THE STATE OF NEW HAMPSHIRE
SUPREME COURT

No. 2004-0319

IN THE MATTER OF THE LIQUIDATION OF
THE HOME INSURANCE COMPANY

Mandatory Appeal Pursuant to Rule 7 from the Merrimack County Superior Court

APPELLANT BENJAMIN MOORE & CO.'S BRIEF

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Questions Presented For Review

1. Whether the agreement between the Liquidator of the Home Insurance Company (the "Liquidator") and certain reinsurance claimants (the "AFIA cedents"), approved by the trial court, which provides for preferred payment of certain estate assets (potentially $75,000,000 or more) to the AFIA cedents, violates the strict priority provisions of the New Hampshire Insurers Rehabilitation and Liquidation Act, when the AFIA cedents are a sub-class of Class V claimants that are not entitled to any distribution in liquidation before all creditors in senior classes have been paid in full?

This issue was the subject of, and therefore preserved by, the following record documents and transcripts: (a) the Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated February 11, 2004, (b) the Response And Objection Of Benjamin Moore & Co. To Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated March 18, 2004, (c) the Objections And Responses Of The ACE Companies To The Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated March 19, 2004, and supporting Memorandum, (d) Benjamin Moore & Co's Supplemental Memorandum Of Law On The Issue Of Whether, As A Matter Of Law, The Liquidator's Proposed Agreement With The AFIA Cedents Violates The Liquidation Statute, dated April 16, 2004, (e) ACE Companies' Supplemental Memorandum In Opposition To Liquidator's Motion For Approval Of Proposed Agreement & Compromise With AFIA Cedents, dated April 16, 2004, (f) the Liquidator's Supplemental Reply In Support Of Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated April 16, 2004, (g) the transcript of the status conference held on April 9, 2004, and (h) the transcript of the hearing held on April 23, 2004.

2. Whether the trial court erred by summarily approving the agreement without an evidentiary hearing, without making any findings, and without conducting any independent review of the agreement to determine whether it is in the best interest of the estate and fair and equitable, or giving the objecting parties a fair opportunity to discover the factual underpinnings of the proposed agreement or its reasonableness.

See issue 1 above for citations to the record where this issue was preserved.

3. Whether Benjamin Moore & Co., as a Class II policyholder claimant, has standing to pursue this appeal when the Liquidator conceded in the trial court that Benjamin Moore & Co. has standing, and when the court-approved agreement authorizes the distribution of tens of millions of dollars to junior Class V creditors before Class II creditors are paid in full, thereby harming Benjamin Moore's interests.

The issue of Benjamin Moore's standing was raised for the first time in the Liquidator's Motion to Dismiss this appeal; Benjamin Moore addresses the standing issue in its brief pursuant to this Court's June 11 Notice.

Constitutional Provisions, Statutes, Ordinances, Rules Or Regulations Involved

R.S.A. 401-C:1, 401-C:21, 402-C:25, 402-C:26, and 402-C:44.

See pp. 36-42 of this Brief for the text of these statutes.

Statement Of The Case

A. Nature Of The Appeal

Benjamin Moore & Co. ("Benjamin Moore") appeals a trial court order that permits the Liquidator of the Home Insurance Company to distribute 50% of the proceeds of certain estate assets (potentially $75,000,000.00 or more) to junior creditors, in violation of the express provisions of the Insurers Rehabilitation and Liquidation Act, R.S.A. 402-C:1 *et seq*. (the "Act" or "liquidation statute"). See R.S.A. 402-C:44 (setting forth a strict order of distribution of estate assets). By authorizing the distribution of assets to a junior group of general creditors before senior policyholder creditors are paid in full, the trial court altered the statutory rules of priority and recognized a special sub-class of preferred creditors who enjoy "super-priority" status. Because the order offends the Act as a matter of law, Benjamin Moore asks this Court to reverse the trial court's decision and vacate the order.

B. Factual And Procedural Background

Benjamin Moore is a policyholder claimant of the Home Insurance Company. See Order of April 29, 2004 (Joint Appendix at 283)(noting that Benjamin Moore is a Class II, or policyholder, claimant); Transcript of April 23, 2004 Hearing at 5 (Joint Appendix at 216)(same). To protect its interests, Benjamin Moore filed a proof of claim in the liquidation proceeding, as required by the Act and the Superior Court's Liquidation Order. Because Benjamin Moore is a policyholder claimant, it enjoys Class II priority in the distribution of assets of the Home estate. R.S.A. 402-C:44 (II)(including "claims by policyholders" in Class II).

As a Class II claimant, Benjamin Moore has a direct and substantial interest in the proper administration of the Home estate. Accordingly, when the Liquidator sought court approval to enter an agreement to facilitate a "scheme of arrangement" under which the Liquidator proposed to distribute 50% of certain estate assets, an amount which could exceed $75,000,000.00,[1] to certain preferred Class V creditors before paying senior claimants in full, Benjamin Moore became concerned.[2] To protect its interests, and to prevent a wrongful distribution of assets to junior claimants, Benjamin Moore filed an objection.

Benjamin Moore's objection was founded on two independently dispositive grounds. First, the Liquidator's proposed distribution of substantial estate assets to the AFIA cedents, a group of general creditors, before senior creditors were paid in full, violated the clear and strict statutory order of distribution set forth in R.S.A. 402-C:44. Accordingly, both the Liquidator's decision to enter into the agreement and the trial court's approval of its terms run directly afoul of the comprehensive statutory priority scheme. Second, the Liquidator failed to proffer sufficient facts to explain why the proposed agreement is in the best interest of the estate and is fair and equitable. Thus, even if the agreement could be squared with the statutory priority scheme, the Liquidator failed to justify an unprecedented arrangement under which a special class of general creditors that the Liquidator admits would normally receive nothing until

1 The precise figure is unclear because the information supplied by the Liquidator in the trial court was not tested by cross-examination. Because the trial court declined to hold an evidentiary hearing, no complete or reliable factual record exists to establish the precise figures. However, the Liquidator has represented in papers in support of his motion for approval of the scheme that the amount of reinsurance that may be available to provide indemnity for AFIA cedent claims may exceed $230,000,000.00. See Exhibit A to the Liquidator's Supplemental Reply In Support Of Motion For Approval, dated April 16, 2004 (Joint Appendix at 350). Under the Agreement, the Liquidator will pay 50% of the net reinsurance recoveries to the AFIA cedents. The trial court concluded, without an evidentiary hearing, that the AFIA cedents will receive "approximately $72.5 million of the estimated $231 million" at issue. See Order dated April 29, 2004 (Joint Appendix at 284).

2 Notably, although Benjamin Moore was a known policyholder, the Liquidator did not even notify Benjamin Moore (or the vast majority of other policyholders and creditors) of his motion. See Notice Of Motion (Joint Appendix at 8).

policyholders claims are paid in full will get a distribution of close to $75,000,000. See Response And Objection Of Benjamin Moore & Co. To Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated March 18, 2004 (Joint Appendix at 10).

Four reinsurers of Home (the ACE Companies) also objected to the Liquidator's Motion. They asserted that the agreement violates the New Hampshire priority statute and that the Liquidator's assertion of the need to reach the proposed compromise with the AFIA cedents to avoid protracted and costly international litigation was unfounded. One of these reinsurers, Century Indemnity Company, also asserted that Home's Liquidator breached Home's agreement with Century related to the handling of claims by Home's AFIA cedents by entering into the subject agreement. See Memorandum of the ACE Companies In Support of Their Objection, at p. 7 & n. 6 (relevant pages attached to this Brief at 44-45). The ACE Companies have asserted that the Liquidator's conduct violates the terms of the reinsurance agreement between the Home and Century, vitiating any indemnity coverage thereunder and thus threatening to eliminate entirely an asset of the estate.

The trial court held a status conference on April 9, 2004, during which it determined that the issue of whether, as a matter of law, the proposed agreement violated the Act should be decided first. See Transcript of April 9, 2003 Status Conference at 9-10 & 19-20 (Joint Appendix 191-92, 201-202). Accordingly, the court scheduled a hearing and permitted the parties to submit additional memoranda on this threshold legal issue. The trial court stated that it would address the need for an evidentiary hearing after deciding the threshold legal issue. Id.

Then, following oral argument on the legal issue, by order dated April 29, 2004, the trial court summarily overruled Benjamin Moore's objection and other objections and granted the Liquidator's motion for approval of the agreement. See Order of April 29, 2004 (Joint Appendix

at 283). The trial court never held an evidentiary hearing, and thus failed to permit the development of a factual record upon which the court could make any determination or findings as to whether the agreement is in the best interest of the estate or whether the agreement is fair and equitable. The trial court's failure to hold an evidentiary hearing denied Benjamin Moore a meaningful opportunity to be heard on the issue of the Liquidator's justification for entering the Agreement.

In its order, the trial court neither discussed the statutory order of distribution mandated by R.S.A. 402-C:44, nor recognized its duty to determine independently whether the agreement is in the best interest of the estate. Rather, the court merely cited the Liquidator's general powers to marshal assets and administer an estate, see Order of April 29 at 2 (Joint Appendix at 284), and concluded, based on these general powers, that the Liquidator had statutory authority to approve the agreement on behalf of the Home estate.[3] Id.

Because the trial court erred when it (a) approved an agreement that directly violates the priority provisions of the Act, (b) failed to allow the development of a factual record or conduct an evidentiary hearing, and (c) failed to conduct any meaningful independent review of whether the proposed agreement is in the best interest of the estate, Benjamin Moore filed a Notice Of Appeal. Benjamin asks this Court to reverse the trial court and hold that the agreement cannot be approved because it fundamentally offends the liquidation statute.

Facts Material To The Consideration Of The Questions Presented

The case arises from a complex series of reinsurance relationships involving an insurance pool known as the American Foreign Insurance Association, later known as AFIA ("AFIA").

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[3] On June 1, 2004, the trial court issued an "Addendum" to its order, indicating that it did not need an evidentiary hearing to rule that the Liquidator's deviation from the statutorily mandated priority scheme was permissible as a matter of law. See Addendum of June 1, 2004 (Joint Appendix at 286). However, at the time the trial court issued its Addendum, Benjamin Moore had already filed this appeal.

See Affidavit of Michael Durkin ¶ 6 (Joint Appendix at 77-78). Through AFIA, United States insurance companies, including the Home Insurance Company ("Home"), conducted business in foreign countries and, through reinsurance contracts, shared the risks insured by the various AFIA members. Id. at ¶ 6-7.

As a member of AFIA, Home was a party to reinsurance treaties with other AFIA members. Under these treaties, other AFIA members (the "AFIA cedents") ceded their risks from AFIA business to Home's branch located in the United Kingdom. (Id. at 6-7); see also Affidavit of Peter Bengelsdorf ¶ 3 (Joint Appendix at 28). Home's UK branch, in turn, reinsured its risks through AFIA as well as a number of other third party reinsurers. Id.

The agreement at issue in this appeal concerns the special treatment the Liquidator proposes to give to certain reinsurance claims that the AFIA cedents have against Home. When the Liquidator determined that the assets of the Home estate would be inadequate to satisfy the claims of all creditors (and would likely be inadequate to pay anything to Class V claimants, such as the AFIA cedents), the Liquidator became concerned that the AFIA cedents would not file claims against the Home estate because, as Class V claimants, they would likely recover nothing. See Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated February 11, 2004, at 5 (Joint Appendix at 43). If the AFIA cedents do not file proofs of claim in the Home case, Home has no right to seek indemnity from those claims under reinsurance contracts Home has with a number of reinsurers, including the ACE Companies. According to the Liquidator, some AFIA cedents also suggested that they might consider options to obtain recoveries through independent arrangements that would bypass the Home liquidation. Id.

Motivated by these concerns, the Liquidator negotiated an agreement[4] with certain AFIA cedents under which the Liquidator would settle the AFIA cedents' claims by paying to them, as a class, 50% of any amounts the Liquidator recovers from Home's reinsurers on account of the AFIA cedent's claims, less certain expenses. Id. at 9. (Joint Appendix at 47). The amount the Liquidator proposes to pay the AFIA cedents is estimated by the Liquidator to be approximately $75,000,000.00. See Exhibit A to the Liquidator's Supplemental Reply Memorandum (Joint Appendix at 350). This amount could be greater depending on the amount of AFIA cedent's claim ultimately allowed.

Under the agreement, the AFIA cedents will be paid based upon the merit and value of their claims. The agreement provides that the payments to the AFIA cedents "will be distributed *pari passu* (as far as reasonably practicable) to all AFIA cedents according to the value of their claims." See Agreement 1.9.1 at 4 (Joint Appendix at 56)(emphasis added). Thus, the larger the AFIA cedents' claims, the more those claimants will receive. The agreement also contains provisions for the resolution of disputes over claims. Id. 1.1.4 at 2, 1.9.7. at 5

Summary Of Argument

The agreement made by the Liquidator, and approved by the trial court, violates the New Hampshire liquidation statute. The Act establishes a clear and comprehensive scheme that governs, *inter alia*, the distribution of estate assets to various classes of creditors. The distribution provisions establish a strict and mandatory rule of absolute priority, under which creditors in a senior class must be paid in full before members in a junior class receive payment.

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4 The agreement was technically entered into by certain AFIA cedents and the Joint Provisional Liquidators for Home appointed in the United Kingdom soon after the Liquidation Order for Home was entered in New Hampshire. The agreement is to be implemented in the UK via a "scheme of arrangement" under English law, which must be approved by the English Court, once the agreement is approved in this jurisdiction.

The statute also expressly prohibits the recognition of a sub-class of creditors. The Act contains no exceptions and does not permit equitable deviation from its terms.

Nevertheless, the agreement at issue provides for the payment of tens, if not hundreds of millions of dollars in estate assets to the Liquidator's preferred sub-class of Class V creditors (the AFIA cedents), before all senior creditors have been paid in full. Thus, the Liquidator's scheme directly offends the Act, and the trial court's approval must be reversed.

Moreover, even if the Act permitted some deviation from the mandated order of priority (which it clearly does not), the trial court erred when it denied the objectors' request for an evidentiary hearing, and failed to conduct an independent review of the propriety of the agreement. Before the trial court may approve an agreement settling claims such as that presented here, the court must find that the agreement is in the best interests of the estate, and that the agreement is fair and equitable. To make these findings, the court must make its own independent conclusions based upon a thorough examination of all of the facts; the court may not simply rubber stamp the conclusions of the liquidator – exactly what happened below. In the trial court here, the Liquidator failed to present a sufficient record to permit the trial court to make the necessary findings. More troubling than the Liquidator's inadequate showing is the fact that the trial court declined to hold an evidentiary hearing in the face of the Liquidator's failure to support the agreement. As a result, the Liquidator's proffer was not subject to cross-examination, and the objecting parties were denied the opportunity to test the Liquidator's evidence or present contrary evidence. In its summary order granting the Liquidator's motion for approval of the agreement, the trial court made no specific findings of fact, and made no independent analysis to determine that the agreement was in the best interests of the estate and was fair and equitable, thus precluding meaningful appellant review of the Liquidator's action.

The Liquidator attempts to avoid the clear bar to the agreement presented by the priority statue by mischaracterizing the agreement as a means for recovering estate assets that will benefit all creditors, and harm no interested party, while at the same time avoiding the risks to the estate related to AFIA cedents' potential effort to pursue recovery of reinsurance indemnity outside the Home insolvency case. The Court cannot, however, ignore the distribution provisions of the agreement, which are an integral aspect of the agreement, and which violate the priority rules under the New Hampshire statute. Moreover, the Court should reject the Liquidator's strained attempt to characterize the proposed distribution of tens, if not hundreds of millions of dollars to the AFIA cedents as payment of administrative expenses, when in fact the agreement treats the distribution as payment in satisfaction of the AFIA cedents' pre-liquidation reinsurance claims. The trial court could only accept the Liquidator's "no harm, no foul" rationale for the agreement by avoiding any meaningful independent inquiry into the risks the agreement presents to the Home estate, and the alternatives to the agreement available to the Liquidator, which would have taken place had further factual development occurred. The Court should reject the Liquidator's attempt to circumvent the statutory priority scheme where he has made no showing of any factual or legal basis for doing so.

Lastly, Benjamin Moore has clear legal standing to pursue this appeal. As the Liquidator conceded in the trial court, Benjamin Moore's status as a Class II policyholder claimant confers standing. Benjamin Moore is a member of a class that the Legislature intended to protect, and its interests will be adversely affected by the illegal distribution of assets to junior creditors that has been authorized by the trial court. Benjamin Moore has the right, and legal standing, to pursue this appeal.

Argument

I. The Trial Court Erred When It Approved The Agreement Because, As A Matter Of Law, The Agreement Violates The New Hampshire Insurance Company Liquidation Statute.

A. Because The Agreement Mandates Payment To Certain Junior Class V Claimants Before All Senior Creditors Have Been Paid In Full, And Because It Creates A Sub-class Of Claimants Who Are Elevated To Super Priority Status, It Violates The Statutory Rule Of Absolute Priority.

The priority provisions of the New Hampshire liquidation statute create a strict, comprehensive, and exclusive scheme for the distribution of estate assets to various classes of claimants. Before enumerating ten (10) separate classes of claimants in order of priority, the statute provides:

> **Order of Distribution.**
>
> The order of distribution of claims from the insurer's estate shall be as stated in this section. . . . .[E]very claim in each class shall be paid in full or adequate funds retained for the payment before the members of the next class receive any payment. No subclasses shall be established within any class.

RSA 402-C:44 (emphasis added). This provision unequivocally establishes three clear principles.

First, distribution of estate assets "shall" be in accordance with the priorities established by RSA 402-C:44 I through X. Accordingly, the statute permits no discretionary or equitable deviation from the statutory scheme. See In re: Liquidation of Coronet Insurance Company, 698 N.E.2d 598, 603 (Ill. App. 1st Dist. 5th Div. 1998)(court lacked the power to deviate from the statutory priority scheme); State v. Interstate Casualty Insurance Company, 464 S.E.2d 73, 77 (N.C. App. 1995)(in light of comprehensive statutory scheme for the determination of claim priority, court could not invoke equitable doctrines to deviate from order of distribution); see

also Couch On Insurance § 6:8 (3d ed.)("Statutory priorities are generally regarded as exclusive and should not be disturbed by the creation of equitable priorities").

Second, the statute codifies a rule of "absolute priority," by commanding that "every claim in each class shall be paid in full . . . before the members of the next class receive any payment." See In Re: The Liquidation of Security Casualty Company, 537 N.E.2d 775, 780 (Ill. 1989)(recognizing the statutory rule of "absolute priority" prohibiting succeeding class claimants from receiving any share in the distribution of assets before the claims of all senior interests have been paid in full, and overruling trial court order that allowed junior class claimants to receive funds ahead of all other claimants). Thus, Class V claimants, such as the AFIA Cedents here, cannot receive any portion of estate assets until all claims in classes I through IV have been paid in full.

Third, "[n]o subclasses shall be established within any class." RSA 402-C:44; see Conservation of Alpine Insurance Co., 741 N.E.2d 663, 667-68 (Ill. App. 1st Dist., 4th Div. 2000)(rehabilitation plan violated the order of distribution when it impermissibly created a sub-class of policyholders claimants for preferential treatment and thus discriminated among members of the same class).

The Liquidator's proposed agreement offends each of these statutory mandates. The clear effect of the agreement the with the AFIA cedents is (1) to create a subclass of claimants (the AFIA Cedents) within Class V, and (2) to elevate the interests of the members of this subclass above the interests of all other claimants. Not only does the agreement impermissibly provide for payment to a subclass of Class V claimants before other claimants are paid, the agreement unlawfully creates a "super priority," because the Liquidator proposes to pay these claimants directly from the proceeds of specific reinsurance claims before even Class I claimants are paid

from general estate assets. See id., 741 N.E.2d at 668; In Re: The Liquidation of Security Casualty Company, 537 N.E.2d at 780 (vacating trial court's recognition of a constructive trust in favor of junior class claimants because the effect would be to impermissibly "boost the [junior claimants] over those in the statutory ladder, granting the [junior claimants] a super-priority ahead of all other claimants in the liquidation proceedings"). For each of these reasons, the proposed agreement clearly violates RSA 402-C:44.

Notably, the Liquidator has freely acknowledged that under the agreement, "[w]e're discriminating in favor of the AFIA Cedents." Transcript of Hearing On April 23, 2004, at Page 17 (Joint Appendix at 228). The Liquidator believes that this discrimination in favor of a sub-class within Class V is nevertheless permissible because, according to the Liquidator, "nobody gets hurt." Id. Even putting aside the disputed, unsupported, and cavalier conclusion concerning harm to other parties, this rationale for the Liquidator's position does not justify the agreement, because the statute does not contain a "no harm, no foul" exception. In fact, there is no exception whatsoever to the statutory rules of priority.

The trial court had no discretion to approve the agreement. Indeed, in connection with an earlier motion seeking relief from the priority statute in the Home liquidation proceedings, the very same court relied upon the mandatory nature of the priority statute to deny such relief. In refusing to deviate from the priority statute, Judge McGuire stated that

> RSA 402-C:5 grants the Court the power to issue … orders as are deemed necessary to prevent, among other things … any other threatened or contemplated action that might lessen the value of the insurer's assets *or prejudice the rights of policyholders.*
>
> * * *
>
> In making distributions pursuant to the liquidation process, RSA 402-C:46 instructs the Commissioner to "pay dividends in a manner that will *assure the proper recognition of priorities….*

> Granting [claimant's] request would be *contrary to the intent of the statute and disrupt the "recognition of priorities" outlined therein*

Judge McGuire Order dated September 18, 2003 (emphasis added) (attached to this Brief at 53).

Although the New Hampshire Supreme Court has not yet had the opportunity to interpret the priority provisions of the liquidation statute, courts in jurisdictions with similar statutes have uniformly recognized that a court lacks the power to deviate from the statutory order of distribution in liquidation proceedings. Oxedine v. Commissioner of Insurance, 494 S.E.2d 545, 548 (Ga. App. 1997) ("the trial court was not authorized to create a new class of claims with greater priority than those stated in [the liquidation statute]."); In re: Liquidation of Coronet Insurance Company, 698 N.E.2d 598, 603 (Ill. App. 1st Dist. 5th Div. 1998)("In a liquidation action, a circuit court is vested with only as much authority as is provided by the Insurance Code", and "orders, which, together, served to elevate [a junior class claimant] to a first-priority claimant, are in opposition to [the purpose of the liquidation statute], and therefore improper"). The Act establishes a comprehensive and detailed scheme for the distribution of the assets of an insolvent insurer, and leaves no room for judicial modification.

B. The Agreement Cannot Be Justified By The Liquidator's General Powers To Administer An Estate, Because The Strict And Specific Order Of Distribution Provisions Are An Absolute And Specific Limitation On The Liquidator's Authority.

The trial court concluded that "the agreement proposed by the Liquidator is authorized under the broad array of powers granted the Liquidator under RSA 402-C:25 and is consistent with the goals and purposes of the statute to protect the interests of the insureds and creditors." Order April 29, 2004 at 2 (Joint Appendix at 284). In so concluding, the trial court accepted the Liquidator's arguments that the general "Powers Of Liquidator" section of the Act override the specific limitations imposed by the priority statute. The Liquidator cited two specific provisions, which state: (1) the Liquidator "may" "[c]ollect all debts and monies due" and "do such other

acts as are necessary or expedient to collect, conserve or protect [estate] assets," RSA 402-C:25 VI; and (2) the Liquidator "may" perform acts that are "necessary or expedient for the accomplishment of or in aid of the purpose of liquidation," RSA 402-C:25 XXII. These provisions do not authorize the proposed agreement.

First, these statutory provisions only outline general powers that the Liquidator "may" exercise in the administration of the estate. These general grants of authority do not trump other specific provisions that directly limit a liquidator's authority. For example, RSA 402-C:44 states that the distribution of estate assets "shall" be in accordance with the detailed priorities set forth in that section of the law. The term "shall" is mandatory. N.H.—Vermont Health Service v. Commissioner of Insurance, 122 N.H. 268, 272 (1982)("The word 'shall,' generally regarded as a command, . . . , indicates that a statute was intended to be mandatory.")(citations omitted).[5] Construing the statute as a whole, and applying the plain and ordinary meaning of the words used, Pennelli v. Town of Pelham, 148 N.H. 365, 366 (2002), it is clear that the distribution of assets must comply with the order of distribution set forth at RSA 402-C:44, and the Liquidator cannot deviate from this order based solely upon a general grant of authority to administer the estate.

Second, the Liquidator's general authority to collect debts and preserve assets does not support the agreement, because this is not all that he is doing. The agreement contemplates the recovery of reinsurance proceeds and the distribution of a substantial portion of those proceeds to AFIA cedents. Both the Liquidator and the trial court overlook the undisputable fact that reinsurance recoveries of the estate based on claims of AFIA cedents become estate assets that

[5] The mandatory nature of Section 44's priority scheme is bolstered by the fact that the legislature used the word "may" in defining the Liquidator's general grants of authority. N.H.—Vermont Health Service, 122 N.H. at 272. By using the word "shall" to define the order of distribution and the word "may" to describe the Liquidator's general powers, the legislature clearly intended the order of distribution to be mandatory in nature, not a provision that may yield to the Liquidator's desire for an "expedient" exercise of permissive authority.

can be distributed only accordingly to the mandatory provisions of RSA 402-C:44. The Liquidator has no authority to divert a full 50% of the proceeds of such reinsurance claims to a subclass of general creditor claimants based on his general authority to collect debts owed to the estate in the first instance.

The trial court's order, if sustained, would permit the Liquidator to ignore any otherwise mandatory statutory limitations or restrictions he deems to be inconvenient or inconsistent with his general power to perform acts "necessary or expedient to the liquidation." The statute's plain language reflects no legislative intent to grant such broad discretionary power to the Liquidator.

C. <u>The Liquidator Has No Statutory Power To Enter Into A Compromise That Violates The Statutory Priority Scheme, Even If He Believes The Compromise Will Benefit The Estate As A Whole</u>.

The Liquidator's powers are derived exclusively from statute. The New Hampshire statute does not grant the Liquidator any specific power as relates to the compromise of claims, except the power to "compound, compromise or in any other manner negotiate <u>the amount for which</u> claims will be recommended to the court." RSA 402-C:45, I (emphasis added). There is no statutory grant of authority to the Liquidator or the court to make or approve claim settlements that deviate from the priority to be accorded to certain claimants.

Despite this absence of any legal authority to alter statutory priorities via settlement of a claim, and the explicit language of R.S.A. 402:C-44, the Liquidator argued below, and the trial court apparently accepted, that this power should be implied in order to "further the underlying legislative intent." <u>See</u> Liquidator's Reply In Support Of Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated April 2, 2004 at 17 (page 48 to this Brief). In this regard, the Liquidator believes that "perfect compliance" with the statutory scheme is not

required, so long as he can show the compromise provides "a benefit to the estate as a whole." Id. at 15 (page 47 to this Brief).

As an initial matter, nothing in Section 402:C-44 suggests that it requires anything less than "perfect compliance." To the contrary, in seeking court approval for agreements such as the one before the court, it is the Liquidator's burden to show that his actions comply in all respects with the statutory scheme under which he functions as an officer of the Court. Moreover, the language of the statute determines whether a compromise concerning priorities is permissible, not the Liquidator's view of the legislative intent.

The starting and ending point for the Court's interpretation of the statute is its language, which states in plain and unambiguous words that the order of distribution "shall" be as provided in Section 402:C-44. Because the language of section of the law is plain and unambiguous, the Court need not look beyond it for further indications of legislative intent. In re Jacobson, ___N.H.___, 842 A.2d 77 (2004). The Court must also look at the statute in the context of the overall statutory scheme, id., but there is no language in the rest of the statute suggesting an intent to give the Liquidator discretionary power to deviate from the priority scheme set forth in Section 402:C-44. The Liquidator cites the language from the preamble section, RSA 402-C:1, IV, stating that one of the law's general purposes is the "equitable apportionment of any unavoidable loss," which the Liquidator claims can only be achieved here by approving this agreement. What the Liquidator overlooks is that the Legislature's judgment as to how to achieve such equitable apportionment is embodied in the mandatory order of distribution provisions of Section 402:C-44. It is the Legislature's function, not the Liquidator's, to determine the best way to accomplish an equitable apportionment of the losses that inevitably occur in a liquidation proceeding. In any event, neither the Liquidator, nor the court below cited

to any legislative history that suggests the Legislature's intent was anything other than that the priority provisions are mandatory.

Finally, the Liquidator argued below that it would be absurd for the court to apply the priority statute as written, because this would preclude him from bringing assets into the estate via this settlement. The Liquidator's answer to this "problem" is to imply an exception to the priority rules allowing his proposed agreement under the guise of the rule of statutory construction that the Court should construe statutes to avoid absurd or unreasonable results. There is nothing absurd about applying a statutory order of liquidation priority as enacted by the Legislature, as numerous court have done faithfully in the past. Indeed, the trial court's order allows the Liquidator to disregard the express language of the statute in a manner that would turn the priority scheme established by the Legislature on its head. The Liquidator's authority to deviate from the priority scheme would not be limited to the AFIA cedents – under the lower court's ruling, the Liquidator has carte blanche to pay any and all lower priority ceding insurers ahead of policyholders so long as those ceding insurers are heavily reinsured.

Section 402-C:44 reflects a legislative judgment that general creditors like the AFIA cedents should not get paid anything until policyholders get paid in full. The courts have consistently held that insurers with reinsurance claims against an insolvent reinsurer do not have the right to be treated as policyholders because of fundamental differences between claims under insurance policies and reinsurance contracts. In re Liquidations of Reserve Insurance Co., 524 N.E. 2d 538, 564 (Ill. 1988); Foremost Life Ins. Co. v. Dep't of Insurance, 409 N.E. 2d 1092, 1097 (Ind. 1980); Neff v. Cherokee Ins. Co., 704 S.W. 2d 1, 6-7 (Tenn. 1986). Thus, the statutory scheme enacted by the Legislature already contemplates that parties with claims under reinsurance contracts, given their low priority, may have little or no incentive to participate in an

insolvency proceeding, as is the case with the AFIA cedents here. A necessary consequence of this system of incentives is that indemnity rights of the insolvent reinsurer (here Home) may be less valuable. This results from the statutory scheme, not from anything unique about the AFIA cedents' claims. The Liquidator would have the Court disregard the statutory scheme and allow him to implement an agreement that substantially modifies the priority system put in place by the Legislature, as a way to address what he calls a "dilemma," but which is in fact a normal and expected consequence of the operation of the statutory scheme. If insurance liquidators can make settlement agreements with certain classes of creditors in derogation of the statutory priority scheme whenever in doing so they unilaterally conclude that more assets may be brought into the estate, the liquidators will replace the Legislature as the authority empowered to make the difficult policy judgments about division of the assets of a defunct insurer.

D. The Agreement Cannot Be Upheld By Characterizing The Payments To The AFIA Cedents As Administrative "Costs" Or "Expenses" Of The Estate.[6]

Faced with objections to his motion based on the statutory priority scheme, the Liquidator argued in the trial court that the payments to the AFIA cedents are proper because they are, in essence, mere "costs" of the administration of the estate, and the AFIA cedents are therefore entitled to Class I priority with regard to these payments. This position is invalid and must be rejected.

Settlement of a claim against the estate is not a "cost" of administration. Oxendine v. Commissioner of Insurance, 494 S.E.2d 545, 548 (Ga. App. 1997)(payments under settlement agreements made during rehabilitation were not "costs" or "expenses" of administration under liquidation scheme, because the settlement payments would be for claims asserted against the

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6 The court below did not address this argument made by the Liquidator in support of its motion to approve the agreement. Benjamin Moore raises it here in anticipation that the Liquidator will argue that this is an alternative reason why the lower court's ruling should be affirmed.

estate, not costs or expenses incurred). According to the Act, "administrative costs" entitled to Class I priority include: "the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the litigation; any necessary filing fees; the fees and mileage payable to witnesses; and reasonable attorney's fees." RSA 402-C:44 I. Payments in satisfaction of the AFIA cedents' claims against the Home estate do not fit within this list of costs. The Liquidator relies on the general "actual and necessary costs of …recovering the assets" language, but this general language must be read in light of the more specific language that follows. See Crowley v. Frazier, 147 N.H. 387, 391 (2001)("we ordinarily construe a general term in a statute in light of related, specific terms"). The more specific language refers to outlays made to pay post-liquidation expenses incurred in pursuing recovery of assets, not pre-liquidation claims. When properly construed, the term "administrative costs" cannot be read to include payments to claimants on account of pre-liquidation claims. See In re Kmart Corp., 359 F.3d 866, 872 (7th Cir. 2004)("Pre-filing debts are not administrative expenses; they are the antithesis of administrative expenses.").

Under the agreement, the AFIA cedents will be paid based upon their claims. The AFIA cedents have no right to payment under the agreement unless they first file a claim, which is then allowed. See Agreement 1.9.1 at 4 (Joint Appendix at 56.) The agreement provides that the payments to the AFIA cedents "will be distributed *pari passu* (as far as reasonably practicable) to all AFIA Cedents according to the value of their claims." Id. (emphasis added). The agreement further contains provisions for the resolution of disputes over claims. Id. 1.1.4 at 2, 1.9.7. at 5 (Appendix at 54 and 57). The Court need look no further than the express terms of the agreement to see that the Liquidator proposes to make payments the AFIA cedents on account of their pre-liquidation claims.

The reason administrative expenses are afforded high priority in the insolvency context is to encourage third parties to provide necessary services and goods to an estate. C.f. In the Matter of Jartran, Inc., 732 F.2d 584, 586, 588 (7th Cir. 1984)(discussing the purpose and policy of top priority for administrative expenses under the Bankruptcy Code); United Trucking Services, Inc. v. Trailer Rental Co., Inc., 851 F.2d 159, 161 (6th Cir. 1988)(same); In Re Monarch Capital Corp., 163 B.R. 899, 906 (D. Mass. 1994)(same). If service providers and vendors were not assured that they would be paid as first priority creditors, they would likely decline to do business with the estate. In the Matter of Jartran, Inc, 732 F.2d at 586, 588. Accordingly, the fundamental public policy that is served by designating administrative expenses as Class I priority claims under the Act is to assure that the Liquidator will be able to secure services (such as legal and accounting services) and goods that are essential to the proper liquidation of the estate.

This policy is not served by the payment of huge sums to the AFIA cedents in partial satisfaction of pre-liquidation reinsurance claims. To deem these payments "costs of the administration" is contrary to both the language and purpose of the statute. Such a result offends the statute, and would confer upon the Liquidator a broad and unprecedented power to determine the priority of claims in a manner never intended by the Legislature. The Liquidator can cite no authority holding that "costs of administration" can encompass payments made to claimants to settle their claims. Such a construction of the statutory language would result in an unprecedented reordering of statutory priorities in contravention of legislative intent.

E. The Liquidator Cannot Invoke Inapplicable Equitable Doctrines To Override The Explicit Statutory Scheme.

As the statutory priority scheme does not give the Liquidator discretion to make an agreement with the AFIA cedents in violation of its explicit terms, the Liquidator resorts to the incantation of various equitable doctrines as a source of discretion to deviate from the statutory scheme. The trial court did not rely on these equitable doctrines in making its decision, and neither should this Court, as they have no application here. Given the statute's plain and unambiguous language, the Court may not consider what the Legislature might have said or add by implication language that the Legislature did not see fit to incorporate into the statute. State v. Rix, 150 N.H. 131, 132 (2003). The absolute priority rule adopted by the Legislature cannot be ignored by the Liquidator simply because he unilaterally does not think it was intended to apply here.

1. The "necessity doctrine" does not apply.

The Liquidator relies upon the so-called necessity doctrine to justify the agreement. This doctrine, however, does not support the agreement. The necessity doctrine originated in old railroad reorganization cases, and had its genesis in the public interest in maintaining functioning railroads in the late nineteenth century. This common law doctrine has been used in more recent Chapter 11 reorganization cases as justification for paying "critical vendors" of the debtor seeking to reorganize, although this practice was recently called into serious question by the Seventh Circuit in In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004). The Kmart court specifically noted that the 1978 Bankruptcy Code superceded any common law necessity doctrine. Id. at 871.

The New Hampshire liquidation statute says nothing about paying certain claimants deemed by the Liquidator to be worthy of preference outside the normal priority scheme, for any

reason. It could have done so in theory, if it felt such discretion should be vested in the Liquidator, but it did not. Allowing the Liquidator to deviate from the statutory priority scheme in such an extreme fashion is to read language into the statute that is not there and cannot be fairly implied from other related provisions of the statute.

2. The "new value corollary" to absolute priority does not exist under New Hampshire's liquidation statute.

The Liquidator also relies on the "new value corollary" to the common law absolute priority rule. However, when the Legislature codified the absolute priority rule in the liquidation statute, it enacted no such exception. This equitable exception to the common law rule is thus inapplicable.

Even if this equitable exception could apply notwithstanding the clear language of the statute, the doctrine would not apply because the AFIA cedents are not contributing any new capital to the Home estate. Instead, they are being invited by the Liquidator to file potentially inflated claims, which the Liquidator will be inclined to allow as a means of maximizing the estate's reinsurance claims. The AFIA cedents will do nothing more under the agreement than file claims and be paid off the top for doing so, at an astounding cost of 50% of the amount of allowed claims, less certain expenses. The AFIA cedents are taking value from the estate that is to be generated from indemnity payments by Home's reinsures; they are not contributing new value. The Liquidator cites no precedent for such an expansive application of the "new value" rule in the context of a liquidation proceeding. Indeed, this concept has been exclusively applied by bankruptcy courts in the context of reorganizations, not liquidations, as shown by the Liquidator's citations in the trial court to nothing but reorganization cases. Based upon the clear statutory language, and the Liquidator's abject failure to show any contribution of new capital by

the AFIA cedents in exchange for the highly preferred treatment the Liquidator proposes to accord them, this equitable doctrine does not support the agreement.

F. The Public Policy Served By The Absolute Priority Rule Of The Liquidation Statute Favors Strict Adherence To The Statutory Scheme.

Courts have consistently recognized that liquidation statutes similar to the Act reflect a sound public policy of protecting the interests of direct policyholders over the interests of claimants, like the AFIA cedents here, with reinsurance claims. See, e.g., Neff v. Cherokee Ins. Co., 704 S.W.2d 1, 3 (Tenn. 1986)("In further support of this policy, . . . the Legislature plainly intends that the assets of an insurance company should be preserved for the benefit of direct policyholders over reinsureds"); In the matter of the Liquidation of Sussex Mutual Insurance Co., 694 A.2d 312, 317 (N.J. App. Div. 1997)("The general public was protected by giving priority to policyholders, whereas contracts of reinsurance, between insurance companies, did not demand the same protection")(citing Aetna Casualty and Surety Co. v. International Re-Insurance Corp., 175 A. 114 (N.J. 1934)); id. at 318 (noting that the statute in question is similar to the New Hampshire statute); In re Liquidations of Reserve Insurance Co., 524 N.E.2d 538, 539-41 (Ill. 1988)(noting essential distinction between the interests of direct policyholders and those of reinsurance claimants, and recognizing the public policy of affording heightened protection for policyholders); see also Lincoln Towers Insurance Agency, Inc. v. Boozell, 684 N.E.2d 900, 904 (Ill. App. 1st Dist. 6th Div. 1997)("liquidation statutes are intended to protect individual policyholders and other claimants without permitting certain classes of creditors to place themselves in a superior position"). As the Ohio Supreme Court recently recognized, "the purpose of the priority for Class 2 claims is to protect consumers who have purchased direct insurance and those in related situations, rather than to protect reinsured insurance companies." Covington v. Ohio General Insurance Co., 789 N.E.2d 213, 216 (Ohio 2003).

To give effect to this policy, the statute unequivocally requires that all policyholders (such as Benjamin Moore) be paid in full before general creditors, including reinsureds (such as the AFIA cedents), receive any payment. As noted by virtually every court to consider the issue, the legislation reflects sound public policy. Neither the Liquidator nor the courts have the authority to alter the priority scheme or contravene the important public policy it embodies. For this reason, the trial court's order – which violates the express terms of the Act and offends its underlying policy – must be reversed.

II. Even If The Legality Of The Agreement Is Upheld, The Trial Court Erred When It Approved the Agreement Because The Liquidator Failed To Proffer Sufficient Facts To Establish That The Agreement Is In The Best Interests Of The Estate And That The Agreement Is Fair And Equitable, And Because The Trial Court Failed To Hold An Evidentiary Hearing.

A. Standards For The Approval Of Claims Settlements In Insolvency Proceedings.

The language of the New Hampshire liquidation statute strictly limits a liquidator's authority regarding settlement of claims. RSA Section 402-C:45 states that a liquidator "may compound, compromise or in any other manner negotiate the amount for which claims will be recommended to the court." (emphasis added). The court must then approve allowance of any claim so compromised, in any amount over $500. Under the statute, a liquidator's negotiating authority is limited to the issue of the amount of a claim; no authority is granted to a liquidator to agree to alter the priority of any claims. Moreover, the statute specifically forbids a liquidator from making agreements that create subclasses within any class of claims, as has occurred here. Section 402-C:44 states that "No subclasses shall be established within any class."

The Court must be guided by these statutory restrictions on the Liquidator's ability to make agreements such as that before the Court. The Court can also take guidance from decisions from other jurisdictions on the standards for review of such agreements. There is a substantial body of case law developed by the U.S. bankruptcy courts that provides some well-established

standards, as do the less common state court decisions made in the context of insurer insolvencies.

The touchstone is that a settlement in a liquidation proceeding must be shown by the proponent, who carries the burden of persuasion, to be in the best interest of the estate, and to be fair and equitable. In re American Reserve Corp., 841 F.2d 159, 161-62 (7th Cir. 1987); In re C.P. del Caribe, Inc., 140 B.R. 320, 326 (Bankr. D.P.R. 1992)("[t]he proponents of a compromise and settlement have the burden of persuading the court"). The Court, after being informed of all the relevant facts and information, must make its own independent determination as to whether the settlement meets the standards for approval. American Reserve, 841 F.2d at 162. The Court may not simply accept the recommendation of the trustee or liquidator that a compromise is reasonable, without conducting its own informed analysis, and it is never enough for a liquidator to justify a settlement with cursory statements such as "the alternative to settlement is extensive litigation at heavy expense." In re Dow Corning Corp., 192 B.R. 415, 422 (Bankr. E.D. Mich. 1996); see also In re American Reserve, 841 F.2d at 162 (the court may not simply accept the trustee's word that the settlement is reasonable, nor may the court merely "rubber stamp" the trustee's proposal).[7] The court must consider any creditors' objections to the settlement, although the creditors' views are not controlling. In re American Reserve, 841 F.2d at 161-62.

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[7] In bankruptcy decisions, the courts have identified the following non-exclusive list of factors to consider in determining if a settlement is in the best interest of the estate:

a. the balance between the likelihood of the trustee's success in litigation compared to the present and future benefits offered by the settlement;
b. the prospect of complex, costly and protracted litigation if settlement is not approved;
c. the difficulties, if any, in collecting any judgment that may be obtained in litigation; and
d. the interests of other creditors.

In re Parkview Hospital, 211 B.R. 603, 608 (Bankr. N.D. Ohio 1996).

As to the "fair and equitable" requirement, the courts have defined this to mean that senior interests are entitled to full priority over junior interests. In re AWECO, Inc., 725 F.2d 293, 298 (5th Cir. 1984); In re American Reserve, 841 F.2d at 162. As stated in American Reserve, "[i]n a settlement context, 'fair and equitable' means that the settlement reasonably accords with the competing interests' relative priorities." Id. This standard ensures faithfulness to the fundamental rule in insolvency proceedings, codified in RSA 402-C-44, that all claims in each class must be paid in full before the members of the next class receive any payment.

The Liquidator acts as a trustee for all the creditors of the liquidation, and as such, his fiduciary duty restrains him from favoring one beneficiary over another. In re Executive Life Ins. Co., 38 Cal. Rptr. 2d 453, 471 (Cal. App. 1995); In re Liquidation of Integrity Ins. Co., 555 A.2d 50, 52 (N.J. Super. 1988). Thus, the Court must also assess whether the proposed agreement is consistent with the Liquidator's fiduciary duty to all creditors of the estate.

The Liquidator's justifications for the agreement, on their face, do not withstand scrutiny under these standards, particularly in the face of the objections and issues raised by Benjamin Moore. And yet the trial court summarily accepted those justifications without question, and without conducting any independent inquiry into whether the agreement is the only viable means for Home to make a recovery on its reinsurance indemnity agreements with the ACE Companies.

B. The Liquidator Failed To Provide Adequate Information For The Court To Determine If The Applicable Standards Are Met.

The Liquidator articulated several justifications for entering into the agreement with the AFIA cedents, none of which were supported by adequate information to permit reasonable assessment by the court or interested parties. He expressed a concern that, without the agreement, the AFIA cedents might not file claims with the Home estate. Then, to seek recoveries for their losses, the AFIA cedents might consider options that would by-pass the

liquidation proceedings. If the AFIA cedents pursued such options, then the Liquidator would have to consider litigation challenging any recoveries. Thus, according to the Liquidator, the agreement is appropriate because, although it results in the payment of huge sums to junior creditors before all senior creditors are paid in full, it would spare the estate the time and expense of pursuing international litigation. These justifications, however, were not supported by any adequate factual showing.

First, in his original motion for approval, the Liquidator stated that the agreement would resolve a potential dispute over rights that "certain [unidentified] of the AFIA Cedents" have asserted to collect reinsurance proceeds directly from the ACE Group. Liquidator's Motion For Approval Of Agreement And Compromise With AFIA Cedents, dated February 11, 2004, at 5 (Joint Appendix at 43). According to Liquidator, he has threatened legal action to prevent this from occurring, but there is no pending litigation. The Liquidator did not identify how many, or which, AFIA cedents have asserted these rights. He later submitted affidavits that identified only six (6) members of AFIA that had "considered" certain "options," including the feasibility of initiating discussions with ACE. See Affidavit of Gernot Warmuth (Joint Appendix at 145); Affidavit of Gareth Hughes (Joint Appendix at 131); Affidavit of Rydian Williams (Joint Appendix at 160). These hearsay[8] affidavits do not establish that any AFIA cedent has in fact initiated serious discussions or taken any action to assert the legal position the Liquidator fears.

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8 Benjamin Moore refers to these affidavits solely for the purpose of identifying the basis upon which the Liquidator sought approval of the motion below, and not for the truth of any of the statements made therein. These affidavits concern hearsay testimony and are inadmissible. N.H.R.Evid. 802. Benjamin Moore did not object to the admission of these affidavits below because the trial court had expressly stated that it would only address the threshold legal issue of whether the Liquidator and the Court had the authority to deviate from the statute and indicated that she would hold an evidentiary hearing to determine whether that authority should be exercised under the circumstances presented. The trial court ruled on the latter issue without holding an evidentiary hearing or giving Benjamin Moore an opportunity to put in any evidence or cross examine the affiants. Because Benjamin Moore was denied the opportunity to address these hearsay statements, the Court should not rely upon those affidavits for the truth of their contents, but simply as evidence that those statement were made.

Nor did the Liquidator offer any information as to the strength of Home's position on this issue, or the potential costs to the estate of protecting its rights through litigation. Based on the scant information provided by the Liquidator, it is impossible to make any reasonably informed judgment as to the extent of the threat to the estate's interests, or the potential costs associated with protecting those interests through available means, including but not limited to litigation.

Moreover, the Liquidator offered no explanation as to why he chose not to offer similar "incentives" to submit claims to direct policyholders of the Home, like Benjamin Moore. Any claim against Home insurance policies for which reinsurance is available (just like the claims of the AFIA Cedents) triggers Home's right to seek recovery of reinsurance proceeds that become generally available to creditors of the estate. But the Liquidator, for reasons not explained, chose to advance the interests of certain of the estate's preferred (but lower priority) creditors over those of Benjamin Moore and other policyholders that are entitled to higher priority, and then compounded the effect of that decision by not giving those policyholders notice of their disenfranchisement.

The Liquidator informed the trial court that the agreement will avoid "costly and time-consuming litigation over whether there will be separate US and UK liquidations or a global New Hampshire proceeding." See Liquidator's Motion for Approval at 6 (Joint Appendix at 44). At the same time, however, the Liquidator stated that both he and the Joint Provisional Liquidators "do not believe that there is any legal merit to the suggestion" that the UK assets[9] could be "walled-off" from the New Hampshire proceedings for exclusive distribution to UK creditors of the Home UK Branch. Id. If the Liquidator is correct, any litigation over this issue is likely to be the opposite of time-consuming and costly, so the risk of such litigation would not

[9] Nowhere in the Motion does the Liquidator identify what the "UK assets" consist of. It is not clear if they are limited to reinsurance recoveries that can be sought on account of the claims of the AFIA Cedents, or whether there are any other significant assets of the Home UK Branch.

appear to justify any significant compromise of the estate's rights. Based upon the information supplied by the Liquidator, there is so little risk to the estate associated with this issue that it could not possibly justify giving the AFIA Cedents the equivalent of an approximately $75 million special priority administrative claim.

C. The Trial Court Failed To Undertake An Independent Evaluation Of The Agreement Or Make Specific Findings Of Fact.

The trial court's Order approving the agreement is only two-and-a-half (2 ½) pages long and lacks any specific findings of fact or citation to the record. The Order merely cites the Liquidator's general powers to administer an estate and then summarily upholds the Liquidator's judgment as reasonable. According to the trial court, the agreement will permit the Liquidator to marshal a significant asset for the estate, and the estate therefore benefits from the agreement. See Order at 2-3. The trial court seems to conclude that as long as creditors might receive any amount that they would not receive unless the agreement is approved, then the estate receives an adequate benefit, regardless of the amount of estate assets that must be sacrificed to effectuate the agreement. The trial court's sole focus was on the benefit to the estate from the agreement, with no analysis of the fact that the Liquidator is proposing to distribute tens and perhaps hundreds of millions of dollars to certain Class V claimants, and the implications of this for other classes of creditors. As a result, under the trial court's reasoning, the Liquidator could have entered into an agreement that gave away 75% or even 90% of the proceeds of the AFIA reinsurance claims, and the trial court would have approved. Such a selective view of the agreement demonstrates the trial court's failure to conduct a complete and adequate review.

The trial court failed to conduct any independent inquiry to satisfy itself that the agreement is in the best interests of the estate and is fair and equitable. The trial court did not analyze whether there are any viable alternatives to this agreement that do not require a

reordering of statutory priorities. Nor did the court examine whether the proposed sharing formula between the estate and the AFIA Cedents is fair and reasonable under all the circumstances, including the risks to the estate should no agreement be approved. The trial court did not even assess on its own whether the risks to the estate identified by the Liquidator are realistic and meaningful, much less such as would justify the arrangement made by the Liquidator with the AFIA Cedents to avoid those risks. Absent any such findings or analysis, it is impossible for this Court to review whether the trial court properly exercised any discretion it claims it had to deviate from the legislatively mandated priorities.

For example, the trial court did not mention in its Order, and apparently did not consider, the arguments made by Benjamin Moore that a commutation agreement between Home and the ACE Companies could potentially bring just as much value into the estate, without the need to pay a $75 million fee to AFIA cedents to file claims. Transcript of April 9, 2004 Hearing at 14 (Joint Appendix at 196). Nor did the trial court address in a direct way the assertion made by the ACE Companies that the agreement with the AFIA cedents constitutes a breach of the Home/ACE agreement, which may jeopardize Home's ability to make *any* recovery from the ACE Companies. The trial court did, however, express concern at the end of its Order about the fact that "the Ace Companies were not included in discussions whereby the proposed agreement was reached and that protracted litigation over this issue will ensue." Order 4/29/04 at 3 (Joint Appendix at 285). Instead of taking this into consideration as part of its independent evaluation of the merits of the agreement, as it should have, the trial court merely urged the parties to negotiate toward a resolution to avoid further litigation. In this sense, the trial court abdicated its responsibility to make an independent evaluation of the agreement, taking all of the relevant

factors into consideration, and instead made a rubber-stamp approval of the agreement while exhorting the parties to settle their differences.[10]

The trial court may not simply "rubber stamp" the Liquidator's assessment of whether a settlement agreement such as this is fair and equitable, or in the best interest of the estate. It must conduct a full and independent review. The trial court's failure to test the Liquidator's factual submissions, to allow other parties to do so, to make any specific findings of fact, or to analyze the relevant criteria for review of such agreements, precludes any meaningful appellate review. For these reasons, the trial court's Order cannot stand.

D. The Trial Court Erred When It Declined To Hold An Evidentiary Hearing.

Although the objecting parties challenged the Liquidator's factual submissions as inadequate, biased, and unreliable, and although the objectors expressed their interest in cross-examining the Liquidator's witnesses and offering their own evidence to dispute the Liquidator's assertions, the trial court refused to hold an evidentiary hearing. As a result, the conclusory and hearsay statements in the affidavits submitted by the Liquidator went untested. The trial court apparently accepted as true the factual premises for the agreement by its summary approval the agreement. In so doing, the court prevented the development of a factual record and denied the parties even minimal due process.

III. Benjamin Moore Has Legal Standing To Pursue This Appeal[11]

To determine whether a party has legal standing in the insurance company liquidation context, courts generally inquire whether the appealing party is among a class of persons that the

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[10] The trial court's June 1, 2004 "clarification" of its April 29, 2004 Order, however, made irrelevant any discussion between ACE and the Liquidator as it removed any doubt that the trial court approved the Liquidator's scheme.

[11] Benjamin Moore filed an Objection and Memorandum of Law in Opposition to the Liquidator's Motion to Dismiss on Standing Grounds, and Benjamin Moore refers to, and incorporates those papers. Benjamin Moore summarizes those arguments here in light of the Court's June 11 order.

liquidation statute is intended to protect. See, e.g., Metcalf v. Investors Equity Life Insurance Company of Hawaii, Ltd., 910 P.2d 110, 111 (Haw. 1996)(concluding that shareholders of liquidated insurance company lacked standing because the statutory purpose of the liquidation statute did not include shareholders as a class of persons to be protected); Hartnett v. Southern American Fire Ins., 495 So.2d 902, 903 (Fla. App. 1986)(same); LeFarge Corp. v. Insurance Department, 690 A.2d 826, 836-37 (Pa. Cmwlth. 1997)(policyholders have standing because they have an interest specifically protected by the liquidation statute) rev'd on other grounds, 735 A.2d 74 (Pa. 1999); see also Plaza v. Stephens, 913 S.W.2d 319, 322 (Ky. 1996)(nonvoting shareholders of insurer in liquidation lacked standing because they lacked "a judicially recognizable interest in the subject matter"). Like the statutes at issue in those cases, the New Hampshire statute identifies the persons the legislature intended to protect. R.S.A. 402-C:1(IV)("the purpose of this chapter is the protection of the interests of insureds, creditors, and the public generally")(emphasis added). The statutory language establishes beyond any doubt that policyholders like Benjamin Moore are a class of persons who have an interest that the statute is designed to protect. C.f. Estate of Ella Kelly, 130 N.H. 773, 778 (1988)(heirs have standing to appeal an order of the probate court, because heirs are among the classes of persons with legal and equitable interests in the estate).

In addition, other provisions of the Act demonstrate that policyholders have an important, protected interest. Under the provisions for Liquidation Orders, the statute provides, "[u]pon issuance of the order, the rights and liabilities of any such insurer and of its creditors, policyholders, shareholders, members, and all other persons interested in the estate are fixed as of the date of filing of the petition for liquidation." R.S.A. 402-C:21 (emphasis added). By referring to "other persons interested in the estate" after a list of persons that includes

policyholders, the Legislature left no doubt that policyholders are persons with an interest in the estate. The provisions for required notices provide, "[t]he liquidator shall give notice of the liquidation order . . . to all persons known or reasonably expected to have claims against the insurer, including all policyholders." R.S.A. 402-C:26 (I)(a)(emphasis added). The requirement that the Liquidator send notice to policyholders is yet another expression of legislative intent to protect the interests of policyholders.[12] Finally, the fact that policyholder claims are Class II claims, second only to administration costs, see R.S.A. 402-C:44(I) and (II), demonstrates that the interests of policyholders are important and substantial.

As a policyholder, Benjamin Moore has a clear, direct, and legally cognizable interest in this proceeding, and it therefore has standing to appeal the trial court's Order. Indeed, the Liquidator conceded at oral argument on his motion that Benjamin Moore has standing. See Transcript of Hearing on April 3, 2004 at 5 (Joint Appendix at 216)("Benjamin Moore is a creditor and we don't dispute their standing").

Moreover, Benjamin Moore has standing because its statutorily protected interests are affected by the agreement. All Class II creditors, and indeed all creditors with priority ahead of Class V, are affected by this agreement because it allows a certain class of Class V creditors to get paid huge sums before senior creditors are paid in full.

The Liquidator argues that Benjamin Moore is not aggrieved because it will benefit from the court's Order in the sense that Class II creditors will share with the AFIA Cedents in a portion of the reinsurance recovery that the Liquidator seeks to make via the agreement. See Liquidator's Memorandum In Support Of Motion To Dismiss at 2, 6, 12 (pages 50-52 of this

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12 That the Liquidator failed to provide any notice to Benjamin Moore (and virtually every other Class II policyholder creditor) of his motion for approval of the agreement with certain preferred Class V junior creditors does not in any way diminish Benjamin Moore's status as a Class II policyholder creditor, although it speak volumes about the Liquidator's attempt at avoiding any meaningful creditor scrutiny of the agreement involved in the motion.

Brief). The potential for some economic benefit to Class II creditors cannot, however, deprive them of their statutory rights under the Act's distribution scheme. Class II creditors have a statutory right to be paid in full before creditors in any of the lower classes get paid anything. The Liquidator made no showing in the trial court that Class II Claimants will be paid in full. The trial court's Order blithely overlooks this gross deviation from the statutory distribution scheme on the basis that Class II creditors will get some economic benefit not otherwise available. This "expediency rationale" for the agreement that is advocated by the Liquidator, and was accepted by the trial court, runs afoul of the statutory distribution scheme, and Benjamin Moore's statutory rights as a Class II creditor. It is those rights Benjamin Moore seeks to vindicate in this appeal.

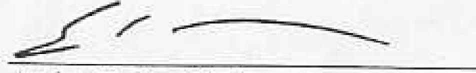
Conclusion

For all the foregoing reasons Court should reverse the trial court's order and enter an order concluding that, as a matter of law, the Liquidator's Agreement violates the statutory priority scheme, and denying the Liquidator's motion on that basis. If the Court determines that the agreement does not violate New Hampshire law on its face, the Court must remand this matter to the trial court for an evidentiary hearing and specific findings by the trial court as to whether the Liquidator can show that the agreement meets the standards for approval.

Respectfully submitted,

June 24, 2004

DOWNS RACHLIN MARTIN PLLC

By: 

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DESIGNATION OF COUNSEL FOR ORAL ARGUMENT

Attorney Andre Bouffard will argue the case on behalf of Benjamin Moore & Co.

CERTIFICATE OF SERVICE

I hereby certify that on June 24, 2004 two true and correct copies of the foregoing Appellant Benjamin Moore & Co.'s Brief was served by federal express, postage prepaid on Peter C.L. Roth Esq., Senior Assistant Attorney General, Environmental Protection Bureau, Department of Justice, State of New Hampshire, 33 Capitol Street, Concord, NH 03301-6397 and Ronald L. Snow Esq., Orr & Reno, PA, One Eagle Square, P.O. Box 3550, Concord, NH 03302-3550.

Eric D. Jones

BTV.268311.2

402-C:1 Title, Construction and Purpose

I. SHORT TITLE. This chapter may be cited as the "Insurers Rehabilitation and Liquidation Act.'

II. CONSTRUCTION: NO LIMITATION OF POWERS. This chapter shall not be interpreted to limit the powers granted the commissioner by other provisions of the law.

III. LIBERAL CONSTRUCTION. This chapter shall be liberally construed to effect the purpose stated in paragraph IV.

IV. PURPOSE. The purpose of this chapter is the protection of the interests of insureds, creditors, and the public generally, with minimum interference with the normal prerogatives of proprietors, through:

. . . .

402-C:21 Liquidation Orders

. . . .

II. FIXING OF RIGHTS. Upon issuance of the order, the rights and liabilities of any such insurer and of its creditors, policyholders, shareholders, members and all other persons interested in its estate are fixed as of the date of filing of the petition for liquidation, except as provided in RSA 402-C:22 and 39.

. . . .

402-C:25 Powers of Liquidator.

The liquidator shall report to the court monthly, or at other intervals specified by the court, on the progress of the liquidation in whatever detail the court orders. Subject to the court's control, he may:

I. Appoint a special deputy to act for him under this chapter, and determine his compensation. The special deputy shall have all powers of the liquidator granted by this section. The special deputy shall serve at the pleasure of the liquidator.

II. Appoint or engage employees and agents, legal counsel, actuaries, accountants, appraisers, consultants and other personnel he deems necessary to assist in the liquidation. RSA 98 shall not apply to such persons.

III. Fix the compensation of persons under paragraph II, subject to the control of the court.

IV. Defray all expenses of taking possession of, conserving, conducting, liquidating, disposing of or otherwise dealing with the business and property of the insurer. If the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the liquidator may advance the costs so incurred out of any available appropriation. Any amounts so paid shall be deemed expense of administration and shall be repaid for the credit of the insurance department out of the first available moneys of the insurer.

V. Hold hearings, subpoena witnesses and compel their attendance, administer oaths, examine any person under oath and compel any person to subscribe to his testimony after it has been correctly reduced to writing, and in connection therewith require the production of any books, papers, records or other documents which he deems relevant to the inquiry.

VI. Collect all debts and moneys due and claims belonging to the insurer, wherever located, and for this purpose institute timely action in other jurisdictions, in order to forestall garnishment and attachment proceedings against such debts; do such other acts as are necessary or expedient to collect, conserve or protect its assets or property, including sell, compound, compromise or assign for purposes of collection, upon such terms and conditions as he deems best, any bad or doubtful debts; and pursue any creditor's remedies available to enforce his claims.

VII. Conduct public and private sales of the property of the insurer in a manner prescribed by the court.

VIII. Use assets of the estate to transfer policy obligations to a solvent assuming insurer, if the transfer can be arranged without prejudice to applicable priorities under RSA 402-C:44.

IX. Acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon or otherwise dispose of or deal with any property of the insurer at its market value or upon such terms and conditions as are fair and reasonable, except that no transaction involving property the market value of which exceeds $10,000 shall be concluded without express permission of the court. He also may execute, acknowledge and deliver any deeds, assignments, releases and other instruments necessary or proper to effectuate any sale of property or other transaction in connection with the liquidation. In cases where real property sold by the liquidator is located other

than in the county where the liquidation is pending, the liquidator shall cause to be filed with the register of deeds for the county in which the property is located a certified copy of the order appointing him.

X. Borrow money on the security of the insurer's assets or without security and execute and deliver all documents necessary to that transaction for the purpose of facilitating the liquidation.

XI. Enter into such contracts as are necessary to carry out the order to liquidate, and affirm or disavow any contracts to which the insurer is a party.

XII. Continue to prosecute and institute in the name of the insurer or in his own name any suits and other legal proceedings, in this state or elsewhere, and abandon the prosecution of claims he deems unprofitable to pursue further. If the insurer is dissolved under RSA 402-C:23, he may apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

XIII. Prosecute any action which may exist in behalf of the creditors, members, policyholders or shareholders of the insurer against any officer of the insurer, or any other person.

XIV. Remove any records and property of the insurer to the offices of the commissioner or to such other place as is convenient for the purposes of efficient and orderly execution of the liquidation.

XV. Deposit in one or more banks in this state such sums as are required for meeting current administration expenses and dividend distributions.

XVI. File any necessary documents for record in the office of any register of deeds or record office in this state or elsewhere where property of the insurer is located.

XVII. Assert all legal and equitable defenses available to the insurer as against third persons. A waiver of any defense by the insurer after a petition for liquidation has been filed shall not bind the liquidator.

XVIII. Exercise and enforce all the rights, remedies and powers of any creditor, shareholder, policyholder or member, including any power to avoid any transfer or lien that may be given by law and that is not included within RSA 402-C:30-32.

XIX. Intervene in any proceeding wherever instituted that might lead to the appointment of a receiver or trustee, and act as the receiver or trustee whenever the appointment is offered.

XX. Enter into agreements with any receiver or commissioner of any other state relating to the rehabilitation, liquidation, conservation or dissolution of an insurer doing business in both states.

XXI. Exercise all powers now held or hereafter conferred upon receivers by the laws of this state not inconsistent with this chapter.

XXII. The enumeration in this section of the powers and authority of the liquidator is not a limitation upon him, nor does it exclude his right to do such other acts not herein specifically enumerated or otherwise provided for as are necessary or expedient for the accomplishment of or in aid of the purpose of liquidation.

. . . .

402-C:26 Notice to Creditors and Others

I. NOTICE REQUIRED.

(a) GENERAL REQUIREMENTS. The liquidator shall give notice of the liquidation order as soon as possible by first class mail and either by telegram or telephone to the insurance commissioner of each jurisdiction in which the insurer is licensed to do business, by first class mail within this state and by airmail outside this state to all insurance agents having a duty under RSA 402-C:27, and by first class mail within this state and by airmail outside this state at the last known address to all persons known or reasonably expected to have claims against the insurer, including all policyholders. He also shall publish notice in a newspaper of general statewide circulation or in Merrimack county, the last publication to be not less than 3 months before the earliest deadline specified in the notice under paragraph III.

. . . .

402-C:44 Order of Distribution.

The order of distribution of claims from the insurer's estate shall be as stated in this section. The first $50 of the amount allowed on

each claim in the classes under paragraphs II, V, and VI except claims of the guaranty associations as defined in RSA 404-B, 404-D, and 408-B shall be deducted from the claim. Claims may not be cumulated by assignment to avoid application of the $50 deductible provision. Subject to the $50 deductible provision, every claim in each class shall be paid in full or adequate funds retained for the payment before the members of the next class receive any payment. No subclasses shall be established within any class.

I. ADMINISTRATION COSTS. The costs and expenses of administration, including but not limited to the following: the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the liquidation; any necessary filing fees; the fees and mileage payable to witnesses; and reasonable attorney's fees.

II. POLICY RELATED CLAIMS. All claims by policyholders, including claims for unearned premiums in excess of $50, beneficiaries, and insureds arising from and within the coverage of and not in excess of the applicable limits of insurance policies and insurance contracts issued by the company, and liability claims against insureds which claims are within the coverage of and not in excess of the applicable limits of insurance policies and insurance contracts issued by the company and claims of the New Hampshire Insurance Guaranty Association, the New Hampshire Life and Health Insurance Guaranty Association and any similar organization in another state. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds or investment values, shall be treated as loss claims. That portion of any loss for which indemnification is provided by other benefits or advantages recovered or recoverable by the claimant shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment made by an employer to an employee shall be treated as a gratuity.

III. CLAIMS OF THE FEDERAL GOVERNMENT.

IV. WAGES.

(a) Debts due to employees for services performed, not to exceed $1,000 to each employee which have been earned within one year before the filing of the petition for liquidation. Officers shall not be entitled to the benefit of this priority.

(b) Such priority shall be in lieu of any other similar priority authorized by law as to wages or compensation of employees.

V. RESIDUAL CLASSIFICATION. All other claims including claims of any state or local government, not falling within other classes under this section. Claims, including those of any non-federal governmental body, for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction or proceeding out of which the penalty or forfeiture arose with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under paragraph VIII.

VI. JUDGMENTS. Claims based solely on judgments. If a claimant files a claim and bases it both on the judgment and on the underlying facts, the claim shall be considered by the liquidator who shall give the judgment such weight as he deems appropriate. The claim as allowed shall receive the priority it would receive in the absence of the judgment. If the judgment is larger than the allowance on the underlying claim, the remaining portion of the judgment shall be treated as if it were a claim based solely on a judgment.

VII. INTEREST ON CLAIMS ALREADY PAID. Interest at the legal rate compounded annually on all claims in the classes under paragraphs I through VI from the date of the petition for liquidation or the date on which the claim becomes due, whichever is later, until the date on which the dividend is declared. The liquidator, with the approval of the court, may make reasonable classifications of claims for purposes of computing interest, may make approximate computations and may ignore certain classifications and time periods as de minimis.

VIII. MISCELLANEOUS SUBORDINATED CLAIMS. The remaining claims or portions of claims not already paid, with interest, as in paragraph VII:

(a) Claims under RSA 402-C:39, II;

(b) Claims subordinated by RSA 402-C:61;

(c) Claims filed late;

(d) Portions of claims subordinated under paragraph V;

(e) Claims or portions of claims payment of which is provided by other benefits or advantages recovered or recoverable by the claimant.

IX. PREFERRED OWNERSHIP CLAIMS. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Interest at the legal rate shall be added to each claim, as in paragraphs VII and VIII.

X. PROPRIETARY CLAIMS. The claims of shareholders or other owners.

BTV.268606.1

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

MEMORANDUM OF THE ACE COMPANIES IN SUPPORT OF THEIR OBJECTIONS AND RESPONSE TO THE LIQUIDATOR'S MOTION FOR APPROVAL OF AGREEMENT AND COMPROMISE WITH AFIA CEDENTS

Respondents Century Indemnity Company ("Century"), ACE Property and Casualty Insurance Company ("ACE P&C"), Pacific Employers Insurance Company ("PEIC"), and ACE American Reinsurance Company ("AARe") (individually, an "ACE Company," collectively, the "ACE Companies") hereby submit this memorandum in support of their objections and response to the Liquidator's Motion for Approval of Agreement and Compromise With AFIA Cedents (the "Motion").[1]

INTRODUCTION

The Motion, under the guise of a "compromise," seeks this Court's approval of an agreement (the "Agreement") with certain AFIA Cedents that squarely violates the New Hampshire Insurers Rehabilitation and Liquidation Act, N.H. Rev. Stat. Ann. § 402-C:1 *et seq.* (the "Act"). The Liquidator of the Home Insurance Company (respectively, the "Liquidator" and "Home") seeks to justify the proposed Agreement by claiming that it "will facilitate the

[1] In addition to the facts set forth below, the ACE Companies incorporate by reference herein the facts set forth in the affidavits of Michael Durkin, the head of the run-off operations of the ACE Group in Europe, sworn to on March 19, 2004, attached hereto as Exhibit A and the affidavit of Richard Daniel Hacker Q.C., the ACE Companies' expert on English law, sworn to on March 12, 2004, attached hereto as Exhibit B (hereinafter referred to respectively as "Durkin Affidavit" and "Hacker Affidavit").

- the Assumption Agreement is governed by New York law (¶ 10), with disputes to be resolved in arbitration to take place in New York (¶ 7).

The last point is particularly relevant given that the Liquidator's Motion refers to the "repatriation" of "U.K. Assets" of Home. (Motion ¶¶ 1, 7, 11.) Although the Liquidator does not define those U.K. assets, the only assets alluded to in the Motion are reinsurance recoveries against Century pursuant to the Assumption Agreement. (*Id.* ¶ 13.) Given that those recoveries would be from a Pennsylvania company pursuant to a contract governed by New York law with New York arbitration provisions, Century is at a loss to understand why the Liquidator seeks to characterize Century's obligations under the Assumption Agreement as "U.K. Assets" of Home.

III. Events Leading Up to the Liquidator's Misconceived Motion

Since 1984, Century (and its predecessor and affiliates) have complied fully with the financial and administrative obligations under the Assumption Agreement to handle and adjust claims by Home's AFIA cedents. (Durkin Affidavit ¶ 11.) In so doing, Century handled such claims without any day to day involvement of Home. (*Id.*) Century continued to fulfill its obligations under the Assumption Agreement throughout the period in which Home was in rehabilitation. (*Id.* ¶ 12.) After the Court's Order of Liquidation on June 13, 2003, in close cooperation with Home's Liquidator, Century has continued to investigate and administer the claims of Home's AFIA cedents pursuant to the Assumption Agreement, but Century has not made any binding determinations. (*Id.*) The Liquidator has taken the position that Century's obligation to investigate and adjust the claims by cedents of Home's U.K. branch continues despite the insolvency of Home. (*Id.*)

On February 11, 2004, the ACE Companies were served with a copy of the Motion, in which the Liquidator seeks this Court's approval of a self-described "compromise" to be implemented by an English "scheme of arrangement" ancillary to these proceedings. (*See, e.g.*, Motion at 1.) At its core, approval of the Motion requires the Court to bless the payment to a

group of Class V creditors (the AFIA Cedents) of approximately 50% of certain reinsurance recoveries made by the Liquidator against Century (*Id.* ¶¶ 13-15), while paying other Class V creditors such as the ACE Companies nothing. This special preference given to a particular subclass of Class V creditors squarely violates § 402-C:44 and is contrary to all established precedent. The Motion thus could inflate claims against Century beyond what they might otherwise have been in an orderly liquidation of Home that lawfully complied with the Act.

Notwithstanding Century's post-liquidation involvement with adjustment and administration of claims by Home's AFIA Cedents, the Liquidator did not inform, involve or consult with Century or any other ACE Company when he was negotiating the proposed Agreement with certain AFIA Cedents. (Durkin Affidavit ¶ 13.) Indeed, the ACE Companies knew nothing of the proposed Agreement until it had already been executed.[5] (*Id.*)

Beyond their lack of knowledge of the Liquidator's negotiations with certain AFIA Cedents about the proposed Agreement (notwithstanding Century's rights under the Assumption Agreement), the ACE Companies were disturbed to learn that the Agreement restricts the AFIA Cedents from communicating with Century regarding settlements of claims that Century has the right to investigate and adjust. Century believes that the Liquidator's conduct in negotiating such provisions directly breaches Home's duty of utmost good faith to Century under the Assumption Agreement.[6] In light of the above, and for the reasons described more fully below, the ACE Companies object to the Liquidator's Motion.

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[5] Although the ACE Companies received notice of the Motion, as discussed below, the Liquidator has failed to notify hundreds of parties affected by the Motion (including many AFIA Cedents). Indeed, it appears that only a handful of the many AFIA Cedents were consulted about the Agreement or served with the Motion. (Motion, Ex. A.)

[6] Whether the Liquidator's conduct and its Motion have violated Home's duties to Century under the Assumption Agreement is not before the Court. Century reserves the right to address separately issues such as Century's obligations for claims, and its rights and duties under the Assumption Agreement generally. Because the Assumption Agreement is governed by an arbitration clause, arbitration is the necessary and appropriate forum for

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

LIQUIDATOR'S REPLY IN SUPPORT OF MOTION FOR APPROVAL OF AGREEMENT AND COMPROMISE WITH AFIA CEDENTS

Roger A. Sevigny, Insurance Commissioner of the State of New Hampshire, as Liquidator of The Home Insurance Company, by his attorneys, the Office of the Attorney General, submits this reply to the objections of the ACE Companies and Benjamin Moore & Co. ("BMC").[1] The objections should be overruled because:

- The objectors do not acknowledge that the Agreement benefits the policyholders of Home by facilitating collection of significant assets – the obligations of one of the ACE Companies, Century Indemnity Company ("Century"), under the INA Agreement, and the obligations of another ACE Group member, Century International Reinsurance Company Limited ("CIRC"), under the BAFCO Reinsurances (see note 2). Those substantial obligations are of little value unless the AFIA Cedents submit and prosecute claims. The Agreement also avoids efforts by the AFIA Cedents to circumvent the liquidation through agreements directly with the ACE Companies or to wall off significant UK assets – the BAFCO Reinsurances – for the exclusive benefit of UK creditors.

- The Liquidator has statutory authority to take all "necessary and expedient" steps to collect and preserve the assets of the estate under RSA 402-C:25 and the Liquidation Order. The costs of collecting such assets – the case here – are administrative expenses within priority class I payable during the course of the liquidation under RSA 402-C:44, I.

- As a cost of "preserving or recovering" the value of the INA Agreement and BAFCO Reinsurances and avoiding time-consuming and expensive litigation, the payments to AFIA Cedents contemplated by the Agreement are costs that the Liquidator may pay as class I priority expenses of administration. They are not distributions on the AFIA Cedents claims with class V priority, and they do not violate the statutory scheme. The objectors' position would frustrate the purpose of the statutes, and the Liquidator's is supported by equitable doctrines.

[1] The Liquidator uses the terms defined in the Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents.

RSA 402-C:41 and the Claims Procedures Order. As the Liquidator has informed the ACE Companies, the Liquidator intends that Century be involved in those determinations and to fully respect Century's right to interpose defenses in the claim determination proceedings as provided in the INA Agreement. See Rosen Aff. ¶ 10, Ex. B.

For these same reasons, the sharing of proceeds does not violate RSA 402-C:61. That statute provides that foreign ancillary liquidators are to pay assets other than special deposits over to the domiciliary liquidator "diminished only by the expenses of the ancillary receivership." RSA 402-C:61. To the extent the Joint Provisional Liquidators make payments in accordance with the Agreement (i.e., by transferring 50% of the Net Proceeds to the Scheme Administrators appointed under the proposed scheme of arrangement), they are administrative expenses of the UK proceeding just as payments by the Liquidator are expenses of the New Hampshire liquidation. The payments form part of the expenses of the ancillary receivership in collecting under the INA Agreement and/or BAFCO Reinsurances.

Finally, the payments do not violate the priority statute's general bar on the creation of sub-classes. RSA 402-C:44. The payments are not a compromise of the AFIA Cedents' class V claims against Home, so there is no creation of a sub-class of class V claimants. They are administrative expenses of collection and within class I.

3. The Agreement Does Not Impermissibly Discriminate Among Creditors But Instead Provides A Benefit To All Creditors.

If the payments were viewed as class V distributions, they would still be appropriate. In the context of a compromise, the issue is not whether there was perfect compliance with the statute but whether there was impermissible discrimination, meaning discrimination that is not justified by a benefit to the estate as a whole. The cases cited

New Hampshire law also permits compromises concerning priorities, as this would further the underlying legislative intent. The Act expressly provides that it is to be "liberally construed" to effect its purpose, RSA 402-C:1, III, and that purpose is "the protection of the interests of insureds, creditors, and the public generally" through, among other things, "[e]quitable apportionment of any unavoidable loss." RSA 402-C:1, IV. The Act provides for the equitable apportionment of unavoidable loss through the priority statute. RSA 402-C:44. It would frustrate the overall purpose of the Act to construe the statutory direction for the equitable apportionment of "unavoidable loss" to prohibit efforts to increase the overall assets of the estate.

Statutes should be construed to effectuate the overall legislative purpose and to avoid absurd or unreasonable results. See, e.g., State v. Rix, 150 N.H. 131, 132-133 (2003); Appeal of Estate of Van Lunen, 145 N.H. 82, 86 (2000). The statutory priorities reflect the overriding legislative intent of the Act to minimize the insolvency's impact on persons who have sought the protection provided by insurance. To construe them as prohibiting the Liquidator from an agreement that would benefit all creditors by increasing the value of the estate is inconsistent with this purpose. The objectors' construction of the statute accordingly should be rejected to avoid the absurd result that any benefit to a lower priority creditor mandates depriving higher priority creditors of additional payment. See State v. Warren, 147 N.H. 567, 568 (2002).

4. Payments to the AFIA Cedents Are Also Supported By Longstanding Equitable Doctrines.

The Agreement is also bolstered by equitable doctrines authorizing a receiver to make payments of the estate's property out of the ordinary course when doing so is in the best interest of the creditors of the estate. The Superior Court overseeing an insurance

THE STATE OF NEW HAMPSHIRE
SUPREME COURT

**In the Matter of the Liquidation of
The Home Insurance Company**

No. 2004-0319

MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS

NOW COMES the appellee, Roger A. Sevigny, Commissioner of Insurance for the State of New Hampshire ("Commissioner"), in his capacity as Liquidator (the "Liquidator") of The Home Insurance Company ("Home"), by and through counsel, the Office of the Attorney General, and submits this Memorandum of Law in Support of Motion to Dismiss. The Liquidator moves this Court to dismiss this appeal for lack of jurisdiction because both appellants lack standing to appeal.

INTRODUCTORY STATEMENT

The present appeal was brought by two intervenors in a matter concerning the liquidation of Home being conducted by the Commissioner pursuant to his statutory duties and powers provided in RSA 402-C. The appeal is of an order of the Merrimack Superior Court, McGuire J. (the "Order"), granting the Liquidator's motion for approval of an agreement and compromise with certain cedents (reinsureds) of Home reflected in a letter agreement ("Agreement") that will enable the Liquidator to bring a significant asset into the estate: recoveries on indemnities provided by one of the intervenors, the ACE Companies. The intervenors objected, contending that certain aspects of the Agreement that would result in money being paid to the cedents through a "scheme of arrangement" under English law were inconsistent with New Hampshire law. The Superior Court granted the Liquidator's motion, and the objectors appealed.

This motion is brought to dismiss the appeals because neither appellant is aggrieved by the Order. The ACE Companies are not aggrieved because no interest of theirs is harmed by the Order. They are potential class V creditors who are unlikely to receive a distribution from the Home estate in any event. Their opposition is prompted by the fact that they are a net debtor to the Home. The arrangement with the cedents does not, however, increase the ACE Companies' obligations; it is simply a means to ensure that they do not receive a windfall because of the liquidation. The other objector, Benjamin Moore & Co. ("BMC"), is not aggrieved because it is a potential class II creditor who will actually receive a substantial benefit, which would not otherwise be available, as a result of the arrangement facilitated by the Order. Its opposition is explicable only as an effort to advance the debtor interests of one of its corporate affiliates, which ultimately reinsures the ACE Companies' obligations to Home.

BACKGROUND

A. The Liquidation

On May 8, 2003, the Commissioner filed a petition to liquidate Home on grounds of insolvency with the Merrimack Superior Court pursuant to RSA 402-C. As Home is domiciled in New Hampshire, the Commissioner is the insurance regulatory official charged with overall responsibility for Home's worldwide liquidation upon appointment as Liquidator by the Superior Court. *See* RSA 402-C:21, 57, 61. Ancillary proceedings may be instituted in foreign countries and by insurance regulators in other states. *See* RSA 402-C:55, 61. On May 8, 2004, the Commissioner also sought and obtained the appointment of Joint Provisional Liquidators in respect to the Home under English law by the High Court of Justice in London. The Superior Court declared Home insolvent and appointed the Commissioner as its Liquidator under New Hampshire law in an Order of Liquidation entered June 13, 2003.

position that they would be in if the AFIA Cedents simply filed their claims without the Agreement. Transcript of Hearing on April 23, 2004, p. 54-57.

2. BMC. BMC asserts that it is a policyholder (class II) creditor of Home. As the Superior Court found, BMC as a creditor would not be harmed by the Agreement because as a class II claimant it would benefit from an increase in the amount to be distributed as a result of the Agreement. Order at 3. BMC also appears to have other interests. In its Rule 7 Notice of Mandatory Appeal, BMC disclosed that it is a wholly owned subsidiary of Berkshire Hathaway, Inc. ("Berkshire"). It is thus an affiliate of National Indemnity Company ("NICO"), another subsidiary of Berkshire. NICO has a reinsurance obligation to indemnify Century for losses arising from the AFIA Treaties through reinsurance protection NICO provided to Brandywine Holdings Corporation ("Brandywine"), another indirect subsidiary of ACE Limited and parent of Century. Second Rosen Aff. ¶¶ 3, 4. *See also* Berkshire website http://www.berkshirehathaway.com/subs/sublinks.html (showing links to subsidiaries BMC and NICO). Finally, INA was BMC's primary insurance carrier for over 20 years, and Century (and NICO) now bears those obligations. Second Rosen Aff. ¶ 5.

a potential creditor, and it is too "inextricably entwined" with the debtor ACE Companies to have independent standing. *See* Palmer v. U.S. Savs. Bank of America, 131 N.H. 433, 441-442 (1989). The ACE Companies do not have any protected interest that would be harmed by the Superior Court's Order, and their appeal should be dismissed for lack of appellate standing.

III. The ACE Companies Have No Standing To Advance The Purported Interests of Other Creditors.

The ACE Companies suggested below that they intervened because they believe that the allowance of the Agreement is unlawful and not in the best interests of the estate.[3] These issues, however, are not pertinent to non-creditors and do not affect a party, like the ACE Companies, that at best has a claim in a priority that will not be benefited or harmed in any way by the Agreement. If appellants such as the ACE Companies are allowed to advance their views of the interests of other persons, those persons' true interests may be disregarded. *See* Palmer v. U.S. Savs. Bank of America, 131 N.H. at 440 (no standing for party engaged in "economic antagonism" inimical to interests of other interested parties); Blanchard v. Boston & M. R.R., 86 N.H. at 265 (discussing practical problems of dueling advocates for the public interest); *accord* Kane v. Johns-Manville Corp., 843 F.2d 636, 644-45 (2d Cir. 1988). As the Superior Court noted, Home's principal class II creditors, the state guaranty funds, did not object to the Agreement because they understood that bringing a significant asset to the estate was in their best interests. Order at 2. It would be unfair to the guaranty funds and other class II creditors to have the ACE Companies usurp their position and purport to assert their interests for the ACE Companies' own self-interested purposes. It is to avoid this kind of unfairness and confusion that

[3] *But see* Transcript, April 23, 2004 at 57, 59-60 (counsel to the ACE Companies suggesting that Agreement might have been lawful and appropriate if they had been brought to the table).

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

In the Matter of Rehabilitation/Liquidation
of the Home Insurance Company

No. 03-E-106

ORDER

This proceeding arises out of a Petition to Intervene in the Home Insurance Company ("the Home") rehabilitation/liquidation proceeding, filed by Inspiration Consolidated Copper Company ("Inspiration"), Phelps Dodge Corporation, and Phelps Dodge Miami, Incorporated (together "Phelps Dodge") (collectively "Inspiration/Phelps Dodge"), creditors of the Home. In an Order dated June 11, 2003, the Court (McGuire, J.) granted prayers A and B of the Inspiration/Phelps Dodge Petition to Intervene allowing them to intervene. The issue currently before the Court is Prayer C of Inspiration/Phelps Dodge's motion to intervene, which requests that the Insurance Commissioner, the administrator responsible for managing the Home's rehabilitation/liquidation, pay the $2.5 million settlement debt in full before any liquidation of the Home. For the reason stated below, prayer C is DENIED.

I. FACTUAL BACKGROUND

Inspiration/Phelps Dodge asserted property damage claims against the Home under four Excess Umbrella Liability Insurance Policies based on environmental contamination of Pinal Creek in Globe, Arizona. These claims were the subject of a civil suit in Arizona Sate Court in 1998 entitled Inspiration Consolidated Copper Company et al. v. The American Ins. Co., et al. (Maricopa County, Arizona, No. CV 98-000530). The

parties settled the suit after trial began but prior to going to the jury. The settlement, subject to approval by the New Hampshire Insurance Department, required the payment of $2.5 million by the Home to Inspiration/Phelps Dodge.

Five months following the settlement agreement, on March 4, 2003, pursuant to RSA 402-C:15, Paula T. Rogers, Commissioner of Insurance for the State of New Hampshire (the "Commissioner"), filed the Verified Petition for Rehabilitation of the Home. The Commissioner filed the petition for the purposes of seeking appointment as receiver of the Home and commencing the rehabilitation process. On March 5, 2003, this Court (McGuire, J.) entered an order, in which the Commissioner was appointed as Rehabilitator for the Home.

Following the Commissioner's determination that the Home was insolvent within the meaning of RSA 402-C:3 and RSA 402-C:20, II and that under RSA 402-C:19 further attempts to rehabilitate the Home would be futile, the Commissioner filed a Verified Petition for Order of Liquidation pursuant to RSA 402-C:5, RSA 402-C:19 and RSA 402-C:20. On June 13, 2003, this Court (McGuire, J.), issued an order of liquidation for the Home, and established the deadline for filing claims pursuant to RSA 402-C:26, II, RSA 402-C:37, I and RSA 402-C:40, II as one year from the date of the order.

As noted above, and consistent with the orders of this Court, Inspiration/Phelps Dodge were granted the right to intervene as creditors of the Home under the liquidation process. In their position as creditors, Inspiration/Phelps Dodge contend that their $2.5 million settlement claim against the Home supersedes other claims held by other creditors of the Home and should be paid in full before any liquidation of the assets of the Home.

Inspiration/Phelps Dodge argue that the Home should be required to pay the full amount of their claim, prior to the liquidation process, because representatives of the Home and Risk Enterprise Management, Ltd. ("REM"), the third party administrator that manages the Home's business on behalf of the Commissioner, approved the settlement agreement which brought an end to the Arizona dispute.

Representatives of the Home signed the agreement, documented in a "Settlement Termsheet" dated November 27 and 29, 2002, five months prior to the Commissioner placing the Home into Rehabilitation. Inspiration/Phelps Dodge note that although the "Settlement Termsheet" was not the final settlement agreement, it did represent the basic requirement that the Home pay Inspiration/Phelps Dodge $2.5 million.

In accordance with the "Settlement Termsheet" and the obligations bestowed upon the Home therein, Inspiration/Phelps Dodge maintain that they are in a unique position as policy holders, because representatives of the Home substantially approved the settlement which became final prior to the Rehabilitation and current Liquidation status of the Home.

The Commissioner in her capacity as Liquidator of the Home counters that granting the Inspiration/Phelps Dodge request would violate the claims process and distribution scheme set forth in RSA chapter 402-C and would be inequitable to other similarly situated policy claims holders. Thus, the Commissioner maintains that the Inspiration/Phelps Dodge claim should be treated like other policy claims in its class.

II. DISCUSSION

Inspiration/Phelps Dodge argue that their $2.5 million settlement claim should be paid out to them prior to the Home liquidation because (1) they are in a unique position

amongst the creditors, having concluded a settlement agreement in which the Home was a participant, five months prior to the Commissioner's submission of the Liquidation Petition of the Home; and (2) the Liquidator has exercised bad faith in not awarding Inspiration/Phelps Dodge their settlement claim. The Court does not agree.

RSA chapter 402-C governs the rehabilitation and liquidation of insurers. The purpose of RSA chapter 402-C is to protect the interests of insureds, creditors, and the public generally. RSA 402-C:1, IV. RSA chapter 402-C "shall be liberally construed to effect the purposes stated in [RSA 402-C:1, IV]." RSA 402-C:1, III. To that end, RSA 402-C:5 grants the Court the power to issue "restraining orders, temporary and permanent injunctions, and other orders as are deemed necessary and proper to prevent", among other things, "[w]aste of the insurer's assets", "[t]he obtaining of preferences, judgments, attachments, garnishments or liens against the insurer or its assets" and "any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders . . . ."

As noted above, the settlement award at issue here stems from property damage claims for which the Home is responsible under four excess umbrella liability insurance policies held by Inspiration/Phelps Dodge. Thus, under RSA 402-C:44, III, the Inspiration/Phelps Dodge claim qualifies as a policy-related claim.

Like other policy claim holders who have not been paid, Inspiration/Phelps Dodge is subject to the order of distribution articulated in RSA 402-C:44, III. Policy claims rank third in priority following administrative costs and wage claims. RSA 402-C:44, III. Ordering the Home to pay Inspiration/Phelps Dodge prior to the liquidation process

would elevate the Inspiration/Phelps Dodge claim to a priority status inconsistent with their policy claim position and would be unfair to other similarly situated claims holders.

In making distributions pursuant to the liquidation process, RSA 402-C:46 instructs the Commissioner to "pay dividends in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of the unliquidated and undetermined claims." Granting Inspiration/Phelps Dodge request would be contrary to the intent of the statute and disrupt the "recognition of priorities" outlined therein.

Moreover, an early disbursement to Inspiration/Phelps Dodge, at a time when the Home is insolvent, would constitute a voidable preference under RSA 402-C:32, I(a) & (b) which provides in pertinent part that:

> [i]f a liquidation order is entered while the insurer is already subject to rehabilitation, transfers otherwise qualifying shall be deemed preferences if made or suffered within one year before the filing of the successful petition for rehabilitation or within 2 years before the filing of the successful petition for liquidation, whichever time is shorter.
>
> (b) the insurer was insolvent at the time of the transfer or (2) the transfer was made within four months before filing the petition, or (3) the creditor receiving it would or to be benefited therby or his agent acting with reference thereto had reasonable cause to believe at the time when the transfer was made that the insurer was insolvent or was about to become insolvent . . . .

Thus, even if the Commissioner of the Home had paid Inspiration/Phelps Dodge the $2.5 million pursuant to the settlement agreement, the payment would have been subject to retrieval under the applicable preference statute above.

As to Inspiration/Phelps Dodge's assertion of bad faith on behalf of the Commissioner, the Court finds that there was no evidence of bad faith presented.

Accordingly, the Court does not find that the Commissioner acted in bad faith in not keeping Inspiration/Phelps Dodge informed regarding the Home's dire financial status.

III. Conclusion

For the reason stated above, the Court rules the Home is not required to pay Inspiration/Phelps Dodge their $2.5 million policy claim, prior to liquidation of the Home. Such a payment would be inequitable under the statutorily defined distribution scheme of the liquidation process. Accordingly, Inspiration/Phelps Dodge, must await payment from the Commissioner according to their status as a policy claims holders.

So Ordered.

Dated: 4/18/03

//Kathleen A. McGuire\\
Kathleen A. McGuire,
Presiding Justice