UNITED STATES DISTRICT COURT
DISTRICT OF NEW HAMPSHIRE

Roger A. Sevigny, Insurance Commissioner As the Liquidator of the Home Insurance Company, Plaintiff, v. Employers Insurance of Wausau, a Mutual Company, Defendant	Civil No. 03-501-JM

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S MOTION FOR REMAND

I. INTRODUCTION

Plaintiff, Roger A.. Sevigny the Insurance Commissioner of the State of New Hampshire acting as the liquidator for two insolvent insurance companies brought this action in the Merrimack County Superior Court against Employers Insurance of Wausau ("EIW") seeking a declaratory judgment regarding EIW's ability to effectuate a triangular offset under certain reinsurance contracts between EIW, The Home Insurance Company ("The Home") and US International Reinsurance Co. ("USI Re") both of which insurers are in separate state court liquidation proceedings. EIW has subsequently removed the case to the federal district court under 28 U.S.C. §§ 1441(a) and (b). Plaintiff now seeks an order remanding this matter back to the

Merrimack County Superior Court based upon principles of *Burford* and *Colorado River* abstention.

II. FACTS

A. Background

On May 8, 2003, Paula T. Rogers, the then Commissioner of Insurance for the State of New Hampshire, as Rehabilitator of The Home petitioned the Merrimack County New Hampshire Superior Court pursuant to RSA 402-C:5, RSA 402-C:19 and RSA 402-C:20 for an order directing her to liquidate The Home pursuant to the New Hampshire Uniform Insurers Rehabilitation and Liquidation Act, RSA c. 402-C (the "Liquidation Act"). Simultaneously, the Commissioner petitioned the Superior Court for an Order of Liquidation to be entered with respect to The Home's subsidiary, USI Re. On August 13, 2003, Roger A. Sevigny was confirmed by New Hampshire's Governor and Executive Council as Commissioner of Insurance.

The Home is a New Hampshire corporation with its statutory offices in Manchester, New Hampshire. The Home is a New Hampshire domiciled insurance company authorized by, licensed by, and subject to regulation by the New Hampshire Insurance Department ("Department"). USI Re is a separate and distinct corporate entity which is a New Hampshire domiciled reinsurance company authorized by, licensed by, and subject to regulation by the Department.

Prior to the Department's commencement of the liquidation, the Department had issued an Order of Supervision on March 3, 1997, pursuant to RSA 402-C:11. In addition, the Department commenced a rehabilitation proceeding against The Home

in the Superior Court by order entered pursuant to RSA 402-C:16 on March 5, 2003, and rehabilitation against USI Re on March 12, 2003.

On June 11, 2003, the Superior Court entered an Order of Liquidation for The Home and appointed the Commissioner as liquidator (the "Liquidator"). On June 13, 2003, a superseding Order of Liquidation was entered for The Home and a separate order entered for USI Re appointing the Commissioner liquidator of USI Re. True copies of the Orders of Liquidation are appended hereto as Exhibits "A" and "B" respectively.

At the time of the liquidations, The Home was involved in approximately 600 suits around the country in all 50 states (either as defendant or providing defense for an insured). After the Liquidation Orders were entered, the Liquidator mailed out over 330,000 proof of claim forms. At the point of liquidation The Home had approximately 11,000 open policyholder claims outstanding (which could mean hundreds of thousands of individual claimholders under the represented policies).

The Home's largest asset, unlike many other insurers for whom premium collections are the largest asset, is its reinsurance recoverables.[1] Reinsurance is the transfer from an insurer to a reinsurer of the risk assumed under all or a portion of a policy or a group of policies. Since the beginning of the Liquidation, the Liquidator has collected reinsurance recoverables for The Home in an amount in excess of $100,000,000. The Home has other reinsurance recoverables with approximately 585 additional reinsurers worth hundreds of millions of dollars more. Clearly, collecting

[1] The Home ceased writing policies and for the most part was divested of its premium based business in 1995.

reinsurance recoverables is a key function of The Home Liquidator's task: to liquidate and marshall assets of The Home into cash. The Liquidator performs this function with respect to these reinsurers after accounting for legitimate offsets. USI Re did not issue policies and instead was a reinsurer.

B. New Hampshire's Comprehensive Uniform and Coherent Scheme for Liquidating Insurers

Under the Liquidation Act, the New Hampshire Superior Court has exclusive jurisdiction for the liquidation of New Hampshire domiciled insurance companies. RSA 402-C:20. Only the State of New Hampshire Commissioner of Insurance in his or her official capacity may conduct liquidation proceedings of a New Hampshire domiciled insurer. RSA 402-C:4 ("no [liquidation] proceeding shall be commenced under this chapter by anyone other than the commissioner of this state and no court shall have jurisdiction to entertain, hear or determine any proceeding commenced by any other person.") New Hampshire law provides that only the New Hampshire Insurance Commissioner may serve as liquidator of a New Hampshire domiciled insurance company. RSA 402-C:21, I ("An order to liquidate the business of a domestic insurer shall appoint the commissioner and his successors in office liquidator and shall direct the liquidator forthwith to take possession of the assets of the insurer and to administer them under the orders of the [Superior] court.")

The entry of a liquidation order is an event similar to the commencement of a bankruptcy proceeding under title 11 of the United States Code. A stay barring actions against the insolvent insurer is put in place and the Commissioner's regulation

of the insurer becomes one of marshaling and liquidating assets for the benefit of policyholders. *See* RSA 402-C:5; 402-C:21; 402-C:28, and 402-C:29; Liquidation Orders ¶¶ (f), (g), (m) & (n); *compare* 11 U.S.C. §§ 362(b), 542 & 547. New Hampshire law puts a single state court in control of the administration, liquidation and distribution of the bankrupt insurance company estate under a statutory scheme modeled, in some respects, after an earlier federal bankruptcy act. *See* RSA 402-C:4 & RSA 402-C:20 (proceedings to liquidate may only be brought by the Commissioner of insurance and only in Merrimack Superior Court). Congress has given this role expressly to state courts through the McCarren-Ferguson Act, 15 U.S.C. § 1012, and through a provision of Title 11 that excludes insurance companies from those entities that may be a "debtor" under the bankruptcy code. 11 U.S.C. § 109(b)(2) & (d) (domestic insurers may not be debtors under chapter 7 & 11).

The Liquidation Act generally provides for abatement of actions against the insurer. RSA 402-C:28, I. The liquidation court also possesses broad equitable powers to enjoin and prevent interference with the liquidator and the proceeding or any "action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders or the administration of the proceeding." RSA 402-C:5, I.

The right of setoff is expressly acknowledged in the Liquidation Act. RSA 402-C:34; *compare* 11 U.S.C §553(a); Bankruptcy Act of 1898, §68. Section 34 provides in pertinent part:

> Mutual debts or mutual credits between the insurer and another person in connection with any action or proceeding under this chapter shall be set off and the balance only shall be allowed or paid . . .

(RSA 402-C:34, I.)

The Order of Liquidation, however, stayed setoff rights of third parties except for setoffs by reinsurers seeking to make offsets consistent with the provision of the Liquidation Act providing for them, i.e. mutual debts and credits. Liquidation Orders at ¶(n)(7); RSA 402-C:5, RSA 402-C:34 ("mutual debts or mutual credits . . . shall be set off . . .") *compare* 11 U.S.C. § 362(a)(7). Thus, any reinsurer seeking to make a setoff that is not founded on mutuality is subject to the Superior Court's stay order, and is obliged to go to that court for equitable relief from that order.

The Liquidation Act and the Liquidation Orders provide that the Commissioner of Insurance is vested in title and entitled to take possession of all the assets of the insolvent insurer subject to the supervision of the Superior Court. RSA 402-C:21 (I) ("An order to liquidate the business of a domestic insurer shall appoint the commissioner and his successors in office liquidator and shall direct the liquidator forthwith to take possession of the assets of the insurer and administer them under the orders of the court."); Liquidation Orders ¶ ¶ (f), (g), (h), & (i). The Commissioner is required to make regular financial reports and monthly liquidation progress reports to the Liquidation Court, as well as a list of assets. RSA 402-C:21 (V), 402-C:25 & 402-C:29. With Liquidation Court approval the Commissioner can appoint a special deputy, appoint employees, counsel, accountants and actuaries, and fix their compensation. RSA 402-C:25 I, II, & III. He can also defray all the expenses of taking possession of the assets of the insurer, including expenses incurred in this litigation. Id. at IV. Subject to the Superior Court's control, the Liquidator can hold

hearings and compel attendance thereat and issue subpoenas. Id. at V. The Liquidator can, under the statute, collect all debts of the insurers, sell, lease, encumber and abandon property of the insurers, and borrow money and enter into contracts to carry out the Liquidation Orders. *See* RSA 402-C: 25 VI, VII & IX; *compare* 11 U.S.C. §§ 363-365, 541-543, 554, 704 & 1106 (describing powers of trustees and debtors in possession to manage estates and their property, including selling, borrowing, recovering, and abandoning property). The Commissioner also has the power to prosecute and defend lawsuits on behalf of the defunct insurer. RSA 402-C:25 XII, XIII, XVII, XVIII & XIX. As in federal bankruptcy proceedings, the Commissioner, with Superior Court involvement, may avoid fraudulent and preferential transfers and disallow claims of parties having received preferences. RSA 402-C:30 - :33; *compare* 11 U.S.C. §§ 502(d), 544, 547 –549.

The order of distribution under the Liquidation Act is an absolute priority like that found in federal bankruptcy law; no creditor in lower priority classes may be paid until those in higher priority classes are paid in full. *See* RSA 402-C:44 & -C:46; 11 U.S.C. §§507, 726 & 1129(b)(2)(B)(ii). In the New Hampshire scheme, a legislative prerogative is exercised and claims of reinsurers are subordinate to claims of policyholders. RSA 402-C:44, III and IV.[2]

Much of the statutory scheme is devoted towards achievement of the two principal imperatives of the liquidation: liquidation of assets in a manner that is

[2] Similarly, in bankruptcy, claims of sureties are subordinated until the person for whose benefit the surety existed is paid in full. *See* 11 U.S.C. § 509(c). This is to ensure application of the well-established principle that it would be an unconscionable windfall for a surety to require its beneficiary to share a loss that the surety was compensated to insure the beneficiary against. *See* Prudence Realization Corp. v. Geist, 316 U.S. 89, 96 (1942); Mutual Trust Life Ins. Co. v. Wemyss, 309 F. Supp. 1221, 1232-33 (D. Me. 1970).

"consistent with the effective execution of the liquidation as rapidly and economically as he can" and distribution "in a manner that will assure the proper recognition of priorities . . . ." RSA 402-C:29 II & 402-C:46 I. The Liquidation Court's involvement in the administration of the insurer, through the actions of the Commissioner to empower and direct the Commissioner in this task, is pervasive.

C. The Liquidator's Action Against EIW

Consistent with the Commissioner's official duty to rapidly liquidate the assets of the insurer, and to protect the priority scheme, on October 8, 2003, the Liquidator filed a Complaint Seeking Declaratory Judgment With Respect to Offsets against EIW and served the Complaint upon EIW's registered agent in New Hampshire on October 28, 2003. The Complaint sought only declaratory relief, not money damages. The basis for the relief was that EIW was attempting to exert illegal triangular setoffs under certain reinsurance contracts in violation of the Superior Court's Liquidation Orders and in violation of New Hampshire state law, both of which prohibit triangular setoffs by requiring mutuality. Complaint at ¶¶ 12-16. *See* RSA 402-C:34 ("Mutual debts or mutual credits . . . shall be set off . . .."); Liquidation Orders ¶ (n)(7) (reinsurers' setoffs not stayed so long as they are consistent with RSA 402-C:34, ie mutual).

What EIW has asserted is that because USI Re owed EIW money, and EIW owed The Home money, EIW could set off its debt to The Home with USI Re's debt to EIW. Mutuality, as set forth in New Hampshire's comprehensive uniform and coherent liquidation law, the Liquidation Orders and common law, requires that the

debts must be "in the same right, and between the same parties standing in the same capacity." Darr v. Muratore, 8 F.3d 854, 860 (1st Cir. 1993); *see* Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995); In re Public Serv. Co. of N.H., 884 F.2d 11, 13-14 (1st Cir. 1989) (mutuality required for setoff); Plante v. Shortell & Son, 92 N.H. 38 (1942) ("It is a cardinal rule of setoffs that the debts involved must be mutual").

Setoff rights —while acknowledged by statutes such as RSA 402-C:34— are an equitable remedy and a creation of state law. Cumberland Glass Mfg. Co. v. De Witt, 237 U.S. 447, 455 (1915); In re Calore Express Co., 288 F.3d 22, 37-38 (1st Cir. 2002) (balancing equities to determine whether setoff improperly denied by bankruptcy court); Adams v. Zimmerman, 73 F.3d 1164, 1173 n. 10 (1st Cir. 1996) ("setoff may be denied in order to do 'equity, prevent injustice and achieve the goals of procedural fairness.'" (citation omitted)); In re PSNH, 884 F.2d at 14; In re Moreira, 173 B.R. 965, 968 (Bankr. D. Mass. 1994) (applying state law to determine whether credit union had a valid right of setoff and mutuality); W. Loyd, The Development of Setoff, 64 U. PA. L. REV. 541 (1916) (tracing equitable origins of setoff back to roman law). Mutuality does not exist between different, albeit related, corporate entities. Gonzalez Hernandez v. de Aragon, 358 F.2d 930, 934-35 (1st Cir. 1966).

Consequently, if the Liquidator is correct about mutuality, the position adopted by EIW is clearly one that can only be legally achieved through an exercise of the Superior Court's equitable discretion. On the other hand, if EIW is correct in its view of mutuality, it is also clear that under the Liquidation Act and common law, the

Superior Court has sufficient equitable discretion to prevent the triangular exercise of setoff in order to "do equity, prevent injustice and achieve the goals of procedural fairness" to preserve one of the primary goals of the liquidation: equality of distribution. *See* Adams v. Zimmerman, 73 F.3d at 1173; RSA 402-C:5(I)(k) (Superior Court may enjoin any action that might prejudice the rights of policyholders). Thus, in either case, the primary issue at stake in this litigation will require an exercise of the court's equitable powers and discretion, precisely the kind of matter that the Supreme Court has clearly held is ripe for *Burford* abstention. *See* Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 731 (1996) (holding that "federal courts have the power to dismiss or remand cases based on abstention principles only where the relief being sought is equitable or otherwise discretionary.")

III. ARGUMENT

A. The Court Should Remand the Action Back to the State Liquidation Court Under Abstention Doctrines

The Court should remand this matter to the Superior Court on the *Burford* and *Colorado River* abstention doctrines because this matter arises as an integral part of the State's liquidation proceedings against insolvent insurance companies. Under those doctrines courts routinely remand matters because insurance insolvency is a subject reserved to the states and because the removed actions will have an impact on the state's ability to establish and operate a coherent and uniform process to accomplish a matter of significant local importance. The question presented by the Liquidator in his complaint against EIW is at the core of the Superior Court's jurisdiction over the liquidation: can a creditor violate the Superior Court's stay order

and the provisions of RSA 402-C-34 and elevate its priority over policyholders with a non-mutual triangular setoff? This court should abstain and allow the Superior Court to establish a uniform rule in this liquidation on that subject.

1. Remand is a Two-part Test.

The decision to remand requires the resolution of a two-part test. First the Court must determine whether the underlying action removed is of the type for which remand, as opposed to a stay is permitted. If the answer to the first test indicates that remand is possible, the second inquiry is whether in the balancing of interests, federal and state, the action is more appropriately heard in the state court. The answers to both tests in this case suggest that this Court can and should remand this action to the New Hampshire Superior Court.

2. Remand is Appropriate Because The Matter Requires an Exercise of the Court's Discretionary and Equitable Powers

Remand of a removed action is an appropriate action under the *Burford* and *Colorado River* doctrines because the Liquidator's suit against EIW is not a suit for money damages. *See* Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 731(1996). The Liquidator's suit is a declaratory judgment action seeking vindication of the injunctive provisions of the Superior Court's Liquidation Orders and the New Hampshire Liquidation Act's statutory limitation on the availability of setoff in the course of an insurance insolvency. Under the Liquidation Act, the Superior Court has the discretion to enjoin any action that might lessen the value of the insurer's assets – including its reinsurance contracts—or prejudice the rights of policyholders. RSA

402-C:5. It exercised that discretion when it enjoined any party from attempting setoffs that lacked mutuality. Liquidation Orders at ¶ (n)(7). EIW, on the other hand, has maintained that it is entitled to non-mutual triangular setoffs. The Superior Court, however, as a matter of equity and in the interests of the policyholders in the liquidation of The Home and USI Re, has foreclosed EIW's non-mutual setoff practices. Consequently, if EIW is to be allowed to continue its non-mutual setoffs it will need to establish an equitable discretionary basis for that in light of the Liquidation Orders and Section 34 of the Liquidation Act. It is thus amply clear that the action removed here seeks discretionary relief against EIW: enforcement of the Superior Court's stay order. On the other side of the coin, EIW is likely to require discretionary relief to prevail: some form of relief from the Superior Court's stay order. Consequently, remand under *Burford* is available in such circumstances where discretionary and equitable relief is at the heart of the dispute. *See, e.g.*, Quackenbush, 517 U.S. at 730 (abstention not limited to just equitable cases but includes any where "federal court is asked to provide some form of discretionary relief"); Burford v. Sun Oil Co., 319 U.S. 315, 317 (1943); Pennsylvania v. Williams, 294 U.S. 189 (1935) (federal court may abstain in favor of pending state court insurer liquidation proceeding that is protective of policyholders interests).

3. Paramount State Interests in the Liquidation of The Home and USI Re Require *Burford* Abstention

The second aspect of the test for remand requires a balancing of the federal interests in exercising jurisdiction over the removed matter with the state's interests in the proceeding staying before the Superior Court conducting the liquidation. This Court should abstain from hearing this matter and remand it to the Superior Court because the sparse federal interests are significantly outweighed by the paramount interests of the state in conducting a liquidation of The Home and USI Re under its comprehensive, uniform and coherent insurer liquidation scheme.

The question presented in the present dispute is one at the core of the liquidation process: can the state court use its equitable powers to promote the interests of the liquidation to protect policyholders and enjoin a non-mutual setoff when (a) that setoff is contrary to state law and long established principles of setoff; (b) that setoff will deprive policyholders of money to satisfy their insurance claims, not just money lost on this reinsurer's setoff claims, but perhaps on many others; and (c) the non-mutual setoff will alter the priority scheme of the liquidation.

The dispute between the Liquidator and the reinsurer is not based upon any federal rights or law and instead is solely a state law claim by the Liquidator under the reinsurance contracts and New Hampshire's insurer insolvency law. Consequently, federal interests are minimal.

The Liquidator recognizes the obvious: abstention is "an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly

before it." Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 813 (1976). The federal courts have recognized, however, that they should abstain when exercising jurisdiction that could result in the federal court interfering in an important state matter for which uniform rules should apply. *See* New Orleans Pub. Serv. Inc. v. Council of the City of New Orleans, 491 U.S. 350, 360-63 (1989) ("*NOPSI*") (abstention appropriate where difficult questions of state law bear on policy problems of substantial public import transcending the result in the case at bar or where federal jurisdiction would be disruptive of state efforts to establish a coherent policy on a matter of public concern); Gonzalez v. Media Elements, Inc., 946 F.2d 157 (1st Cir. 1991) (*per curiam*) (abstention appropriate under *Burford* in litigation involving uniform insurer liquidation scheme); *but see* Fragoso v. Lopez, 991 F.2d 878 (1st Cir. 1993) (*Burford* abstention not appropriate in appeal of tort claim against insured and insolvent insurer originally decided by federal court).[3] The abstention doctrines are best viewed as delineating the considerations of federalism, comity, and judicial administration that may justify overriding the strong presumption in favor of exercising federal jurisdiction, not as setting out discrete mechanical tests: "the various types of abstention are not rigid pigeonholes into which federal courts must try to fit cases." NOPSI, 491 U.S. at 359; *see* Wolfson v. Mutual Benefit Life Ins. Co., 51 F.3d 141, 145 (8th Cir. 1995). Federal courts routinely acknowledge the flexibility in the doctrines as the basis for abstaining from hearing matters at the core of proceedings in state courts for the liquidation of insolvent insurers.

[3] As discussed below, however, *Fragoso* is the exception that proves the rule. In *Fragoso*, the court declined to order *Burford* abstention because the issue in question was not one requiring a uniform rule.

Federal courts around the country hold that in most instances abstention in favor of ongoing state court insurance insolvency proceedings is warranted because those proceedings are important state matters for which uniform rules are critical and policy problems of substantial public concern are being resolved. *E.g.* Quackenbush, 517 U.S. at 733 (Kennedy, J., concurring) ("States as a matter of tradition and express federal consent, have an important interest in maintaining precise and detailed regulatory schemes for the insurance industry. . . . The fact that a state court rather than an agency was chosen to implement California's scheme provided more reason, not less, for the federal court to stay its hand."); Callon Petroleum Co. v. Frontier Ins. Co., 351 F.3d 204, 209 (5th Cir. 2003) (*Burford* abstention in context of insurance company insolvency "classic example" and "proper, if not obligatory"); Feige v. Sechrest, 90 F.3d 846 (3d Cir. 1996); Wolfson v. Mutual Ben. Life Ins. Co., 51 F.3d 141, 147 (8th Cir. 1995); Barnhardt Marine Ins., Inc. v. New England Int'l Surety of America, Inc., 961 F.2d 529 (5th Cir. 1992) ("*Burford*-type abstention is appropriate in an action against an insurance company which is the subject of a [state] liquidation proceeding."); Hartford Cas. Ins. Co. v. Borg-Warner Corp., 913 F.2d 419 (7th Cir. 1990); Grimes v. Crown Life Ins. Co., 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 489 U.S. 1096 (1989); Todd v. DSN Dealer Serv. Network, Inc., 861 F. Supp. 1531, 1541-43 (D. Kans. 1994); AMS Marketing, Inc. v. Fidelity Sec. Life Ins. Co., 830 F. Supp. 1284 (D. Az. 1993); Corcoran v. Universal Reinsurance Corp., 713 F. Supp. 77 (S.D.N.Y. 1989); *see also* First Penn-Pacific Life Ins. Co. v. Evans, 304 F.3d 345, 349 (4th Cir. 2002) (corporate liquidation process in state court should be afforded *Burford* abstention), *cert. denied*, 123 S. Ct. 1622 (2003); Caudill v. Eubanks Farms,

Inc., 301 F.3d 658, 662 (6th Cir. 2002) (same); Friedman v. Revenue Mgmt. of N.Y., Inc., 38 F.3d 668 (2d Cir. 1994) (same); In re Cilley, 58 F. 977, 987-88 (C.C.D.N.H. 1893) (federal courts should abstain in favor of state probate jurisdiction for winding up decedents' estates).[4]

These authorities conduct an analysis using the *Burford* and *Colorado River* doctrines to determine whether the federal court should exercise its discretionary power to refuse to hear a case when keeping the case "would impair the 'independence of state governments in carrying out their domestic policy'" and when the importance of the policies in question "transcends the result in the case then at bar." Grimes, 857 F.2d at 703 (quoting from *Colorado River* and *Burford*). *See also* Quackenbush, 517 U.S. at 716; Feige v. Sechrest, 90 F.3d at 847 ("at this point in our jurisprudence, there can be little doubt that parallel federal and state proceedings would disrupt Pennsylvania's legislative framework for the liquidation of insolvent insurers.") As demonstrated above, New Hampshire has developed a comprehensive and uniform scheme for the liquidation of The Home and USI Re. Under New Hampshire's law, the Superior Court entered an injunctive order prohibiting the non-mutual triangular setoffs claimed by EIW. The Liquidator's suit in equity for

[4] In *Cilley* Judge Aldrich reasoned: "we might and ought to consider the common understanding, as well as the consequences which would result, --which view would best harmonize with the theory of our government, and tend in the highest degree to promote the administration of justice . . .. It is not necessary for us to enlarge upon the reasons of public policy, economy, convenience, speed, and the process necessary for the adjustment of such affairs . . . as reasons for leaving such proceedings . . . free from the interference of [federal courts]." 58 F. at 987-88. "It is of no little consequence to the convenience of citizens and the ordinary administration of justice in the state courts, whether proceedings of this character are left with the convenient forum of the state [courts], where for more than a century it has been understood they belong, or whether they are to be wrested therefrom, and made subject to federal jurisdiction and regulation . . . ." Id. at 989.

declaratory relief —removed here before an answer was filed by EIW— was the Liquidator's attempt to vindicate and effectuate that order.

The impact of a ruling on this matter could have far reaching impacts on the liquidation. If EIW is permitted to take its non-mutual triangular setoff, substantial assets will be denied to the thousands of policyholders holding hundreds of millions of dollars in claims who are dependent upon the liquidation for their insurance benefit. In addition, to the extent of that setoff, EIW's claim will rise in priority above the claims of policyholders because non-mutual setoff has the effect of creating an improper preference. These two results will frustrate both of the key state law mandates for the liquidation procedure: maximization of asset recovery and equality of distribution. But what is more problematic, and transcendent of the result in this case, is that a ruling from this Court would create law for the receivership, at a very early stage in the process (the receivership is only some 6 months old and is expected to continue for years) that may be used by other reinsurers and creditors to open a channel to leapfrog the priority scheme simply by using federal jurisdiction. *See* Clark v. Fitzgibbons, 105 F.3d 1049, 1051 (5th Cir. 1997) (allowing proceedings to go forward in federal court would "undermine" the liquidation scheme by permitting creditors to "leapfrog ahead of all the other claimants" and "start a race to the courthouse in any other jurisdiction where claims against [the insurer] might have arisen.")

While the Superior Court has not ruled on EIW's triangular setoff issue yet, it has issued rulings protective of the stay and the order of priorities, demonstrating the key role these play in this liquidation. *See* Liquidation Orders at (n)(7) (staying

setoffs except mutual ones with reinsurers); Order of Superior Court, dated June 11, 2003 (denying motion of class action plaintiffs to modify stay to protect policyholders and avoid waste of insurer's assets); Order of Superior Court, dated Sept. 18, 2003 (denying request of insured for payment of a settlement to assure priorities and avoid preferences) (true copies of both Orders are appended as "D" and "E" respectively). The equities and the impact of a setoff such as sought by EIW will have to be balanced by the Court with the overall direction and imperatives of the liquidation as a whole considered. This is a role for which deference to the Superior Court and the interest of the state in having a coherent and uniform rule established is especially significant.[5]

B. The McCarren-Ferguson Act Evidences Federal Intent That Judicial Deference to State Insurance Insolvency Proceedings is Appropriate

The McCarren-Ferguson Act, 15 U.S.C. §1012, provides evidence of Congressional intent to remove federal influences on the business of regulation of insurance. The McCarren-Ferguson Act provides in pertinent part:

> No Act of Congress shall be construed to invalidate, impair or supercede any law enacted by any State for the purpose of regulating the business of insurance . . .

(15 U.S.C. § 1012(b))

[5] The impact will have a ripple effect in the industry as well. The liquidation of The Home is a billion dollar problem. Its largest policyholder creditors are state insurance guaranty funds. *See* RSA 402-C:44 (III). These funds pass their losses from liquidations on to insurers doing business in their respective locales, as assessments, who in turn pass these costs back to policyholders through premium rate increases. *E.g.* RSA 404-B:16.

Similarly, provisions of the federal Bankruptcy Code, title 11, of United States Code, §§ 109(b) & (d), 303(a), & 1112(f), express the requirement that federal courts not conduct bankruptcy proceedings for insurance companies. *See* Rewerts v. Reliance Ins. Co., 170 F. Supp. 2d 847, 849 (C.D. Ill. 2001).

Federal courts across the nation have concluded that because the insurance liquidation statutes are for the protection of policyholders, they are sufficiently concerned with the regulation of insurance such as to encourage, and in some instances *require*, the federal courts to defer jurisdiction to those proceedings. *See* Quackenbush, 517 U.S. at 733 (Kennedy, J., concurring) (citing McCarren-Ferguson Act as basis for abstention); United States v. Fabe, 508 U.S. 491, 502, 504-505 (1993) ("federal law must yield" to state insurance insolvency statutes "integrally related" to "the enforcement of insurance contracts by ensuring the payment of policyholders' claims despite the insurance company's intervening bankruptcy" under McCarren-Ferguson Act); Davistar Corp. v. United Republic Life Ins. Co., 152 F.3d 1277, 1282 (10th Cir. 1998), *cert. denied*, 119 S. Ct. 1112 (1999); Munich American Reinsurance Co. v. Crawford, 141 F.3d 585, 590-96 (5th Cir. 1998) (dismissed because McCarren-Ferguson requires that federal court not take jurisdiction over reinsurance contract dispute involving acts by reinsurer violating stay orders by state court liquidating insurance company), *cert. denied,* 119 S. Ct. 539 (1998); Hartford Cas. Ins. Co. v. Borg-Warner Corp., 913 F.2d at 420, 426-27; Corcoran v. Ardra Ins. Co., 842 F.2d 31, 32, 37 (2d Cir. 1988); Lac D'Amiante Du Quebec, Ltee. v. American Home Assurance Co., 864 F. 2d 1033, 1045-48 (3d Cir. 1988) (ordering *Burford* abstention in context of insurance company insolvency with reference to McCarren-Ferguson

Act); Gonzalez v. Media Elements, Inc., 946 F.2d at 157; Rewerts, 170 F. Supp. 2d at 849. Courts facing the issue hold that where the liquidation of an insurer is designed to protect the right of policyholders to receive some of the benefit of their insurance bargain, McCarren-Ferguson militates towards abstention by expressing a federal preference for state resolution of core issues. *See* Quackenbush, 517 U.S. at 733 (Kennedy, J., concurring).

Here, where the application of the Superior Court's injunctive order prohibiting non-mutual setoffs is the central issue to the dispute with EIW, and the question of setoffs goes directly to collection of the bankrupt insurer's assets and the maintenance of lawful priorities, these core issues are integral to the functionality of the insurance insolvency scheme and the protection of policyholders. A ruling from a federal court that allowed the triangular setoff would contradict the state court's stay, negate a term of the Liquidation Act and create a new preference for reinsurers in conflict with the interests of policyholders while at the same time denying policyholders access to key assets in the liquidation. *See* Davistar, 152 F.3d at 1282 (federal court should not issue orders that will conflict with insurance liquidation court's stay orders); *accord* Prudence Realization Corp. v. Geist, 316 U.S. at 96 (guarantor cannot compete with beneficiary and share liquidation proceeds); Balzotti v. RAD Investments, 273 B.R. 327, 331 (D.N.H. 2002) (resolution of proceeding that will affect recoveries on contracts are in core of bankruptcy court's jurisdiction an best kept to bankruptcy court). Obviously, this is just the kind of federal interference in the protection of policyholders that McCarren-Ferguson is designed to prevent.

McCarren-Ferguson's message is that federal courts should leave these issues to state court determination.

C. Abstention is Appropriate Where The Matter at Bar is Embryonic and Related to the Core of the Liquidation.

In this circuit, abstention considerations turn on the timing of the request with relation to the extent of the litigation, and upon the nature of the claim for which abstention is sought. In *Fragoso v. Lopez*, the First Circuit distinguished its earlier decision in *Media Elements* and denied *Burford* appellate abstention of a medical malpractice/wrongful death tort claim against an insured doctor and her insurer, an insolvent Puerto Rican insurance company. Fragoso, 991 F.2d at 880, 883-86.

As applied to the facts in the present matter *Burford* abstention should be applied based upon the reasoning of *Fragoso*. In *Fragoso* the First Circuit considered whether it should abstain from hearing an appeal of a federal court's summary judgment grant. The insolvency of the insurance company occurred only after the lower court had ruled and shortly after the appeal had been assigned for hearing. Fragoso, 991 F.2d at 880. Thus, the appealing defendants sought to interrupt the federal appellate process in mid-stride after significant work had gone into the matter by the federal courts. Id. at 884-85 (discussing importance of timing making Fragoso's "a very weak candidate for abstention"). The court decided to deny the request to abstain under *Burford* because of the timing of the request and because the underlying suit was a tort claim lacking any equitable component. Id. at 882, 883 (referring to "genre of litigation") & 884 ("[d]eciding appeals like Fragoso's, which will have at most an indirect effect on the liquidator's claims process by potentially

giving rise to an additional claim against the insolvent insurance company, will neither discombobulate local proceedings or frustrate the Commonwealth's regulatory system."). *Fragoso* is "idiocratic and fact-specific. . . . a singularly important difference." Id. at 885.[6]

Following the court's reasoning in *Fragoso*, it is clear that the differences matter a great deal. The Liquidator's case against EIW has just begun. "Ordinarily, the more embryonic a case, the more significant an interference with the state framework for handling insurance liquidation if the federal tribunal does not yield." Id. at 885; *see* Wolfson, 51 F.3d at 146-47 (stressing importance of relative progress of federal action because of doctrine of conserving judicial resources); *accord* Callon Petroleum, 351 F.3d at 209 (denying abstention because request was untimely). Not only is the dispute with EIW embryonic, but the liquidations themselves are still in their formative stage. The Liquidator has many years and many reinsurance contracts looming ahead of him. If it chooses not to abstain, this Court will be putting itself in the position of being a contributing author to the composition of the receiverships in their structure and basic rules of conduct. On the other hand, only relatively minor federal judicial resources have gone into this matter to date so the economy of resources will not be harmed by a remand to the state court for completion of this action.

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[6] The *Fragoso* court's discussion of whether *NOPSI* means that *Burford* abstention can only be utilized in deference to state administrative proceedings is clearly *obiter dicta*. If such had been the basis of its holding, the entire *Burford* analysis would have been completely unnecessary. *See* Quackenbush, 517 U.S. at *passim* (considering *Burford* abstention in state insurance insolvency judicial proceeding without questioning whether it could be permitted outside of administrative proceeding); Id. at 733 (Kennedy, J. concurring) ("The fact that a state court rather than an agency was chosen to implement California's scheme provided more reason, not less, for the federal court to stay its hand.")

Moreover, the Liquidator's case against EIW is not a simple tort claim resolution that would have little conceivable effect on the architecture of the liquidation proceedings, but instead is a complex equitable matter closely connected to the core functions of the liquidations: the marshalling of assets and the maintenance of the state law priority scheme. An interference with the exercise of the Superior Court's equitable powers by this Court could "discombobulate" the state liquidation processes and frustrate the Superior Court's stay orders. A ruling permitting EIW's triangular, non-mutual setoff will elevate EIW's priority and will cost policyholders money in lost insurer assets. As noted above, reinsurance recoverables are the life's blood of this receivership and the Superior Court and the Liquidator must be afforded the opportunity to conduct this core function of the liquidation process free of interference from other forums.

Thus, putting this case through the analytical process set forth in *Fragoso* should predictably lead to a different result than that reached in *Fragoso*. In *Fragoso* abstention was not appropriate because the claim was late and not related to the core of the insurance liquidation. By contrast, in this case, where the adjudication of the claim against EIW is in its early stages and is closely related to the liquidations' core, abstention and remand should be allowed to avoid significant interference with the state framework. Id. at 885. *See, e.g.*, Grimes, 857 F.2d at 705-706 (liquidator's determination with respect to reinsurance contracts has "major ramifications for the policyholders" turning on a "fundamental and important question of state law and policy" and a "matter of no little concern"); Corcoran v. Ardra Ins. Co., 842 F.2d at 36-37 (holding that remand was required due to importance of reinsurance collections

to state liquidation). Unlike *Fragoso*, this is a case where "federal decisionmaking demands 'significant familiarity with distinctively local regulatory facts or policies.'" Fragoso, 991 F.2d at 884 (quoting from *NOPSI*). The Court will be required to know in its decision making what the importance of the Superior Court's injunctive orders barring non-mutual setoffs is to the liquidation processes as envisioned by the Superior Court judge who entered them. Unlike *Fragoso,* this is a case where the state should be allowed "to develop . . . the uniformity to achieve important local interests." Id. The relief sought by the Liquidator in his declaratory judgment action against EIW asks the Superior Court to establish one of the basic rules for the liquidations with respect to a critical class of asset. Right now the Superior Court's injunctive orders say, in essence: no triangular setoffs by reinsurers. The liquidations will be hampered by the potential for there being a second set of rules for parties that can establish diversity. As a result, a decision not to abstain will destroy the object of uniformity for these liquidations. Together these principles suggest that uniformity in this instance is a paramount state interest and the Court should remand.

IV. CONCLUSION

The State of New Hampshire has in place a comprehensive, coherent and uniform scheme for the liquidation of these insurers. The liquidation procedures are conducted by the Superior Court and the Commissioner of Insurance working closely together to bring in assets, maintain priorities and thereby protect the interests of, first and foremost, policyholders. Reinsurance is the primary asset of The Home. The liquidations are in the early stages but already in place are injunctive orders prohibiting triangular non-mutual setoffs.

The Court should remand this action to declare the setoff rights between the Commissioner and EIW on the basis of *Burford* and *Colorado River* abstention principles because these questions require a critical exercise of the Court's equitable jurisdiction in matters where the state's interests in conducting the liquidation for the benefit of policyholders is paramount and the need for a uniform rule is manifest.

Respectfully submitted,

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