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

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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").

collection of a multimillion dollar asset of the Home estate and that it has been entered into in an effort to avoid "costly, uncertain and protracted multi-jurisdictional litigation." (Motion ¶ 1.) There is no realistic threat of "multi-jurisdictional litigation," let alone litigation that is "costly, uncertain and protracted."

As discussed below, there are compelling reasons why the Court cannot sanction the alleged "compromise" the Liquidator requests:

- The proposed Agreement directly contravenes the order of distribution statute, § 402-C:44, in multiple ways;
- The Liquidator has no authority to reach a "compromise" that violates § 402-C:44;
- There is no basis for the Liquidator's claim that such a "compromise" is necessary and appropriate to avoid costly and protracted international litigation;
- The Liquidator cannot circumvent the statutory scheme by offering unlawful "incentives" to one subclass of creditors;
- Such "incentives" cannot be passed off as an "administrative expense" of the estate;
- The proposed Agreement is contrary to New Hampshire law and well-established principles governing cross-border insolvencies and ancillary proceedings, which require that (a) all assets must be returned to the domiciliary liquidation for distribution; and (b) the ancillary proceeding must defer to the domiciliary liquidation; and
- The Motion violates due process because it has been made without adequate notice to affected parties and, if the Court does not summarily reject the Motion, discovery will be required before there can be a meaningful hearing on the merits.

In such circumstances, the Liquidator's Motion must be denied.

FACTUAL AND PROCEDURAL BACKGROUND

I. The ACE Companies' Interests as Creditors of Home

Century, ACE P&C, PEIC, and AARe are members of the ACE Group. All of the ACE Companies are incorporated in Pennsylvania with their principal place of business in Philadelphia. The ACE Companies are creditors of Home. (Durkin Affidavit ¶ 4.)

Before Home was placed into rehabilitation, Home was a reinsurer of the ACE Companies pursuant to various separate and independent reinsurance agreements. As creditors, the ACE Companies stand to suffer financial damage as a result of Home's inability to fulfill its contractual obligations due to its insolvency. In total, the ACE Companies possess claims against Home (for paid losses, reserves, and incurred but not reported losses) of at least $13,458,546.[2] The ACE Companies will be filing proofs of claim against Home for no less than that amount on or before the current bar date for such claims in June 2004. The ACE Companies understand that their claims will be treated as Class V claims pursuant to § 402-C:44. (Durkin Affidavit ¶ 5.)

II. Century's Interest as a Reinsurer of Home's AFIA Obligations

A. Background of AFIA

The Liquidator's Motion concerns obligations assumed by Home as part of its participation in an insurance "pool" previously known as the American Foreign Insurance Association and later as AFIA. AFIA was an unincorporated entity formed in 1918 through which its members -- U.S. insurance companies -- carried on business outside of the U.S.

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2 Broken down by individual company, those claims are as follows:

Century	$ 11,912,063
ACE P&C	$ 1,288,003
PEIC	$ 25,480
AARe	$ 233,000

Other companies within the ACE Group also have sizeable creditor claims against Home that will be pursued in the liquidation proceeding. (Durkin Affidavit ¶ 5.)

(Durkin Affidavit ¶ 6.) The structure of the pool was that various AFIA member companies obtained licenses or authorizations to operate branches in foreign countries and carry on the business of insurance through such branches in their own names. (*Id.*) Regardless of which company issued a policy or contract of reinsurance in any given instance, through a series of reinsurance agreements, every risk ultimately was shared by each member of AFIA in a fixed percentage equal to its number of "units of participation" in AFIA. (*Id.*) The AFIA members also arranged for common reinsurance that protected all members in excess of certain claim levels. (*Id.*)

In connection with its participation in AFIA, Home opened a branch office in London, England through which it issued policies of insurance and reinsurance. (Durkin Affidavit ¶ 7.) Home's London office was not a separate English company or subsidiary; the results of the London office's activities were included in Home's accounts that would have been inspected by the New Hampshire insurance regulators as part of their regular examination and oversight of Home. (*Id.*)

It is important to note that Home issued reinsurance agreements to "AFIA Cedents" (as defined in the Motion) that were not located solely in the U.K. (Durkin Affidavit ¶ 14.) To the contrary, numerous companies that come within the Liquidator's definition of "AFIA Cedents" were domiciled in the U.S., Canada, Bermuda, and indeed throughout the world. (*Id.*) A listing of the domiciles of various AFIA Cedents is attached as Exhibit B to the accompanying Durkin Affidavit.

B. Century's Assumption of AFIA Liabilities

The merger between Insurance Company of North America ("INA") and Connecticut General Insurance Company that created the CIGNA Corporation in 1982 set in motion a series of transactions that resulted in the sale of the rights and interests in the AFIA business to CIGNA

in 1984.[3] (Durkin Affidavit ¶ 8.) As part of the transfer of the AFIA business to CIGNA, Home (and other AFIA companies) entered into an Insurance and Reinsurance Assumption Agreement (the "Assumption Agreement") with INA (a CIGNA company) dated January 31, 1984, pursuant to which INA reinsured 100% of Home's liabilities under the insurance and reinsurance contracts Home had issued.[4] (*Id.* ¶ 9.) A true and correct copy of the Assumption Agreement is attached as Exhibit A to the Durkin Affidavit.

Century became the successor to INA with respect to the Assumption Agreement by virtue of a corporate restructuring under Pennsylvania law. (Durkin Affidavit ¶ 10.) Century thereafter was acquired by the ACE Group when ACE purchased the CIGNA Property and Casualty Companies in 1999. (*Id.*) Thus, Century is now Home's counterparty with respect to the Assumption Agreement. (*Id.*)

The Assumption Agreement contains the following terms that are relevant to the matters raised in the Motion:

- Century assumed all obligations of Home (¶ 2);
- Century assumed the obligation to administer the business, including the investigation and settlement of claims, and was given full power of attorney to act on Home's behalf for that purpose (¶ 3);
- in the event of Home's insolvency, Century's reinsurance obligations are payable to Home or its liquidator; in turn, Century has the right to receive notice of any claim, and investigate and interpose defenses to such claims in the liquidation proceedings (¶ 6); and

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[3] That merger resulted in the situation in which CIGNA owned one member of AFIA (Aetna Insurance Company) while also competing with AFIA through CIGNA's existing affiliates. This situation was contrary to the governing principles of AFIA, and led to negotiations that resulted in CIGNA's purchase of all AFIA interests. No new business was written through AFIA after it was acquired by CIGNA (with the exception of business written by a CIGNA affiliate until approximately 1987 in accordance with the sale documents). (Durkin Affidavit ¶ 8.)

[4] With regard to Home's direct insurance obligations, there was a statutory transfer in the U.K. whereby CIGNA companies were substituted for Home and the other AFIA companies. Such a transfer (or novation) did not take place with regard to the assumed treaty reinsurance operations of Home. (Durkin Affidavit ¶ 9 n.3.)

- 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

ARGUMENT

I. The Proposed Agreement Violates the New Hampshire Insurers Rehabilitation and Liquidation Act

A. The Liquidator's Proposal Violates the Plain Language of the Order of Distribution Statute

Section 402-C:44 of the New Hampshire Insurance Code establishes multiple classes of claims. The portions relevant to the present dispute are as follows:

> 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.
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> I. Administrative 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 litigation; any necessary filing fees; the fees and mileage payable to witnesses; and reasonable attorney's fees.
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> II. Policy Related Claims. -- All claims by policyholders . . . beneficiaries, and insureds arising from and within the coverage of . . . insurance policies and insurance contracts issued by the company . . . .
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> . . . .
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> V. Residual Classification. -- All other claims . . . not falling within other classes under this section.

N.H. REV. STAT. ANN. § 402-C:44 (emphasis added). Consistent with this statutory framework, the Court's Order of Liquidation issued on June 13, 2003 (the "Order") explicitly directed the Liquidator to make payments on all claims against the Home estate -- including the claims of residents in foreign counties -- in accordance with § 402-C:44. (Order ¶ w.)

The Liquidator's proposal violates § 402-C:44 and the Order in two ways. First, it creates impermissible subclasses by splitting Class V in two, with one group consisting of the

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those issues. Century also reserves its right to seek reimbursement of expenses under the Assumption Agreement, including those incurred in relation to this Motion.

AFIA Cedents and the other group consisting of other Class V creditors (including the ACE Companies). Second, the 50% "incentive" that the Liquidator proposes to pay to the AFIA Cedent subclass violates the statutory order of distribution by allowing the AFIA Cedent subclass to leap ahead of Classes II, III and IV to receive millions of dollars that otherwise would go to creditors in those classes.

Section 402-C:44 is comprehensive and clear. For this reason, the ACE Companies respectfully suggest that the Liquidator should not have made, and this Court cannot approve, a proposal inconsistent with the plain language of the statute. *See State v. Rix*, 150 N.H. 131, 834 A.2d 273, 275 (N.H. 2003); *Appeal of Northeast Rehab. Hosp.*, 149 N.H. 83, 85-86, 816 A.2d 970, 972 (N.H. 2003); *Marcotte v. Timberlane/Hampstead Sch. Dist.*, 143 N.H. 331, 337, 733 A.2d 394, 399-400 (N.H. 1999). The Liquidator's Motion therefore should be denied.

B. The Liquidator's Proposal Also Violates Corresponding Portions of the Act Relating to Multi-Jurisdiction Liquidations

Nothing in the Act suggests that its core priority scheme can be circumvented because an ancillary foreign proceeding has been commenced or because some claimants may reside in foreign countries. To the contrary, the Act states that "[i]n a liquidation proceeding begun in [New Hampshire] against an insurer domiciled in [New Hampshire], claimants residing in foreign countries or in states not reciprocal states must file claims in [New Hampshire] . . . ." N.H. REV. STAT. ANN. § 402-C:57(I). Moreover, where New Hampshire has commenced a liquidation for a New Hampshire-domiciled company, any receiver in another state or foreign country must transfer to the New Hampshire liquidator "any assets within his control other than special deposits, diminished only by the expenses of the ancillary receivership." *Id.* § 402-C:61. Indeed, if the ancillary receiver fails to do so, "the claims filed in the ancillary receivership, other than special deposit claims or secured claims, shall be placed in the class of claims under § 402-C:44, VIII," *i.e.,* in the lowest priority class. *Id.*

In contrast to the Act and the Order,[7] the Liquidator's proposal actually seeks to withhold assets from Home's New Hampshire estate in order to provide a preference to the AFIA Cedents. New Hampshire law does not permit an ancillary receivership to be established for such an unlawful purpose. The Liquidator's request to do so therefore should be summarily rejected.

II. The Liquidator's Efforts to Justify His Violation of the Act Are Without Merit

In the Motion, the Liquidator alleges without any detail or evidentiary support that the proposed Agreement is necessary to compromise "disputes" over the proceeds of the Assumption Agreement. (Motion ¶ 7.) The primary purported concern is that, absent the "compromise," the AFIA Cedents might attempt to use an English insolvency proceeding to "wall off" the proceeds of the Assumption Agreement (which the Liquidator asserts may be "U.K. Assets") for distribution exclusively to the AFIA Cedents (and not to Home's other creditors). (*Id.*)

Even assuming that such "disputes" existed, the Liquidator has no authority to "compromise" them in a manner that violates the Act. In addition, as discussed below, the alleged "disputes" are illusory and a mere pretext for seeking the Court's approval for an unlawful proposal.

A. The Liquidator Has No Authority to Violate the Act on the Basis of an Alleged "Compromise"

The mandatory application of § 402-C:44 cannot be understated. In contrast to a rehabilitation, which has as its purpose the preservation, wherever possible, of an insurance company threatened with insolvency, a liquidation is corporate death, the sole purpose of which is to marshal the insurer's assets and distribute them among the company's creditors. For this

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[7] The Order is consistent with these provisions in that it directs the Liquidator to work with any joint provisional liquidator or comparable person appointed by a foreign tribunal "with respect to all or any portion of the estate of The Home located outside the United States (the 'foreign estates') for the purpose of preserving, recovering and incorporating into the domiciliary estate all assets of The Home located outside the United States." (Order ¶ v) (emphasis added). Thus, the Order contemplates that all foreign assets (without diminution) will be returned to this Court for proper distribution to creditors under the Act.

reason, the Act sets forth uniform, logical procedures by which a company shall be efficiently and effectively liquidated.[8] One of the linchpins of these procedures is the order of distribution of claims.

The Liquidator appears not to dispute the fact that his proposal would violate the order of distribution scheme set forth in § 402-C:44. He nonetheless apparently believes that the proposal may be lawfully approved if it is "fair and reasonable and in the best interests of the liquidation and the policyholders and other creditors of The Home." (Motion ¶ 21.) The Act, however, allows the Liquidator no such discretion.

Although no New Hampshire court has considered whether one group of creditors may be allowed to circumvent the statutory priority scheme, similar issues have been addressed by other courts supervising U.S. insurer insolvency proceedings. For example, in *In re Liquidation of Security Casualty Co.*, 537 N.E.2d 775 (Ill. 1989), the Illinois Supreme Court considered whether defrauded shareholders of an insurance company in liquidation should be able to impose a constructive trust on the proceeds of a stock offering that were in the possession of the insolvent insurer. The constructive trust effectively would have satisfied the shareholders' claims outside of the priority statute.[9] The court determined that "the liquidation provisions of the Insurance Code provide the exclusive scheme for determining priorities in distribution" of an insolvent insurer's assets. *Id.* at 782. It therefore ruled that "equitable relief, such as a

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[8] For example, liquidation begins with the entry of a liquidation order, which "fixes" the rights and liabilities of the insurer and its creditors; only claims arising on or before the "fixing date" are eligible for payment. N.H. REV. STAT. ANN. § 402-C:21. Creditors holding eligible claims then must file proofs before a "bar date;" absent court intervention, claims filed after this date may not be paid. *Id.* §§ 402-C:37-:38. Once filed, claims are valued, then paid according to the priorities set forth in § 402-C:44.

[9] Like New Hampshire, Illinois has a comprehensive statutory scheme for the liquidation of insolvent insurance companies, including a provision regarding the priority of distribution of assets that mirrors New Hampshire's in all material respects. *See, e.g.*, 215 ILCS 5-205.

constructive trust, is precluded [and that the trial court] could not avoid the effect of the statutory scheme by imposing a constructive trust on [the insurer's] assets."[10] *Id.*

Similarly, in *Illinois ex rel. Boozell v. Coronet Insurance Co. (In re Liquidation of Coronet Insurance. Co.)*, 698 N.E.2d 598 (Ill. App. 1998), the Illinois Appellate Court found that the trial court had erred in holding that an attorney's claim under a retaining lien should be considered a Class I administrative expense of the estate. The appellate court noted that the trial court was "vested with only as much authority as is provided by the Insurance Code; equitable remedies in contradiction to those plainly set forth within the Insurance Code are therefore precluded." *Id.* at 603; *accord Northwestern Nat'l Ins. Co. v. Kezer (In re Aspen Indem. Corp.)*, 812 P.2d 688, 690 (Colo. App. 1990) (holding that state insurance priority of distribution statute is "both specific and comprehensive" and "leaves no room for the judiciary to add to the type of claims to be preferred or to establish a method of preference not created by the statute").

Indeed, so absolute are statutory distribution priorities that plans to rehabilitate a financially troubled insurer have been rejected where they violate those priorities, even though rehabilitators generally have greater discretion than liquidators to manage an insolvent insurer's affairs.[11] *See, e.g., Illinois ex rel. Shapo v. Alpine Ins. Co. (In re Conservation of Alpine Ins. Co.)*, 741 N.E.2d 663, 667-68 (Ill. App. 2000) (rejecting proposed rehabilitation plan that differentiated among members of the same priority class); *Commercial Nat'l Bank v. Superior Ct., (In re Rehabilitation of Executive Life Ins. Co.)* 14 Cal. App. 4th 393, 408-11 (Cal. App.

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10 The legislative history of the National Association of Insurance Commissioners Insurers Rehabilitation and Liquidation Model Act (which contains a similar order of distribution section) reveals that the various state insurance commissioners agreed with the court in *Security Casualty* that "to allow a lower class creditor to receive a preference over a higher class creditor based on equitable remedies is inconsistent with the priority scheme." *See* Legislative History of NAIC Insurers Rehabilitation and Liquidation Model Act, § 47 (Priority of Distribution) at 555-94.

11 *See, e.g., Grode v. Mutual Fire, Marine & Inland Ins. Co.*, 572 A.2d. 798, 804 (Pa. Commw. Ct. 1990) (holding that "the Insurance Commissioner, as Rehabilitator, is given broader discretion to structure a rehabilitation plan than is given to her as statutory liquidator").

1993) (same). New Hampshire's order of distribution statute is equally comprehensive and thus equally exclusive. N.H. REV. STAT. ANN. § 402-C:44. The Liquidator's proposed Agreement vitiates § 402-C:44 and therefore must be rejected.

B. There is No Credible "Threat" or "Dispute" Purportedly Justifying the Alleged "Compromise"

Even if a wholesale violation of the statutory priority scheme could be justified on the basis of a necessary "compromise" (which, as demonstrated above, it cannot), no good faith compromise exists here. There is no evidence of any credible threat that the AFIA Cedents could (or would seek to) "wall off" the alleged "U.K. Assets" in an English insolvency proceeding, or that such an attempt would result in the "complex, protracted and costly litigation" that the Liquidator alleges. In fact, the purported "threat" (to the extent it has actually been made by any AFIA Cedent) is an empty one.

As set forth in the Affidavit of Richard Hacker, Q.C., there is no legitimate risk that creditors that did business with Home via its U.K. Branch would be able to "wall off" (or "ring fence," as the concept is described under English law) Home's alleged "U.K. Assets" for their exclusive benefit. Such efforts in the past have been repeatedly and uniformly rejected by the English courts, and would be summarily dismissed with an award of costs to the Liquidator if attempted in this instance. This is because English law applies the principle of "universality," whereby any company liquidated in England is "wound up" for the benefit of <u>all</u> of the company's creditors, not just for the benefit of those creditors that are resident in, or that did business with, the company in England. (Hacker Affidavit ¶ 30.) Indeed, if the company being liquidated is domiciled outside England (as is Home), an English court would treat the English liquidation as being ancillary to the liquidation in the domiciliary jurisdiction. (*Id.*) While theoretically any creditor (and not just English creditors) could file a claim against Home in an English ancillary proceeding, and Home's English liquidator would marshal any English assets

of Home (to the extent any exist), <u>all such claims and assets ultimately would be distributed through the domiciliary liquidation in New Hampshire</u>. (*Id.*) This mirrors what § 402-C:61 of the Act requires in Home's New Hampshire liquidation (as the Liquidator concedes at ¶ 6 of the Motion).

Notably, an English court would <u>not</u> engage in an inquiry as to which assets were "local" assets and which were not -- it is the essence of the universality principle that <u>all</u> assets are to be assembled for the benefit of <u>all</u> creditors. (Hacker Affidavit ¶ 31.) Even if such an inquiry would be entertained, however, recoveries pursuant to the Assumption Agreement would not be considered a "U.K. Asset" of Home. (*Id.* ¶ 40.) This is because the Assumption Agreement is governed by New York law (and/or New Hampshire law to the extent that Home's liquidation proceedings are relevant). (*Id.*) Any collection action under the Assumption Agreement would take place in a New York arbitration against Century, a Pennsylvania company. An English liquidator thus has no superior right to the proceeds of the Assumption Agreement (¶ 40), and those proceeds would not be available to be "ring-fenced" in England in any event.

Moreover, the proposed Agreement and underlying scheme of arrangement contain flaws that would be subject to challenge in an English court. For example, the scheme appears to apply only to the AFIA Cedents, and not to Home's other Class V creditors (such as the ACE Companies). It thus constitutes a violation of the *pari passu* principle and is subject to challenge under English law. (Hacker Affidavit ¶ 22.)

As demonstrated above and in the Hacker Affidavit, the Liquidator's claim that risky, complex litigation would result from opposing a "ring-fencing" claim does not withstand scrutiny. His assertion that opposing such a claim would result in substantial added expense to the Home estate likewise is easily dismissed. Any such attempt would be dealt with by the English Companies Court -- a court with specialist knowledge in insolvency matters -- on a

summary basis. (Hacker Affidavit ¶¶ 42-43.) Moreover, the Liquidator would recover a substantial portion of the attorneys' fees and costs incurred from the AFIA Cedents in the event he was successful in resisting their "ring-fencing" application (as should be the case). (*Id.* ¶ 44.) Thus, the Liquidator's claim that such expense justifies the "compromise" reflected in the Agreement should be summarily rejected.

Finally, it is worth noting that the Liquidator's attempt to avoid "complex, protracted and costly litigation" already has failed -- given the objections made to the Motion. Moreover, regardless of the result before this Court, it is the ACE Companies' present intent, for the reasons set forth above, to pursue all available remedies on appeal and in England to redress the inequities and flaws of the proposed scheme of arrangement.[12] Thus, "complex, protracted and costly litigation" is assured so long as the Liquidator continues to pursue implementation of the proposed Agreement.

There is no legitimate "dispute" to be "compromised" by the Agreement, and no good faith reason why the Liquidator seeks its approval from the Court. At bottom, the Liquidator seeks approval of for the payment of an unlawful "sweetener" to creditors that otherwise would receive no distribution of assets from the Home estate so that the Liquidator may use those creditors' claims to tap the reinsurance available under the Assumption Agreement. The Liquidator should not be allowed to make an "end-run" around § 402-C:44 by disguising this "sweetener" as a "compromise." If such conduct were permissible, there would be nothing to stop the Liquidator from, *e.g.*, agreeing to pay a holder of a large claim more than a holder of a small one, or paying all persons who did business with the insolvent insurer to submit claims, regardless of their priority in the order of distribution scheme, in order to reach the maximum

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[12] Indeed, given the obvious shortcomings of the proposed scheme under English law, it is possible that the Liquidator could be required to pay the ACE Companies' costs.

amount of assets that might relate to those claims. Section 402-C:44 was designed to prevent such dubious conduct, and it should not be sanctioned here.

C. The Liquidator's Purported Justifications for the Illegal "Incentive" Do Not Withstand Scrutiny

It should be self-evident that a Liquidator cannot violate the governing statutory framework simply because a proposed course of action ostensibly will bring more money into the insolvent estate. If that were the case, a liquidator would have free rein to employ all sorts of illegal schemes and incentives by claiming that the end justifies the means.

In that context, the Liquidator's claimed concern that the AFIA Cedents might not file proofs of claim with the Home estate is a red herring. It will always be the case in insurance insolvencies that parties with little prospect of recovering funds might decide that it is not worthwhile to pursue those claims. When the New Hampshire legislature relegated certain classes of claimants to the bottom of the priority list, it clearly understood that those claimants might not possess a strong incentive to file. That is the statutory scheme, and the Liquidator must live with the incentives put in place by the legislature. The Liquidator cannot create his own set of "incentives" by paying off creditors to file when those "incentives" are not sanctioned by the Act.

Moreover, the Liquidator's assertion that some AFIA Cedents will not bother to file proofs of claim absent an "incentive" to do so cannot be taken at face value. As an initial matter, the fact that some cedents have yet to file their proofs is irrelevant because those proofs are not due until June. Moreover, it is not typical for reinsured creditors of an insolvent insurer simply to abandon their claims. To the contrary, most creditors -- even Class V creditors -- do so as a matter of routine practice -- particularly where the claim is sizeable. One common reason for doing so is that reinsured companies often are reinsurers as well, and they frequently will have the right to offset their obligations and their creditor claims (as some of the ACE Companies may

be able to do in whole or in part). The Liquidator provides no explanation why one particular group of Class V creditors (the AFIA Cedents) requires an incentive to file when other Class V creditors do not.

The Liquidator's suggestion that certain unnamed AFIA Cedents might seek to enter into "side agreements" with Century likewise cannot justify the Liquidator's proposal. The Liquidator does not allege that any such "side agreements" actually exist; thus, the theoretical propriety of such arrangements is not ripe and hence not properly before the Court.[13] The mere potential for a dispute over a theoretical question cannot justify a wholesale violation of the order of distribution scheme contained in the Act.

D. The Liquidator Cannot Pass Off His Improper Distribution Scheme as an Administrative Cost of the Estate

The Liquidator suggests, in passing, that the tens of millions of dollars he is proposing to pay the AFIA Cedents can be justified as "a cost of obtaining and collecting an asset of the Home estate." (Motion ¶ 21.) This suggestion is so far from the ordinary and common sense interpretation of "administrative expenses" that it is difficult to take it seriously. Indeed, a past attempt to transform settlement proceeds into an "administrative expense" in an insurance insolvency was squarely rejected. In *Oxendine v. Commissioner* (*In re Coastal States Life Ins. Co.*), 494 S.E.2d 545 (Ga. App. 1997), the Georgia Court of Appeals considered whether settlements that had been entered into with general creditors of an insurer during rehabilitation should be paid as an administrative expense once the insurer was placed into liquidation. The court rejected the general creditors' argument that the settlements should be treated as administrative expenses because they "preserved the assets of the estate." *Id.* at 548. In so

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[13] In the event that such a dispute ever would ripen for resolution, given that it would involve an interpretation of the parties' rights under the Assumption Agreement, the claim would be subject to the arbitration agreement contained therein, and Century reserves all of its rights in that regard.

ruling, the court noted that "[n]o reasonable definition of 'costs' or 'expenses' can include the [settlement] claims . . . . These claims are for money which appellees claim from the [insurer's] estate and not administrative costs or expenses incurred." *Id.*

As in *Oxendine*, placing a judicial imprimatur upon the payment of tens of millions of dollars to unsecured creditors as an "administrative expense" defies "common sense and sound reasoning." *Id.* Indeed, if these payments can be characterized as an administrative expense, *anything* can be so characterized, thus rendering the entire statutory scheme meaningless. The Court should not sanction such an absurd result.

III. The Proposed Agreement Violates Well-Established Principles Governing Cross-Border Insolvencies and Ancillary Proceedings

Cross-border insolvencies are no longer a novelty. Most insolvencies of any size or complexity tend to have ramifications across state and national boundaries. Accordingly, well established principles have evolved in both the U.S. and the U.K. for administering such insolvencies -- principles that are virtually identical regardless of whether the primary liquidation is located in the U.S. or the U.K. The Liquidator's proposal flies in the face of those well established principles, and its approval would be unprecedented.

As discussed above, it is well recognized in the U.K. that "where a foreign company is being wound up in its place of incorporation, the 'home' liquidation is to be regarded as the principal liquidation with an English liquidation being only ancillary thereto" and that the home forum "has primary responsibility for the administration of the insolvency of a foreign incorporated or domiciled debtor." (Hacker Affidavit at ¶¶ 29-30). The doctrine of "universality" likewise requires that all of the assets of the company must be distributed by one

court "for the benefit of all [of the company's] creditors."[14] (*Id.* at ¶ 30) (emphasis in original). For these reasons, the English courts have squarely rejected the "ring-fencing" concept the Liquidator proposes. (*See id.* at ¶¶ 33-38.)

Ancillary proceedings in the United States follow similar principles. In the insurance insolvency context, as detailed in § I.B. above, the Act requires ancillary receivers to show deference to the domiciliary liquidation. N.H. REV. STAT. ANN. § 402-C:61. Similarly, § 304 of the Bankruptcy Code allows for the commencement in the U.S. of a case ancillary to a foreign proceeding.[15] As the bankruptcy court noted in *Armco Inc. v. North Atlantic Insurance Co. Ltd. (In re Bird)*, 229 B.R. 90 (Bankr. S.D.N.Y. 1999), a case which involved a § 304 proceeding commenced in New York in aid of an English liquidation of an insurance company:

> The principal goal of a § 304 case is to permit foreign debtors to prevent the piecemeal distribution of assets in the United States by means of legal proceedings initiated in domestic courts by local creditors.
>
> . . . The very purpose of the § 304 proceeding is to extend the English automatic stay to American creditors and assets and not allow creditors to do here what they would not be allowed to do in the United Kingdom.
>
> . . . The automatic stay is designed to offer the debtor repose from his or her creditors' collection efforts, to protect creditors from each other, and to insure an orderly liquidation or administration of the estate.

Id. at 94 (citations omitted; emphasis added). The federal bankruptcy courts have consistently followed these principles for ancillary proceedings commenced under § 304.[16]

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[14] The Second Circuit has described the "universality" approach as follows: "[A] primary insolvency proceeding is instituted in the debtor's domiciliary country, and the ancillary courts in other jurisdictions -- typically in jurisdictions where the debtor has assets -- defer to the foreign proceeding and in effect collaborate to facilitate the centralized liquidation of the debtor's estate according to the rules of the debtor's home country." *Bank of N.Y. v. Treco (In re Treco)*, 240 F.3d 148, 153 (2d Cir. 2001).

[15] 11 U.S.C. § 304(a).

[16] Courts overseeing other § 304 cases have agreed that the role of an ancillary proceeding is to protect all creditors of the estate and to ensure equality of distribution. *See Aranha v. Eagle Fund, Ltd. (In re Thornhill Global*

The proposed Agreement allows the kind of "territorial grab" of assets by local creditors that U.S. and U.K. law heretofore have not permitted. It unfairly favors one subset of creditors over other creditors in the same class, as well as creditors in other classes. It undermines the priority scheme established by New Hampshire law rather than showing deference to it. In such circumstances, there can be no serious question that the proposed Agreement should not be approved by this Court.

IV. The Liquidator's Motion Is Procedurally Defective, and Its Approval Would Violate the Fifth and Fourteenth Amendments to the United States Constitution and Part I, Article XV of the New Hampshire Constitution

A. The Liquidator has provided grossly inadequate notice to interested parties

If the Liquidator's proposal is implemented, the economic interests of each of Home's numerous policyholders and creditors will be affected. Indeed, the Liquidator asserts that the present motion involves amounts in excess of $100 million. (Motion ¶ 14.) Moreover, Century and every other reinsurer of Home will be affected by the Liquidator's novel proposed "end run" around § 402-C:44. Indeed, virtually all companies who either reinsure or are reinsured by U.S. companies would be highly interested in this Motion and the potential precedent it could create, given that the scheme proposed by the Liquidator could create a gaping priority loophole that could be exploited in virtually any significant U.S. insurance insolvency.

Despite the unprecedented scope and value of the relief sought in the Motion, the Liquidator has deigned to provide notice only to *five* parties or groups of parties. *See* Notice of

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Deposit Fund), 245 B.R. 1, 14 (Bankr. D. Mass. 2000) (enjoining state court action by U.S. creditor Mercurius of Bahamian debtor Thornhill Global and noting that the injunction "merely places Mercurius in the same position as Thornhill Global's other creditors"); *In re Culmer*, 25 B.R. 621, 628 (Bankr. S.D.N.Y. 1982) ("'The theme of the Bankruptcy Act is equality of distribution of assets among creditors, . . . and correlatively avoidance of preference to some . . . . The road to equity is not a race course for the swiftest.'") (quoting *Israel-British Bank (London) Ltd. v. FDIC*, 536 F.2d 509, 513 (2d Cir. 1976)). § 304(c), which lists the criteria for determining whether a party may obtain injunctive and other relief in a § 304 proceeding, reflects the same precepts of universality and deference to the principal liquidation. *See* 11 U.S.C. § 304(c)(1), (3), (4).

Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents at 1. What the Liquidator has done violates well settled constitutional norms:

> Notice by mail or other means as certain to ensure actual notice is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of *any* party, whether unlettered or well versed in commercial practice, if its name and address are reasonably ascertainable.

Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 800 (1983). New Hampshire law is fully in accord:

> For more than a century, the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified. The notice must be of such nature as reasonably to convey the required information and must be more than a mere gesture.

Berube v. Belhumeur, 139 N.H. 562, 567, 663 A.2d 598, 601 (N.H. 1995) (citations omitted); *see also State v. Hess*, 118 N.H. 491, 492, 387 A.2d 1183, 1184 (N.H. 1978) (citing *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 318 (1950)) ("When the name and address of a party is known, due process requires at least that notification be attempted by mail addressed personally to the party."). The timing of a hearing is also of crucial importance:

> The fundamental requisite of due process is the opportunity to be heard, and that opportunity is useless unless one is informed of the matter pending and the hearing is granted at a meaningful time and in a meaningful manner.

Royer v. New Hampshire Dep't of Employment Sec., 118 N.H. 673, 679, 394 A.2d 828, 831 (N.H. 1978) (citing *Armstrong v. Manzo*, 380 U.S. 545, 550 (1965)).

Each creditor of Home is potentially affected by the Motion and has a right to be heard with regard to it:

> It is not necessary for a proceeding to directly adjudicate the merits of a claim in order to 'adversely affect' that interest. In *Mennonite* itself, the tax sale proceedings did not address the merits of the mortgagee's claim. Indeed, the tax sale did not even completely extinguish that claim, it merely 'diminished the value' of the interest. Yet the Court held that due process required that the mortgagee be given actual notice of the tax sale.

Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478, 488 (1988) (citations omitted). Similarly, due process requires actual notice of the Liquidator's Motion to all affected parties.

The Liquidator certainly has records detailing the identities of Home's policyholders and other creditors (*e.g.*, reinsureds), and thus should be required to provide notice to these obviously interested persons. It would be wrong for the Court to rule on the Liquidator's Motion when even the most minimal due process requirements have been ignored.

B. Century's Rights Will be Violated If the Present Motion is Considered Without Adequate Discovery and Further Briefing

A "meaningful" hearing on the present motion will require adequate discovery and further briefing. The Liquidator's Motion does not cite any case law. In fact, the only support provided by the Liquidator for the Motion is the affidavit of Peter A. Bengelsdorf, which is virtually identical to the Motion itself and replete with legal conclusions, hearsay, and vague and unsupported assertions. The Liquidator cannot seriously contend that the proposed Agreement should be approved on this meager basis, and it would be manifestly unfair for meaningful evidentiary and case support for the proposal to be furnished for the first time in a reply brief.

The Liquidator's Motion rests on factual assertions about matters that the ACE Companies either contest or have no knowledge of. Therefore, the ACE Companies wish to obtain limited written discovery and to depose Mr. Bengelsdorf and possibly others with pertinent knowledge of the facts and circumstances described in the Motion.[17] As the Liquidator's factual position emerges, the ACE Companies may offer fact witnesses of their own to counter assertions made by the Liquidator's witnesses; if so, the Liquidator may wish to depose those witnesses. The Liquidator may wish to depose Mr. Hacker, the ACE Companies'

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[17] Copies of ACE Companies' proposed interrogatories and document requests are attached to their Objections as Exhibits A and B.

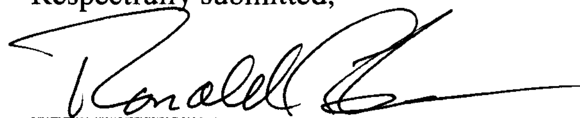
expert on English law; if the Liquidator is able to find someone to disagree with Mr. Hacker, the ACE Companies will want to depose that person.

Accordingly, unless this Court is prepared to deny the Liquidator's Motion summarily, the ACE Companies respectfully request a status conference so that the Court may set an appropriate schedule for the completion of discovery, further briefing and an evidentiary hearing.

CONCLUSION

For the foregoing reasons, the ACE Companies respectfully request that the Liquidator's Motion be denied, or alternatively that a hearing be held in which a fair and appropriate procedure is established to develop a legal and factual record upon which the Liquidator's Motion properly may be considered.

Respectfully submitted,



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The undersigned certifies that he served a copy of the foregoing on the following counsel via electronic mail and overnight mail on March 19, 2004.

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