lump sum after months of nonpayment does not amount to an adjustment that eliminates the preference. This is particularly true if Virginia law prohibits claimants from earning interest on their claims;<sup>42</sup> these claimants may have forever lost the time value of the money they should have been receiving. This, of course, would amount to a preference. In addition, the reality may be that claimants who rely on the payments for sustenance suffer the loss of their home or a significant deterioration of their health, because the needed income flow is interrupted. This preference is just as real as that which may result in an overpayment or underpayment to a claimant.

The Commission may not solve this conflict by stopping all payments for several reasons. First, the statute does not envision waiting until all issues related to apportionment have been finalized before beginning distribution. Rather, the assets are to be distributed "as they become available." Second, the Commission has already recognized the importance to the claimants of continued payment of the Assumed Claims.<sup>43</sup> Third, the reality is that in Virginia and a number of other states, workers' compensation payments are being made. As noted above, these payments create a preference possibility that must be addressed.

As a practical matter, payments by a receiver can rarely, if ever, be made without any possibility of a preference. The VPCIGA acknowledged in its comments that payments may be made that might result in a preference as long as it "can be subsequently adjusted so that ultimately there is no preference."<sup>44</sup> If it later turns out that the "adjustment" cannot be made, then there may be a preference. As noted above, this case presents just such a situation if we deny payments at this time. Also, after we made our determination that liquidation was required,

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<sup>42</sup> Cf. Swiss Re Life Company America v. Gross, 253 Va. 139, 147 (1997) (Virginia law prohibits creditors of an insolvent estate from earning interest on their claims).

<sup>43</sup> Case No. INS-2003-00024, Order of Liquidation With a Finding of Insolvency and Directing the Cancellation of Direct Insurance Policies, filed on June 20, 2003, at 2, 3 (Deputy Receiver of ROA authorized to continue making certain ROA workers' compensation policy payments until such time as the payments can be made by the guaranty associations).

<sup>44</sup> VPCIGA Objection at 5.

the Deputy Receiver of ROA paid all workers' compensation claims for four weeks before the guaranty associations took over payments. That act has not been questioned or challenged although it might lead ultimately to small preferences if it is later determined that some of the claims were neither "covered claims" nor "claims of other policyholders arising out of insurance contracts." In short, the Deputy Receiver of ROA is not required to refuse to make all payments because they may possibly result in a small preference.

The Deputy Receiver of ROA must adhere to the statutory mandates of § 38.2-1509 that require us to distribute the assets as they become available without preference. We must, therefore, avoid both of the preferences described above to the extent possible. If we cannot avoid the possibility of at least one of the preferences, we must minimize the possibility and extent of any such preference.

Sometimes, we can avoid, or greatly minimize, the possibility of a preference by paying out only a small fraction of the available assets in equal percentages to all similarly situated claimants.<sup>45</sup> Here, however, we are limited because certain of the claimants have been and continue to be paid one hundred percent of their claims even though the Commission has not determined that they are any more entitled to the payments than those included as Assumed Claims. Thus, we find, in this case, we cannot avoid the possibility of one of the preferences described above.

In order to reduce any preferences that may be caused by the current payments to one group and not the other, we find that we must direct the Deputy Receiver of ROA to make

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<sup>45</sup> While, as noted above, we have made no determination at this time as to whether the Assumed Claims are "covered claims" or "claims of other policyholders arising out of insurance contracts," the Deputy Receiver of ROA has argued that these claimants are ROA policyholders. Certain guaranty associations agree. Certain other guaranty associations, on the other hand, have determined that the Assumed Claims are not "covered claims" under their respective state laws. *See, e.g.*, Kentucky Claimants Joinder in Coastal Region Board of Directors' Memorandum in Support of Deputy Receiver's Authority to Make Worker's Compensation Payments, filed on September 29, 2003, at 2, fn. 1 (Kentucky Claimants assert that the Kentucky Insurance Guaranty Association and Arkansas Insurance Guaranty Association are currently paying the Assumed Claims in their respective states); Response to Objections at 6 and Exhibit A; Transcript at 168 (counsel to the Deputy Receiver of ROA represents that three of the eight guaranty associations are currently paying the Assumed Claims).

indemnity and wage-replacement payments under what have been described as Assumed Claims. These payments should reduce or minimize possible preferences caused by the failure to pay any Assumed Claims that may later be determined to be payable under § 38.2-1509 B 1. On the other hand, if the Assumed Claims are found not to be covered by that section, the possibility of ultimate preferences should not be significant. First, others may be responsible for paying the Assumed Claims; during the hearing we were assured that these claimants will be paid.<sup>46</sup> Sources of possible payment include payments from guaranty associations, uninsured employers' funds, employers, self-insurance guaranty associations, and surety bonds. We fully expect the Deputy Receiver of ROA to pursue diligently every such alternative avenue of payment.

The extent of any preference, if one is created, should also be minimized by several factors. First, the payments will only be made until a decision is rendered by this Commission on the "policyholder arising out of insurance contracts" issues referred herein to a Hearing Examiner. Second, we are only authorizing those payments that are indemnity and wage-replacement payments. Finally, we note that the total amount of payments authorized herein appears to represent a small fraction of the estate's total assets.<sup>47</sup> Hence, we find that the possibility and extent of any preference that might ultimately be determined to result from our decision will be very small.<sup>48</sup>

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<sup>46</sup> Transcript at 259 (Counsel to the SDRs of the Tennessee Companies); 337 (Counsel to the VWCC).

<sup>47</sup> Application at 4, 10 (Assumed Claims include approximately 450 injured workers and \$125,139 in weekly payments). The total amount should be substantially less than this, since we are herein authorizing only the indemnity and wage-replacement portion of the Assumed Claims and not direct payments to physicians, hospitals, or other health care facilities. Moreover, at least some of the guaranty associations are paying the Assumed Claims. See fn. 45. ROA has over \$400 million in assets. Response to Objections at 19.

<sup>48</sup> Nor do we believe that our interpretation of § 38.2-1509 B 1 should result in a flood of applications from other claimants. The present situation is unusual, if not unique. Our decision in this proceeding is further supported by the "hardship" exception to the priority scheme encompassed within § 38.2-1509; it is clearly within this Commission's authority to consider and balance the equities in determining when it is appropriate to distribute estate assets. The authority conferred on the Commission to act as a court of equity and to enter appropriate orders in §§ 38.2-1502, 38-2-1507, and 38.2-1508 also permits us to consider the hardships involved when an applicant seeks to receive or disburse assets under § 38.2-1509. In addition to the "hardship" arguments advanced in this particular case, we also note the special status given to workers' compensation claimants by the General Assembly in § 38.2-1606 A 1 a i, which requires that a claimant receive "the full amount of a covered claim for benefits under a workers' compensation insurance coverage."

We direct the Deputy Receiver of ROA to pay the Assumed Claims only insofar as they constitute indemnity and wage-replacement payments. We do not authorize the payment of physician or hospital bills at this time.

Accordingly, IT IS ORDERED THAT:

- (1) The Application of the Deputy Receiver is APPROVED, except as modified herein;
- (2) The determination of whether the SITs and GSIA's or employers thereof constitute "other policyholders arising out of insurance contracts" pursuant to § 38.2-1509 B 1 ii is hereby assigned to a Hearing Examiner and is assigned Case No. INS-2003-00239. The Hearing Examiner shall conduct all further proceedings associated with making the aforesaid determination, concluding with the filing of the Hearing Examiner's final report to the Commission. In the discharge of such duties, the Hearing Examiner shall exercise all the inquisitorial powers possessed by the Commission, including, but not limited to, the power to administer oaths, require the appearance of witnesses and parties either in person or by any other means, require the production of documents, schedule and conduct prehearing conferences, admit or exclude evidence, grant or deny continuances, and rule on motions, matters of law, and procedural questions. An objection to a ruling by the Hearing Examiner shall be stated with the reasons therefore at the time of the ruling, and the objection may be argued to the Commission as part of a response to the Hearing Examiner's Report. A ruling by the Hearing Examiner that denies further participation by a party in interest or the Commission staff in a proceeding that has not been concluded may be immediately appealed to the Commission by filing a written motion with the Commission for review. Upon the motion of any party or the Staff, or upon the Hearing Examiner's own initiative, the Hearing Examiner may certify any other material issue to the Commission for its consideration and resolution. Pending resolution by the Commission of a ruling appealed or certified, the Hearing Examiner shall retain procedural control of the proceeding;

(3) The Hearing Examiner appointed shall cause the testimony taken at any hearing to be reduced to writing and promptly deliver his written findings and recommendations together with the transcript of the hearing to the Commission for its consideration and judgment; and

(4) This matter is continued.

**Morrison, Commissioner, Concurring in Part and Dissenting in Part,**

I do not believe that § 38.2-1509 permits the conclusion reached by the majority. I must respectfully dissent from that portion of the majority's finding that permits disbursement of ROA assets at this time to pay the Assumed Claims.

However, I concur with the decision insofar as it refers to a Hearing Examiner the question of whether the SITs and GSIA's or employers thereof constitute "other policyholders arising out of insurance contracts" pursuant to § 38.2-1509 B 1 ii.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter. 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.

Morris, Philip B.  
Esquire  
Morris & Morris  
PO Box 30

Richmond VA 23218-0030

Dillon, Melvin J.  
Special Deputy Receiver  
c/o Reciprocal of America &  
The Reciprocal Group  
4200 Innslake Drive

Glen Allen VA 23060

Manchester, Curtis G.  
Esquire  
ReedSmith LLP

Riverfront Plaza, W. Tower  
901 E. Byrd St., Ste. 1700  
Richmond VA 23219-4069

Stephenson, Kathryn A.  
Esquire

Trauger, Ney & Tuke  
Southern Turf Building  
222 4th Avenue North  
Nashville TN 37219-2117

Harman, Michael E.  
Esquire  
Harman, Claytor, Corrigan & Wel  
PO Box 70280

Glen Allen VA 23255

Wagner, Jody M.  
Treasurer of Virginia  
101 N 14th Street

Richmond VA 23219

Matherne, J. G.  
Esquire  
Wyatt, Tarrant & Combs, LLP  
2525 West End Ave Ste 1500

Nashville TN 37203-1423

Kneedler, H. L.  
Counsel to Special Dep. Receive  
ReedSmith LLP

Riverfront Plaza, W. Tower  
901 East Byrd Street, Suite 170

Richmond VA 23219-4069

Marston, Jr., Walter A.  
Esquire  
ReedSmith LLP

Riverfront Plz. W. Tower  
901 E. Byrd St., Ste. 1700

Richmond VA 23219-4069

McNally, Kevin R.  
Esquire  
ReedSmith LLP

Riverfront Plz, W. Tower  
901 E. Byrd St., Ste 1700  
Richmond VA 23219-4069

Ambrosius, Paul W.  
Esquire

Trauger Ney & Tuke  
Southern Turf Building  
222 Fourth Ave., N.  
Nashville TN 37219-2117

Mitchell, Wiley F.  
Esquire  
Willcox & Savage PC  
1800 Bank of America Center

Norfolk VA 23510

Long, Michelle  
Esquire  
Tennessee Hospital Association  
500 Interstate Blvd

Nashville TN 37210

Bennett, Mark  
Counsel to Deputy Receiver  
Cantilo & Bennett LLP Ste 200  
7501-C N Capital of Texas Hwy

Austin TX 78731

Gibson, William Esquire Wyatt Tarrant & Combs LLP 2525 West End Ave Ste 1500			Shechter, Leslie F. Esquire Farmer & Luna PLLC 333 Union St Ste 300		
Nashville TN 37203-1423 Luna, J. W. Esquire Farmer & Luna, PLLC 333 Union St Ste 300			Nashville TN 37201 Reeves, Ross C. Esquire Willcox & Savage One Commercial PI Ste 1800		
Nashville TN 37201 Katchmark, Michael R. Esquire Willcox & Savage, PC One Commercial PI Ste 1800			Norfolk VA 23510 Moorman, R. K. Esquire Frost Brown Todd LLC 2700 Lexington Financial Center 250 W Main St Lexington KY 40507-1749 Gullett, William C. Esquire Frost Brown Todd LLC 250 W Main St Ste 2700		
Norfolk VA 23510 de Beer, Jan Esquire Frost Brown Todd LLC 250 W Main St Ste 2700			Lexington KY 40507-1749 Mitchell, Greg E. Esquire Frost Brown Todd LLC 250 W Main St Ste 2700		
Lexington KY 40507-1749 Hubbard, William B. Esquire Weed Hubbard Berry & Doughty, P 201 Fourth Ave N Ste 1420			Lexington KY 40507-1749 Riou, Pierre J. Esquire Cantilo & Bennett LLP Ste 200 7501 C N Capital of Texas Hwy		
Lexington KY 40507-1749 Hubbard, William B. Esquire Weed Hubbard Berry & Doughty, P 201 Fourth Ave N Ste 1420			Austin TX 78731 Smith, Robyn E. Esquire Weed Hubbard Berry & Doughty, P 201 Fourth Ave N Ste 1420		
Nashville TN 37219 Cantilo, Patrick H. Special Deputy Receiver PO Box 184			Nashville TN 37219 Friedman, Steven G. 2421 Ivy Rd		
Austin TX 78767-0184			Charlottesville VA 22903		

Molen, John K.  
Esquire  
Bradley Arrant Rose & White LLP  
One Federal Place  
1819 Fifth Ave N  
Birmingham AL 35203

Dolan, Jr., Louis E.  
Esquire  
Nixon Peabody LLP  
401 9th St NW Ste 900  
Washington DC 20004-2128

Midkiff, Charles F.  
Esquire  
Midkiff, Muncie & Ross, P.C.  
Suite 160  
9030 Stony Point Parkway  
Richmond VA 23235

Condyles, Michael A.  
Esquire  
Kutak Rock LLP  
Bank of America Center  
1111 E Main St Ste 800  
Richmond VA 23219

Albritton, IV, W. H.  
Esquire  
Bradley Arrant Rose & White LLP  
One Federal Place  
1819 Fifth Ave N  
Birmingham AL 35203

Lupinacci, Timothy M.  
Esquire  
Maynard Cooper & Gale PC  
2400 AmSouth/Harbert Plaza  
1901 6th Ave N  
Birmingham AL 35203-2602

Grill, Matthew W.  
Esquire  
Maynard Cooper & Gale PC  
2400 AmSouth/Harbert Plaza  
1901 6th Ave N  
Birmingham AL 35203-2602

Barrett, Peter J.  
Esquire  
Kutak Rock LLP  
Bank of America Center  
1111 E Main St Ste 800  
Richmond VA 23219