

FILED
SUPERIOR COURT OF CALIFORNIA
COUNTY OF ORANGE
CENTRAL JUSTICE CENTER

AUG 26 2011

ALAN CARLSON, Clerk of the Court

BY F. IBARRA DEPUTY

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10 SUPERIOR COURT OF THE STATE OF CALIFORNIA
11 COUNTY OF ORANGE

13 **INSURANCE COMMISSIONER OF THE**
14 **STATE OF CALIFORNIA,**

15 Petitioner,

16 v.

17 **PACIFIC NATIONAL INSURANCE**
18 **COMPANY, a California corporation,**

19 Respondent.

Case No. 03CC01065

**NOTICE OF VERIFIED APPLICATION
AND VERIFIED APPLICATION FOR
ORDER APPROVING SECOND
INTERIM DISTRIBUTION OF ASSETS;
MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT THEREOF**

Date: September 28, 2011
Time: 1:30 p.m.
Dept: C31
Judge: Honorable Frederick P. Horn

23 TO ALL INTERESTED PARTIES AND THEIR ATTORNEYS OF RECORD:

24 PLEASE TAKE NOTICE that Petitioner Insurance Commissioner of the State of
25 California ("Commissioner"), in his capacity as the Liquidator of Pacific National Insurance
26 Company, will and hereby does apply to the Court for an Order Approving Second Interim
27 Distribution of Assets on September 28, 2011, at 1:30 p.m. in Department C31 of the Orange
28 County Superior Court, Central District, located at 700 Civic Center Drive West, Santa Ana,

1 California 92701.

2 The verified application is made pursuant to California Insurance Code section 1037. The
3 Commissioner seeks an order approving an interim distribution of assets in the amount of
4 \$19,000,000 to the California Insurance Guarantee Association.

5 Said application is based upon this notice, the memorandum of points and authorities
6 attached to the application, the records and files of this case, and other oral or documentary
7 evidence which may be presented at the hearing of said application.

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9 Dated: August 26, 2011

Respectfully Submitted,

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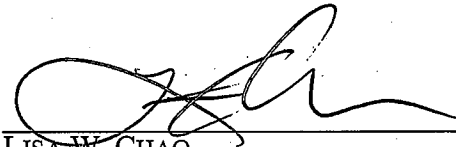
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LISA W. CHAO
Deputy Attorney General
*Attorneys for Petitioner Insurance
Commissioner of the State of California, in
his capacity as the Liquidator of Pacific
National Insurance Company*

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1 **VERIFIED APPLICATION**

2 Petitioner Insurance Commissioner of the State of California (“Commissioner”), in his
3 capacity as Liquidator of Pacific National Insurance Company (“Pacific National”), states as
4 follows:

5 **FACTUAL BACKGROUND**

6 1. Pacific National was an insurance company domiciled in California and transacted
7 primarily workers’ compensation insurance. Due to its financially hazardous condition, the
8 Commissioner applied to this Court for an order of conservation. On May 14, 2003, this Court
9 issued the order appointing the Commissioner as Conservator.

10 2. On August 5, 2003, the same court issued an order finding that Pacific National
11 was insolvent and, on that basis, terminating the Commissioner’s status as conservator and
12 appointing the Commissioner to serve as the Liquidator of Pacific National (“Liquidation
13 Order”). The finding of insolvency triggered the duty of the California Insurance Guarantee
14 Association (“CIGA”) to pay all covered policyholder claims in California pursuant to Insurance
15 Code section 1063, et seq.

16 3. In order to qualify to underwrite workers’ compensation business in California,
17 Pacific National was required to post statutory deposits with the insurance regulator. Insurance
18 Code sections 11698 and 11698.3 require the Commissioner to take possession of Pacific
19 National’s statutory deposits and to transfer them to CIGA upon a finding of insolvency that
20 obligates CIGA to pay claims.

21 4. On January 30, 2004, pursuant to Insurance Code section 11698.3, the
22 Commissioner released \$23,416,358 to CIGA from Pacific National’s statutory deposit. In
23 accordance with Insurance Code section 1035.5, subdivision (d), CIGA’s final claim against
24 Pacific National is offset by the amount of the statutory deposit.

25 5. On June 23, 2010, this Court entered an Order Approving Interim Distribution of
26 Assets to CIGA. Pursuant to the Court’s Order, on July 1, 2010, the Commissioner distributed
27 \$10 million to CIGA.

28 6. As of June 30, 2011, Pacific National has general assets totaling approximately

1 \$26 million, including liquid assets of approximately \$21.5 million and recoverables from
2 reinsurers of approximately \$4.5 million, and liabilities totaling approximately \$85.7 million,
3 which results in a net deficiency of approximately \$59.7 million. The full details of Pacific
4 National's assets, liabilities, and expenses are provided in the Statement of Available Assets and
5 Liabilities and the Statement of Changes to Net Assets attached hereto as Exhibit A and
6 incorporated herein by this reference.

7 7. As of June 30, 2011, Pacific National has incurred administration expenses (Class
8 1) of \$3,463,674.

9 8. As of June 30, 2011, Pacific National had Class 2 liabilities of approximately
10 \$118.1 million, of which \$23.4 million was paid to CIGA in 2004 and \$10 million was paid to
11 CIGA in 2010 as described in paragraphs 4 and 5 above. CIGA is the only Class 2 claimant in
12 the Pacific National estate.

13 9. Based on the amount of Class 2 liabilities and the limited assets available, it is
14 unlikely that general creditor claims will be considered.

15 **PROPOSED INTERIM DISTRIBUTION**

16 10. The Commissioner herein proposes a second Interim Distribution to Class 2 (i.e.,
17 CIGA) of \$19,000,000.

18 11. This proposed interim distribution of \$19 million plus the earlier release of the
19 statutory deposit of \$23.4 million and the interim distribution of \$10 million equal approximately
20 44.4% of CIGA's claim against Pacific National.

21 12. The Commissioner will continue his efforts to collect reinsurance due to the
22 Pacific National liquidation estate and will file a proper application with this Court for the final
23 distribution of assets.

24 WHEREFORE, Petitioner Insurance Commissioner of the State of California, in his
25 capacity as the Liquidator of Pacific National Insurance Company, prays this application be
26 granted and that this Court issue an order as follows:

27 a. Authorizing the Commissioner to make for a second interim distribution of assets
28 to CIGA in the amount of \$19,000,000; and

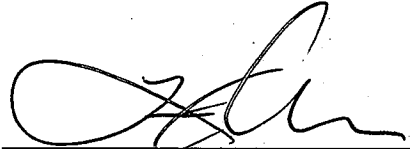
1 b. Authorizing the Commissioner to take any and all action necessary to accomplish
2 the purposes of the order prayed for herein.

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Dated: August 26, 2011

Respectfully Submitted,

KAMALA D. HARRIS
Attorney General of California
W. DEAN FREEMAN
FELIX E. LEATHERWOOD
Supervising Deputy Attorneys General



LISA W. CHAO
Deputy Attorney General
*Attorneys for Petitioner Insurance
Commissioner of the State of California, in
his capacity as the Liquidator of Pacific
National Insurance Company*

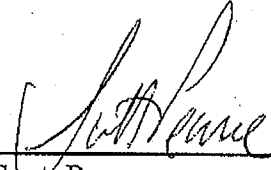
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VERIFICATION

I, Scott Pearce, state that I am a Senior Estate Trust Officer with the California Insurance Commissioner's Conservation and Liquidation Office and have overall responsibility for the liquidation of Pacific National Insurance Company. I have read the VERIFIED APPLICATION FOR ORDER APPROVING SECOND INTERIM DISTRIBUTION OF ASSETS; and know the contents thereof. The statements contained therein are not all within my personal knowledge, and I am informed that no single officer of the Conservation and Liquidation Office has personal knowledge of all these matters. The statements are based upon information assembled by employees authorized to maintain and analysis the records of Pacific National Insurance Company in liquidation. I am informed and believe that the statements based upon that information are true. As those matters that are within my own personal knowledge, the statements therein are true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at San Francisco, California, on August 25, 2011.



Scott Pearce
Senior Estate Trust Officer

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 **A. The Commissioner Has Broad Powers To Administer An Insolvent Insurer Estate.**

3 The purpose of an insurance insolvency proceeding is to ensure the orderly and equitable
4 distribution of assets of the insolvent insurer to those entitled to share in those assets. (*In re Title*
5 *USA Corp* (1996) 36 Cal.App.4th 363.) Insurance Code sections 1010 – 1062, which address
6 such proceedings, expressly delegate duties and powers to the Commissioner with respect to the
7 administration of insolvent insurer estates. (Ins. Code, § 1016.) Chief amongst his authorities
8 and responsibilities are the Commissioner’s power to collect assets and the duty to distribute them
9 ratably among creditors subject to claim priorities. (*Jones & Sons v. Independent Ins. Co.* (1942)
10 52 Cal.App.2d 374, 378-379; see Ins. Code, § 1025 (requiring claims of same class to share
11 ratably), § 1033 (setting claim priorities), § 1037 (enumerating Commissioner’s powers to
12 marshal assets).) The enumerated powers are not a limitation of the Commissioner’s powers and
13 do not “exclude in any manner his or her right to perform and to do such other acts not herein
14 specifically enumerated, or otherwise provided for, which the commissioner may deem necessary
15 or expedient for the accomplishment or in aid of the purpose of such proceedings.” (Ins. Code, §
16 1037.)

17 The Commissioner is afforded broad discretion in the exercise of his duties, subject to
18 review by the court under the “abuse of discretion” standard. (*In Re Executive Life Ins. Co.*
19 (1995) 32 Cal.App.4th 344, 356, 358.) Thus, the court must review the Commissioner’s action to
20 determine if it was “arbitrary, i.e. unsupported by a rational basis, or is it contrary to a specific
21 statute, a breach of the fiduciary duty of the conservator as trustee, or improperly
22 discriminatory....” (*Ibid.*)

23 **B. Interim Distribution of Assets to Approved Class 2 Claimant Is Within the Authority**
24 **of the Commissioner.**

25 Insurance Code section 1033 provides for the priority of claims allowed in an insurance
26 liquidation proceeding in relevant part as follows:

- 27 (a) Claims allowed in a proceeding under this article shall be given preference in
28 the following order:

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- (1) Expense of administration.
- (2) All claims of the California Insurance Guarantee Association or the California Life and Health Insurance Guarantee Association, and associations or entities performing a similar function in other states, together with claims for refund of unearned premiums and all claims under insurance and annuity policies or contracts, including funding agreements, of an insolvent insurer that are not covered claims....
- (3) Claims having preference by the laws of the United States.
- (4) Unpaid charges due under the provisions of Section 736.
- (5) Taxes due to the State of California.
- (6) Claims having preference by the laws of this state.
- (7) Claims of creditors not included in paragraphs (1) to (6), inclusive.
- (8) Certificates of contribution, surplus notes, or similar obligations, and premium refunds on assessable policies.
- (9) The interests of shareholders or other owners in any residual value in the estate.

The list of claimants in Section 1033, subdivision (a)(2) above constitutes the Class 2 claimants of an insolvent insurance company. In this case, the California Insurance Guarantee Association ("CIGA") is the only Class 2 claimant approved by the Commissioner. Given the amount of CIGA's Class 2 claim and the limited assets of Pacific National, it is unlikely that any claim below Class 2 will be considered.

Further, the Commissioner proposes a second interim distribution to CIGA in the amount of \$19 million out of liquid assets of approximately \$21.5 million. The remaining assets after distribution will be sufficient to pay secured claims and the higher priority disbursement required under Insurance Code section 1033(a)(1). Therefore, the Commissioner should be allowed to make his proposed distribution of \$19 million to CIGA.

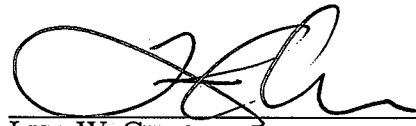
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1 Based on the foregoing reasons, the Commissioner respectfully requests that the Court
2 grant the application and approve the second interim distribution to the California Insurance
3 Guarantee Association.

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5 Dated: August 26, 2011

Respectfully Submitted,

6 KAMALA D. HARRIS
7 Attorney General of California
8 W. DEAN FREEMAN
9 FELIX E. LEATHERWOOD
10 Supervising Deputy Attorneys General

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12 LISA W. CHAO
13 Deputy Attorney General
14 *Attorneys for Petitioner Insurance*
15 *Commissioner of the State of California, in*
16 *his capacity as the Liquidator of Pacific*
17 *National Insurance Company*

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EXHIBIT "A"

Insurance Commissioner of the State of California
 Conservation & Liquidation Office

Pacific National Ins Co

STATEMENT OF ASSETS AND LIABILITIES
 As of June 30, 2011

	(Opening Balance)		
	May 31	Jun 30	
	2003	2011	Change
ASSETS			
Cash and cash equivalents:			
Unrestricted	\$406,455	-	(\$406,455)
Participation in pooled investments	-	\$21,457,526	21,457,526
Non-pooled short-term investments			
Unrestricted	35,751,149	-	(35,751,149)
Accrued investment income	361,456	41,345	(320,111)
Recoverable from reinsurers	4,872,417	4,531,518	(340,899)
Salvage and subrogation recoverable	(62,393)	-	62,393
Premium balances	(431,343)	-	431,343
Receivable from affiliates	152,902	-	(152,902)
Agent's balances	1,056,462	-	(1,056,462)
Deposits and other assets	936	-	(936)
Total Available Assets	42,108,041	26,030,389	(16,077,652)
LIABILITIES			
Accrued administrative expenses	\$1,128	\$843,053	\$841,925
Claims against policies, including guaranty associations, before distributions	45,888,907	118,090,203	72,201,296
Early access and other Class 2 distributions	-	(33,416,359)	(33,416,359)
California and Federal claims having preference	-	7,144	7,144
All other claims	865,430	239,312	(626,118)
Total Estimated Liabilities	46,755,465	85,763,353	39,007,888
 NET ASSETS (DEFICIENCY)	 (\$4,647,424)	 (\$59,732,964)	 (\$55,085,540)

Insurance Commissioner of the State of California
 Conservation & Liquidation Office

Pacific National Ins Co

STATEMENT OF CHANGES TO NET ASSETS
 and December 31, 1998 to 2007

	<u>2003 to 2010</u>	<u>Jun 30 ytd 2011</u>	<u>Conservation to Jun 2011</u>
Income			
Premium Collections	(\$1,540,042)	-	(\$1,540,042)
Salvage/Subrogation Recoveries	3,103,177	\$51,082	3,154,259
Miscellaneous Income	114,601	-	114,601
Net Investment Income	3,772,993	113,337	3,886,330
	<u>5,450,729</u>	<u>164,419</u>	<u>5,615,148</u>
Operating Expenses			
Legal and Consulting	\$615,542	\$25,499	\$641,041
General and Administrative	309,985	230	310,215
Allocated Overhead Expenses	2,458,937	53,481	2,512,418
	<u>3,384,464</u>	<u>79,210</u>	<u>3,463,674</u>
Losses and Other Expenses			
Incurred Losses and Claims Expense	\$53,081,129	\$3,655,680	\$56,736,809
Loss (gain) on Disposition of Fixed Assets	659,605	-	659,605
Provision for Federal Income Taxes	8,218,100	(7,380,053)	838,047
	<u>61,958,834</u>	<u>(3,724,373)</u>	<u>58,234,461</u>
NET INCOME (LOSS)	<u>(59,892,569)</u>	<u>3,809,582</u>	<u>(56,082,987)</u>
Adjustments to assets and liabilities	997,447	-	997,447
Changes to Net Assets	<u>(\$58,895,122)</u>	<u>\$3,809,582</u>	<u>(\$55,085,540)</u>

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 with postage thereon fully prepaid that same day in the ordinary course of business.

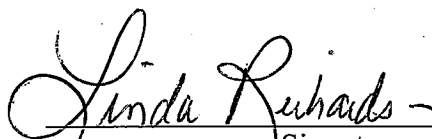
On August 26, 2011, I served the attached **NOTICE OF VERIFIED APPLICATION AND VERIFIED APPLICATION FOR ORDER APPROVING SECOND INTERIM DISTRIBUTION OF ASSETS; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** by placing a true copy thereof enclosed in a sealed envelope in the internal mail collection system at the Office of the Attorney General at 300 South Spring Street, Suite 1702, Los Angeles, CA 90013, addressed as follows:

C. Guerry Collins
Locke Lord Bissell & Liddell LLP
300 South Grand Ave., Suite 2600
Los Angeles, CA 90071
*Attorneys for California Insurance
Guarantee Association*

Brian E. Riewe
Brian E. Riewe, P.C.
4408 Spicewood Springs Rd.
Austin, TX 78759
*Attorneys for Special Deputy Receiver of
Highlands Insurance Company*

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on August 26, 2011, at Los Angeles, California.

Linda Richardson
Declarant



Signature