

COPY

**FILED**

SUPERIOR COURT OF CALIFORNIA  
COUNTY OF ORANGE  
CENTRAL JUSTICE CENTER

NOV 20 2007

ALAN SLATER, Clerk of the Court

BY:     R. LUCEY    , DEPUTY

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

EDMUND G. BROWN JR.  
Attorney General  
W. DEAN FREEMAN  
Supervising Deputy Attorney General  
LISA W. CHAO, State Bar No. 198536  
Deputy Attorney General  
300 South Spring Street, Room 1702  
Los Angeles, California 90013  
Telephone: (213) 897-2481  
Fax: (213) 897-5775

Attorneys for Insurance Commissioner of the  
State of California, in his capacity as the  
Liquidator of Pacific National Insurance Company

SUPERIOR COURT OF THE STATE OF CALIFORNIA  
COUNTY OF ORANGE

INSURANCE COMMISSIONER OF THE  
STATE OF CALIFORNIA,

Applicant,

v.

PACIFIC NATIONAL INSURANCE  
COMPANY, a California corporation,

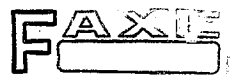
Respondent.

CASE NO. 03CC01065

**INSURANCE COMMISSIONER'S  
STATUS REPORT ON PACIFIC  
NATIONAL INSURANCE COMPANY  
LIQUIDATION ESTATE**

Application Filed: May 14, 2003

Judge: Frederick P. Horn  
Department: C31



1 TO THE COURT AND ALL INTERESTED PARTIES AND THEIR ATTORNEYS OF  
2 RECORD:

3 Steve Poizner, Insurance Commissioner of the State of California ("Commissioner" or  
4 "Liquidator"), in his capacity as Liquidator of Pacific National Insurance Company ("PNIC"),  
5 submits the following Status Report on estate matters.

6 **INTRODUCTION**

7 PNIC was an insurance company domiciled in California and transacted primarily  
8 workers' compensation insurance. It was also licensed to underwrite commercial multi-peril,  
9 commercial automobile, and other liability insurance. Due to its financially hazardous condition,  
10 the Commissioner applied to this Court for an order of conservation of PNIC. On May 14, 2003,  
11 this Court issued the order appointing the Commissioner as the conservator of PNIC.

12 As conservator, the Commissioner determined that it was futile to continue the business  
13 operations of PNIC and applied to this Court for an order of liquidation. On August 5, 2003, this  
14 Court issued an order of liquidation and terminated the Commissioner's appointment as  
15 conservator and appointed the Commissioner as liquidator.

16 Upon this Court's issuance of a liquidation order and a finding of PNIC's insolvency, the  
17 Liquidator relinquished all open claim files to the California Insurance Guarantee Association  
18 ("CIGA") for the adjustment and payment of covered claims. CIGA thus became responsible for  
19 administering (reviewing, approving, paying) the claims of California policyholders.

20 This Status Report sets forth for the Court and all interested parties, in detail, the progress  
21 made to date on establishing an orderly and efficient liquidation of PNIC. The report is intended  
22 to provide the Court with an overview of the liquidation process, the administrative operation of  
23 the company in conservation and liquidation, and the actions taken by the Liquidator to marshal  
24 assets of the estate.

25 **ADMINISTRATION OF THE PNIC LIQUIDATION ESTATE**

26 A. **Roles of the Court and the Commissioner in the Liquidation Process**

27 The Insurance Code provisions that govern this proceeding are set forth in sections 1010  
28 through 1062 (several other relevant Insurance Code sections are found in other chapters and

1 articles of the Code, but the primary insolvency code is in sections 1010-1062). Although the  
2 Legislature has vested the Insurance Commissioner as Liquidator with very broad discretion to  
3 conduct the liquidation process in the manner that he determines to be in the best interests of  
4 policyholders and creditors, the Court plays a vital role in the process. In addition to assisting the  
5 Liquidator in enforcing the various injunctions set forth in the Liquidation Order (which  
6 injunctions were specifically authorized by the Legislature to assist the Court and the Liquidator  
7 in conducting an orderly and efficient liquidation), the Court acts as the arbiter of disputed claims  
8 (see Ins. Code § 1032), and several other provisions of the Insurance Code instruct the Liquidator  
9 to seek the guidance and approval of the Court on matters relating to the expenses of  
10 administration, compensation paid to consultants, professionals and legal counsel, asset  
11 dispositions, and larger investment transactions. (See Ins. Code §§ 1035, 1036 and 1037(d) &  
12 (g).)

13 The Legislature has provided relatively little guidance with respect to the specific  
14 transactions and expenses that require Court approval, leaving it to the Liquidator and the Court  
15 to establish approval and oversight procedures that are reasonable and make sense given the  
16 particular needs of each insolvent insurer estate, and that facilitate the Court's assessment of  
17 whether the Commissioner is properly exercising his broad discretion as statutory liquidator.  
18 (See, e.g., *Quackenbush v. Executive Life Ins. Co.*, 32 Cal.App.4th 344, 358, and 401-403 (1995)  
19 [standard of review for court's review of liquidator's decisions is "abuse of discretion;" and  
20 liquidator must supply the court with adequate information to permit intelligent evaluation of the  
21 basis for the liquidator's determinations].)

22 **B. Overview of Insurer Insolvency Administration.**

23 In many respects, an insurance company in liquidation is like a "regular" insurance  
24 company. Some obvious differences are: (1) the Insurance Commissioner was appointed  
25 liquidator (or statutory receiver) by order of this court; (2) the liquidator derives his substantial  
26 powers from the Insurance Code (Ins. Code §§ 1010-1062); and (3) the liquidator's primary goals  
27 are to marshal and collect all available assets, to aggressively prosecute appropriate claims  
28 against the companies, directors, officers and others responsible for the company's failure for the

1 benefit of policyholders and creditors, and ultimately to wind up the business as quickly and  
2 efficiently as possible. Despite these distinctions, a company in liquidation is a business that  
3 must be operated and managed. The Liquidator therefore must employ people, utilize and update  
4 computers and facilities, contract with vendors and professionals and do the many other things  
5 described below to perform the necessary tasks to marshal assets and pay claims. (See Ins. Code  
6 § 1010 (authorizing the Commissioner "to conduct . . . the business of [the insurer], or so much  
7 thereof as to the commissioner may seem appropriate"); and § 1037(a) (granting the  
8 Commissioner the power and authority "to carry on and conduct the business and affairs of [the  
9 insurer]".))

10 To meet these goals administratively, the Liquidator uses the services of the  
11 Commissioner's Conservation and Liquidation Office ("CLO"). These services are supplemented  
12 by specialized vendors, contractors and consultants. The Liquidator also employs a number of  
13 attorneys. Non-litigation legal services mainly are provided by the Department of Insurance's  
14 Legal Division. The Office of the Attorney General is the Liquidator's primary litigation counsel.  
15 Both sets of attorneys are supplemented by private counsel with expertise in specialized areas of  
16 the law.

17 **C. Commissioner's Conservation & Liquidation Office**

18 The CLO is an administrative service entity created by the Commissioner to administer  
19 the estates of insurers undergoing conservation or liquidation in California. Upon obtaining a  
20 conservation or liquidation order, the Commissioner generally delegates his statutory  
21 administrative duties to a special deputy insurance commissioners, pursuant to Insurance Code  
22 section 1035, subdivision (a).

23 Shortly after liquidation, the Commissioner closed all of PNIC's offices (terminated office  
24 leases and sold all furniture, fixtures, and equipment) and consolidated operations (Accounting,  
25 Claims, Reinsurance, and Information Technology) into the CLO. These operations continue  
26 with the Commissioner's CLO personnel.

27 ///

28 ///

1 **D. Functional Operations Of The PNIC Liquidation Estate**

2 **1. Claims**

3 Shortly after this Court issued the liquidation order, the Commissioner mailed  
4 approximately 20,250 Proof of Claim ("POC") forms to persons possibly interested in PNIC's  
5 assets. With this Court's authorization, the Claims Bar Date was set at July 30, 2004.

6 There were 4,445 POCs timely returned to the Liquidator. Most of the POC process  
7 involves CIGA's evaluation of covered claims, as defined in Insurance Code section 1063.1,  
8 subdivision (c) and 1063.2. As of September 30, 2007, the Liquidator and CIGA have  
9 administered and closed all but 682 of these claims. The CIGA is administering these 682 open  
10 claims.

11 Insurance Code section 1033, subdivision (a), sets forth the priority for payment of claims  
12 against PNIC as follows:

13 Class 1: Expense of administration

14 Potential Class 1 claimants include employees for employment benefits and vendors of  
15 services for services rendered to the Liquidator during conservation and/or liquidation. In the  
16 eight months after conservation, the Liquidator had two full time employees working on Class 1  
17 claims for vendor services rendered between conservation and liquidation.

18 Class 2: Claims of CIGA

19 These are payments made by CIGA to policyholders, including payments of unearned  
20 premiums, and payments they have made to injured workers and service providers (e.g., doctors)  
21 plus CIGA's administrative expenses.

22 Class 2 claims also include policyholder claims that are not covered ("non-covered") by  
23 an insurance guaranty association ("IGA") and policyholder claims that exceed an IGA's  
24 statutory coverage limit ("overcap claims"). In California, the coverage limit for non-worker's  
25 compensation claims is \$500,000. (See Ins. Code § 1063.1(c)(1) and (c)(7)). There are not any  
26 non-covered or overcap claims in the PNIC liquidation.

27 Classes 3 through 9: Other claims for federal and state taxes, by general creditor and  
28 shareholders.

1           The Liquidator has determined that even under the most optimistic estimates of  
2 reinsurance and litigation recoveries and other asset dispositions, PNIC probably will not have  
3 sufficient assets to fully pay the approved Class 2 claims. If any portion of Class 2 claims remain  
4 unpaid, then the Liquidator will be prohibited from making any distribution to priority Classes 3-  
5 9. The Commissioner has further concluded that incurring administrative expense to review and  
6 adjudicate claims that fall into Classes 3 through 9 would constitute a waste of estate assets.  
7 Consequently, in 2006, the Commissioner mailed "no asset" letters (informing claimants that  
8 their claims fall into a class for which it is unlikely there will be a distribution of assets) to those  
9 claimants whose claims are subordinate to Class 2.

## 10           **2. Disbursement of Assets to CIGA**

11           On January 30, 2004, the Commissioner released \$23,416,358 to CIGA from PNIC's  
12 statutory deposit pursuant to Insurance Code section 11698.3. In accordance with Insurance Code  
13 Section 1035.5, subdivision (d), CIGA's final claim against PNIC will be offset by the amount of  
14 the statutory deposit.

## 15           **3. Reinsurance**

16           Reinsurance is the transfer of risk from one insurance company to another insurance  
17 company. In summary, it is a process whereby the first insurance company (called the cedent) is  
18 indemnified by the second insurance company (the reinsurer, also called the assuming insurer) for  
19 all or part of the claim liabilities under policies issued by the ceding insurer, which pays the  
20 reinsurer a premium in return.

21           Reinsurance recoverables are usually the largest assets of an insolvent insurer. As of  
22 March 31, 2007, the Commissioner has billed reinsurers a total of \$527,650.94 and has collected  
23 a total of \$524,126.92 since liquidation.

## 24           **4. Information Technology**

25           PNIC's information technology support is provided by its parent company, Highlands  
26 Insurance Group ("Highlands"), which itself is in receivership in its home state of Texas. At the  
27 time of PNIC's liquidation, the Highlands system was not shut down due to the California  
28 liquidation. Highlands has agreed to cooperate with all requests for information. During PNIC's

1 conservation, a data extract procedure was developed between the Commissioner and Highlands.  
2 Since liquidation, the Commissioner has taken PNIC's data and converted it for use in the CLO's  
3 Guardian of Liquidated Data ("GOLD") system. The GOLD system contains PNIC's historical  
4 policy and claim information as well as the paid loss information from CIGA.

5 **5. Accounting**

6 PNIC's Statement of Available Assets and Estimated Liabilities as of September 30, 2007  
7 is appended hereto as Exhibit A. A summary of the financial condition of PNIC is as follows:

8 As of September 30, 2007, PNIC had approximately \$20.3 million in assets and had  
9 approximately \$77.9 million in net liabilities which results in an approximate net deficiency of  
10 \$57.6 million.

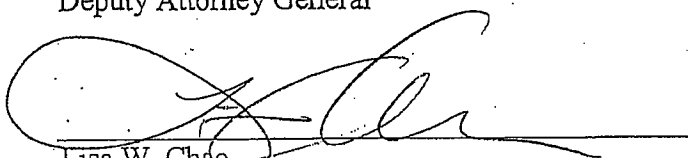
11 The largest claim (approximately \$101 million) against PNIC's assets is from Class 2  
12 claimants; however, as noted above, that is slightly offset by the \$23.4 million the Commissioner  
13 released to CIGA.

14 **CONCLUSION**

15 The Commissioner expects to continue to improve the manageability of the Pacific  
16 National liquidation estate and to accelerate its resolution.

18 Dated: November 20, 2007

EDMUND G. BROWN JR.  
Attorney General  
W. DEAN FREEMAN  
Supervising Deputy Attorney General  
LISA W. CHAO  
Deputy Attorney General

21  
22  
23   
Lisa W. Chao

24 Attorneys for Insurance Commissioner of the State  
25 of California, in his capacity as the Liquidator of  
26 Pacific National Insurance Company

**EXHIBIT "A"**



**913 Pacific National Ins Co****STATEMENT OF AVAILABLE ASSETS AND ESTIMATED LIABILITIES**

As of September 30, 2007

	Jun 30 2007	Sep 30 2007
<b>ASSETS</b>		
Participation in pooled investments, at market	11,861,000	12,188,000
Accrued investment income	61,000	63,000
Recoverable from reinsurers	6,224,000	7,048,000
Salvage and subrogation recoverable	7,000	7,000
Premium balances	84,000	83,000
Other receivable	942,000	942,000
<b>Total Available Assets</b>	<b>19,178,000</b>	<b>20,331,000</b>
<b>LIABILITIES</b>		
Secured claims	16,000	16,000
Administrative expenses (Class 1)	4,000	103,000
Claims against policies, including guarantee associations (Class 2), before distributions	102,063,000	101,422,000
Early access and other Class 2 distributions	(23,416,000)	(23,416,000)
California and Federal claims having preference (Classes 3 to 6)	7,000	7,000
All other claims (Class 7)	(225,000)	(214,000)
<b>Total Estimated Liabilities</b>	<b>78,449,000</b>	<b>77,918,000</b>
<b>NET ASSETS (DEFICIENCY)</b>	<b>(59,271,000)</b>	<b>(57,588,000)</b>

**ADMIN EXPENSES (\$)**

	2Q 2007	3Q 2007
Legal expenses	1,300	1,600
Consultants and temps	4,000	36,100
Office expenses	500	100
Capitalized software expenses	500	500
Allocated overhead expenses	85,800	77,300
	<b>92,100</b>	<b>115,600</b>

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: Insurance Commissioner v. Pacific National Insurance Co.

No.: 03CC01065

I declare:

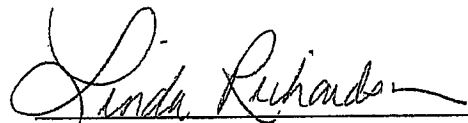
I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service that same day in the ordinary course of business.

On November 20, 2007, I served the attached **INSURANCE COMMISSIONER'S STATUS REPORT ON PACIFIC NATIONAL INSURANCE COMPANY LIQUIDATION ESTATE** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the internal mail collection system at the Office of the Attorney General at 300 South Spring Street, Suite 1702, Los Angeles, CA 90013, addressed as follows:

Monte D. Richard, Esq.  
Hosp, Gilbert, Bergsten & Phillips  
301 N. Lake Ave., Suite 410  
Pasadena, CA 91101

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on November 20, 2007, at Los Angeles, California.

Linda Richardson  
\_\_\_\_\_  
Declarant

  
\_\_\_\_\_  
Signature