

IN THE CHANCERY COURT OF THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY

STATE OF TENNESSEE, ex rel.,)
PAULA A. FLOWERS,)
Commissioner of Commerce and)
Insurance for the State of Tennessee,) No. 03-3731-IV
)
Petitioner,)
v.)
)
EXCHANGE INSURANCE COMPANY,)
a Tennessee domiciled insurance company,)
)
Respondent.)

**VERIFIED PETITION FOR ENTRY OF CONSENT ORDER APPOINTING THE
COMMISSIONER RECEIVER
FOR PURPOSES OF REHABILITATION; AND INJUNCTION**

Petitioner, Paula A. Flowers, Commissioner of Commerce and Insurance for the State of Tennessee ("Commissioner" or "Department"), by her counsel, Paul G. Summers, Attorney General of the State of Tennessee, seeks the following *expedited relief and immediate entry* of a Consent Order of Rehabilitation, alleging as follows:

NATURE OF THE ACTION

1. This is an action requesting prompt entry of a Consent Order appointing the Commissioner as receiver for rehabilitation under Tenn. Code Ann. §§ 56-9-101, et seq., the Insurers Rehabilitation and Liquidation Act (hereinafter "the Act"), of Exchange Insurance Company, a Tennessee domiciled insurance company with its principal place of business in Nashville, Tennessee ("EIC," "Respondent," or "insurer"). EIC holds a certificate of authority

from the Tennessee Department of Commerce and Insurance to act as an insurer under the provisions of Tenn. Code Ann. §§ 56-23-101 *et seq.* for state stock fire insurance companies. This petition is sought because EIC has been under an Agreed Order of Administrative Supervision of the Commissioner, pursuant to Tenn. Code Ann. § 56-9-501 *et seq.*, since December 19, 2002, due to impaired statutory capital and surplus, and because, financial information related to company now indicates that it will not be able to remedy this situation without rehabilitation under the Act.

2. EIC, as a state stock fire insurance company, authorized prior to May 7, 1969 as a state mutual fire insurance company, is required to maintain combined capital and surplus of at least \$300,000, pursuant to Tenn. Code Ann. § 56-23-101(d). EIC reported it had capital and surplus as of its March 31, 2003 Quarterly Financial Statement of only \$84,941; therefore, its capital and surplus is impaired and it lacks the minimum surplus required by statute to operate in this State.

3. EIC's financial condition is financially hazardous due to uncertainty about its ability to emerge from the surplus impairment to comply with law, and because its borderline financial ability to satisfy all claims may be insufficient for unknown risks. EIC has undergone some measures under the Administrative Supervision of the Commissioner to stabilize its financial position and to minimize further risk, including a beneficial arrangement for assumption of insurance risks effective April 1, 2003, and operational changes taken to issue no new or renewal insurance policies. The Commissioner contemplates that EIC will have to operate in this run-off status for some time without sufficient return to adequate surplus or sustained profitability. Rehabilitation is intended to be beneficial because of statutory protections afforded to EIC, and additional measures may be taken through rehabilitation to

stabilize its status, to fully ascertain its financial condition, and to limit costs. Rehabilitation will allow the Commissioner to fully control and monitor this financial condition should it become apparent that EIC cannot honor its ongoing insurance obligations. Currently, the Commissioner is informed and believes that EIC should be capable of honoring valid obligations to policyholders, and the Commissioner as receiver will evaluate whether any further measures are required to allow EIC to emerge from rehabilitation or to wind down its business. The Commissioner has reasonably determined that EIC is now in a condition which, without rehabilitation, is hazardous financially to the policyholders, creditors and the public. The Commissioner consequently is seeking orders of rehabilitation for EIC in this Court.

4. The Commissioner deems it prudent and necessary for EIC immediately to enter into rehabilitation voluntarily in Tennessee under the control of the Tennessee Commissioner of Commerce and Insurance. Under the circumstances, EIC has agreed to a voluntary rehabilitation by which its condition can be preserved, and its assets can be marshaled, stabilized and applied for the benefit of its policyholders and creditors, as allowed by statute. The Commissioner requests an order under Tenn. Code Ann. §§ 56-9-302 and -303, consented to by EIC, permitting the Commissioner, as Rehabilitator, to take control of EIC's assets and management, to act as receiver to attempt to rehabilitate and revitalize EIC.

5. EIC has executed a Consent Order of Rehabilitation, the original of which is lodged with this Petition, and a copy of which is attached to this Petition as Exhibit A. The Consent Order requested also imposes an injunction against suits and other acts that could interfere with the efforts of the receiver. The Consent Order continues this Court's supervisory control over the action if further relief is required. There is a proper sufficient basis for the following order pursuant to Tenn. Code Ann. §§ 56-9-301(1) and (12). EIC waives summons

and the right to be heard before entry of this Consent Order. Consequently, there is good cause for entry of this Order.

6. The Commissioner hereby requests formal delinquency proceedings under the Act, for the Court to appoint the Commissioner rehabilitator (hereinafter referred to as "Receiver") of EIC for the purposes of rehabilitation as provided by Tenn. Code Ann. §§ 56-9-301 *et seq.*, with all the powers granted to rehabilitators by statute and this Court's orders, and to enjoin all persons described in the Consent Order from interfering with the conduct of the duties of the receiver as provided by Tenn. Code Ann. § 56-9-105. A receivership to rehabilitate the company is requested to enable the Receiver to assume control, to take title of assets, to determine the actual financial condition of EIC in light of the competing claims to its assets and to consider a plan to revitalize EIC and to propose it to this court. If the Commissioner were to determine that further revitalization attempts would be futile, the Commissioner would promptly move this Court to convert this action to a liquidation of EIC.

JURISDICTION AND VENUE

7. This Court has sole subject matter jurisdiction of this action pursuant to Tenn. Code Ann. § 56-9-104. Venue of this action is properly in the Chancery Court of Davidson County pursuant to Tenn. Code Ann. § 56-9-104(e).

THE PARTIES

8. The Petitioner, Paula A. Flowers, is the duly appointed Commissioner of Commerce and Insurance for the State of Tennessee. Pursuant to Tenn. Code Ann. §§ 56-9-101, *et seq.*, the rehabilitation, liquidation, or conservation of a domestic insurance company is to be conducted by the Commissioner after her appointment as receiver by the Court. Tenn. Code

Ann. §§ 56-9-301, et seq. The Commissioner shall appoint a special deputy or deputies in order to carry out her day to day duties as Receiver of this organization.

9. The Respondent, Exchange Insurance Company (hereinafter EIC, Respondent, the company, or the insurer) holds a certificate of authority as a Tennessee insurance company from the Commissioner under Tenn. Code Ann. § 56-23-101. EIC is chartered and licensed as a state stock fire insurance company, and must comply with all laws, regulations and requirements applicable to such insurers in this State. EIC has sold policies of insurance only within the State of Tennessee. EIC's principal offices are located at 209 14th Avenue North, Nashville, Tennessee 37203 and its Vice President is Marcia Cohen at the same address. EIC has been subject to an Agreed Order of Administrative Supervision by the Commissioner since December 19, 2002.

LEGAL GROUNDS JUSTIFYING REHABILITATIVE RECEIVERSHIP

10. Tenn. Code Ann. §§ 56-9-301 authorizes the Commissioner to petition the Davidson County Chancery Court for an order making her Rehabilitator of EIC, a Tennessee domestic insurer. The Commissioner may apply by petition to the Chancery Court of Davidson County for an order authorizing the Commissioner to rehabilitate a domestic insurer on any one or more of the grounds stated in Tenn. Code Ann. § 56-9-301, including that:

(1) The insurer is in such condition that the further transaction of business would be hazardous financially to its policyholders, creditors or the public.

...; or

(12) The board of directors, or the holders of a majority of the shares entitled to vote, or a majority of those individuals entitled to the control of those entities specified in § 56-9-102, *request or consent to rehabilitation under this chapter.*

Tenn. Code Ann. § 56-9-301(1) and (12).

11. The grounds for rehabilitation are present here and do not require the Commissioner to prove that EIC is insolvent or to wait for that degree of financial crisis before taking action for the protection of policyholders, creditors and the public interest in this company in Tennessee. EIC should have a combined statutory capital and surplus of \$300,000, but had reported to the Department only having \$84,941 statutory capital and surplus as of March 31, 2003. (Copies of excerpted assets and liabilities pages in EIC's Quarterly Statement as of March 31, 2003 on file are attached to this Petition as Exhibit B; See, Surplus as Regards Policyholders, line 35, page 3). Here the consent of the company has been given, and the financially hazardous circumstances of surplus impairment exist so that independent statutory grounds exist for entry of the Consent Order of Rehabilitation without delay.

FEATURES OF REHABILITATIVE RECEIVERSHIP

12. **Management and Possession of EIC.** When a rehabilitator is appointed pursuant to Tenn. Code Ann. § 56-9-301, several statutory powers flow from that order under the Act. The order to rehabilitate the insurer directs the Commissioner, as Rehabilitator, immediately to take possession of the assets of EIC, and vests title to all assets in the Rehabilitator. Tenn. Code Ann. § 56-9-302. The order does not constitute the anticipatory breach of any contracts of EIC and it shall not be grounds for retroactive revocation or retroactive cancellation of EIC's contracts, unless such is done by the Rehabilitator. The Rehabilitator takes actions deemed necessary by her to reform and revitalize EIC. The powers of EIC's directors, officers and managers are suspended, subject to redelegation by the Rehabilitator. The Rehabilitator has full power to direct and manage, to hire and discharge employees subject to any contract rights they may have, and to deal with the property and business of the insurer. Tenn. Code Ann. § 56-9-303. This may include operating the insurer for

a significant time or for a short period. The Rehabilitator has power to appoint one or more special deputy commissioners to carry out her duties, and in the Consent Order, paragraph 6, appoints Kathy Fussell, Insurance Analysis Director in the Department's Insurance Division, who has also served as the EIC's administrative supervisor.

13. Paragraph 8 of the Rehabilitation Order orders the Rehabilitator to take such action as she deems necessary or appropriate to reform and revitalize the insurer. She shall have all the powers of the directors, officers, and managers, whose authority shall be suspended, except as they are redelegated by the Rehabilitator. The Commissioner recognizes that services of National Lloyds Insurance Company and/or NLASCO, Inc. pursuant to agreements for management and reinsurance entered into during the period of EIC's Administrative Supervision are necessary to the success of rehabilitation and runoff, and therefore will take steps to continue those services of National Lloyds Insurance Company and NLASCO, Inc. under the agreements, which shall not in any way be construed as a violation of the injunctive relief granted in this Order. The Rehabilitator upon appointment will have full power to direct and manage, to hire and discharge employees subject to any contract rights they may have, and to deal with the property and business of the insurer. She shall also have the full power to review all contracts of EIC and make any amendments, modifications, terminations, adjustments or new contracts deemed necessary in order to effectuate this Rehabilitation

14. **Management and Operations for Run-Off in Rehabilitation:** EIC has been under supervision of the Commissioner since December 19, 2002 due to the inadequacy of its capital and surplus. (See attached agreed orders of supervision, collective Exhibit C). Certain measures have been taken during supervision that are intended to better manage and control EIC's risk and future expenses. EIC has entered into certain agreements with the approval of the

Commissioner with National Lloyds Insurance Company, a Texas insurer, effective April 1, 2003. On that date, EIC entered into portfolio reinsurance and management agreements with an unrelated insurance company, National Lloyds Insurance Company, attached to this Petition as Exhibits D and E, respectively. (Multiple Line Quota Share Reinsurance Treaty, and Management Agreement). Under the general terms of the portfolio reinsurance agreement, National Lloyds reinsured 100% of EIC's in-force business as of April 1, 2003, and assumed 100% of all related claims incurred after March 31, 2003. Upon expiration of the current in-force periods of the reinsured policies, National Lloyds has and will have the opportunity to write renewal coverage on a direct basis with the policyholders. EIC has ceased writing new or renewal policies and is deemed to be in a run-off status. Under the general terms of the management agreement, National Lloyds' affiliate, NLASCO Services, Inc., has agreed to oversee and administer the run-off of the EIC in-force business as of March 31, 2003, and the related settlement of claims incurred prior to April 1, 2003. In addition, the third-party insurance company acquired substantially all of EIC's property and equipment in April 2003 and has agreed to assume substantially all of the Company's operating expenses during the run-off period. The Commissioner deems that continuing the management and insurance arrangements pursuant to these agreements is beneficial to the successful run-off of EIC.

15. **Injunctive Relief.** The Commissioner as Rehabilitator may apply for injunctive relief under Tenn. Code Ann. § 56-9-105 to prevent transaction of the insurer's business, transfer of property, interference, waste of assets, destruction of records or data, or continuation or initiation of a number of types of actions against the insurer or its policyholders or enrollees. The Commissioner requests such injunctions against institutions of any actions against EIC pending further order of this Court for the protection of EIC and its enrollees upon the

appointment of a receiver, all as more fully set forth in Order terms in the prayer for relief hereto. The Order of Rehabilitation explicitly acknowledges, in this case, that EIC's agreements with National Lloyds and NLASCO, Inc. for management and reinsurance are to continue, subject to the Rehabilitator's power to manage and control the business, and that such shall not be a violation of any injunction provided by the order. Order, Paragraph 2. The Court is asked to specifically authorize the Rehabilitator to continue EIC's contractual and financial arrangements for management and reinsurance with **National Lloyds Insurance Company and NLASCO, Inc.** pursuant to the Management Agreement and Multiple Line Quota Share Reinsurance Treaty, and any amendments thereto that may be agreed upon between the Rehabilitator and those parties, in the same manner as provided prior to the filing of the Petition for Rehabilitation, subject to the powers of the Commissioner as Rehabilitator to manage and direct EIC, and to supervise its contracts, and such services and expenses during this rehabilitation shall be paid for and considered administrative services expenses of this rehabilitation;

16. **Cooperation with Receiver.** Furthermore, under Tenn. Code Ann. § 56-9-106, all persons who have been performing or are concerned in any way with the affairs of EIC are required to cooperate with the Commissioner.

17. **Stay.** Under Tenn. Code Ann. § 56-9-304, actions in which EIC is a party or is obligated to defend, are stayed for 90 days or such additional time as is needed to allow the rehabilitator to take action in the pending litigation.

18. **Development of Rehabilitation Plan.** Under Tenn. Code Ann. § 56-9-303(e), if the Rehabilitator determines that reorganization, consolidation, conversion, reinsurance, merger or other transformation of the insurer is appropriate, the Rehabilitator prepares a plan to effect

such changes. The Rehabilitator shall account to the Court and report periodically as to the likelihood that a plan will be prepared and the timetable for doing so. The Rehabilitator applies for approval of such plan, and after notice and hearing prescribed by the Court, the Court may approve such plan, disapprove it, or approve it as modified. Any plan approved under Tenn. Code Ann. § 56-9-303(e) shall be, in the judgment of the Court, fair and equitable to all parties concerned. The Rehabilitator then carries out the plan.

19. **Avoidance Powers.** The filing of a petition for rehabilitation affords statutory remedies upon the entry of an order of either rehabilitation or, if needed, any subsequent liquidation, which enable the receiver to avoid preferential, fraudulent, and certain other financial transfers prior to the filing date of the petition. These statutory powers, found at Tenn. Code Ann. §§ 56-9-315 and 316 are desirable because they increase the possible available funds for the benefit of the rehabilitating insurer's policyholders and creditors.

20. **Rehabilitation Conclusion Options.** Whenever the Commissioner believes further attempts to rehabilitate an insurer would substantially increase the risk of loss to creditors, policyholders or the public, or would be futile, the Commissioner may petition this Court for an order of liquidation under Tenn. Code Ann. § 56-9-305. The directors of EIC may defend against such a petition. Additionally, the directors have statutory rights to petition the Court for a termination of the rehabilitation. Termination of rehabilitation may be sought by the Rehabilitator or the Court itself. Tenn. Code Ann. § 56-9-305(c).

21. For all the foregoing reasons, the Commissioner respectfully requests that the Consent Order appointing Commissioner Rehabilitator of Exchange Insurance Company, Inc. be granted and entered at the earliest opportunity. Respondent has waived hearing prior to entry of the Consent Order.

WHEREFORE, premises considered, Petitioner prays as follows:

A. That an Order Appointing the Commissioner and her successors in office as Rehabilitator of Respondent Exchange Insurance Company, Inc. be entered with the terms of the attached Exhibit A Consent Order;

B. That preliminary injunctive relief under Tenn. Code Ann. § 56-9-105 and related injunctions authorized under Tenn. Code Ann. § 56-9-304 be accorded in the terms set forth in the Consent Order;

C. That EIC not be required to file a response to this Petition prior to entry of the Order and that summons be waived;

D. That the filing of this petition and any requested Order be entered without cost bond as provided by Tenn. Code Ann. § 20-13-101.

E. That this Court retain jurisdiction for such other and related relief as is appropriate.

THIS IS THE FIRST APPLICATION FOR EXTRAORDINARY RELIEF.

Respectfully submitted,

PAUL G. SUMMERS (BPR 6285)
Attorney General and Reporter

SARAH A. HIESTAND (BPR 14217)
Senior Counsel
Attorney General, Financial Division

P.O. Box 20207
Nashville, TN 37202
(615) 741-6035

68754

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing Verified Petition for Entry of Consent Order Appointing the Commissioner Receiver for Purposes of Rehabilitation has been delivered by fax and U.S. Mail postage prepaid to:

Respondent

Exchange Insurance Company** **Summons Waived
c/o Marsha Cohen, Vice President
209 14th Avenue North
Nashville, Tennessee 37203 fax 615-329-2975

Management Agreement Contacts:

National Lloyds Insurance Company	NLASCO Services, Inc.
Greg Vanek, President	Attn: Gordon Robinson
P.O. Box 2650	900 Austin Avenue, 12th floor
Waco, Texas 76702-2650	Waco, Texas 76701
Fax (254) 399-0765	Fax (254) 756-0050

Pat Beard, Esq.
Beard & Kultgen
5400 Bosque Blvd., Suite 301
Waco, Texas 76710
Fax (254) 776-3591

this ___ day of _____, 2003.

SARAH ANN HIESTAND

IN THE CHANCERY COURT OF THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY

STATE OF TENNESSEE, ex rel.,)	
PAULA A. FLOWERS,)	
Commissioner of Commerce and)	
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)	
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v.)	
)	
EXCHANGE INSURANCE COMPANY,)	
a Tennessee domiciled insurance company,)	
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Respondent.)	

VERIFICATION

1. I, Paula A. Flowers, am the duly appointed Commissioner of Commerce and Insurance for the State of Tennessee.

2. I have read the foregoing Verified Petition for Entry of Consent Order Appointing the Commissioner Receiver for Purposes of Rehabilitation; and Injunction; and swear that the information contained therein is true and correct to the best of my knowledge, information and belief, including information from the Insurance Division of the Department of Commerce and Insurance. I respectfully request that the Court enter the Consent Order promptly based on the circumstances set forth in the Petition and the Consent Order.

PAULA A. FLOWERS
Commissioner of Commerce and Insurance
for the State of Tennessee

SWORN TO AND SUBSCRIBED before me on this _____ day of _____, 2003.

NOTARY PUBLIC

My Commission Expires: _____