THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

2004 APR -2 P 3: 19

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

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

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

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

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

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

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

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- The benefits to the Home's policyholders from the Agreement are evidenced by the support of the Liquidator's motion by insurance guaranty funds that pay covered policyholder level claims. The Financial Services Authority (the UK insurance regulator) has also evidenced its "non-objection" and view that the arrangement contemplated by the Agreement "envisages a better outcome for creditors compared with the potential availability of assets if a scheme is not approved." Affidavit of Gareth Howard Hughes ("Hughes Aff.") Ex. GHH1 at 1.

- Three of the ACE Companies are net debtors of Home, and their arguments are intended to delay and reduce claims against their own – Century and CIRC. The interests of debtors are not within the area of concern of the insurer liquidation statutes, and they should be disregarded.

- The Liquidator gave appropriate notice of the motion. Due process does not require an expensive mass mailing to policyholders and cedents and publication notice for every motion that might potentially affect creditors.

Introduction

The ACE Companies present themselves as interested in preserving the statutory scheme for the liquidation of insolvent insurers. The true goal of their objection, however, is to delay and reap a windfall at the expense of Home's policyholders and other creditors. The happenstance of insolvency should not create a windfall for debtors.

As explained in the Liquidator's motion, without the Agreement, AFIA Cedents have little reason to file and prosecute significant claims in the liquidation. This would reduce the obligations of one of the ACE Companies, Century, and another member of the ACE Group, CIRC, by many millions of dollars to the detriment of Home's creditors. Absent the Home liquidation, Century and/or CIRC would have paid the claims of AFIA Cedents on behalf of Home. The Liquidator does no more than seek to hold Century and CIRC to their obligations to pay the same amounts to the estate. These amounts will not be collectible unless the AFIA Cedents file and prosecute claims. By facilitating the collection of Century's and CIRC's obligations and avoiding attempts by AFIA Cedents

to deal directly with ACE or "wall off" UK assets exclusively for UK creditors, the Agreement benefits Home's creditors by increasing the assets available for distribution.

The ACE Companies desperately want to avoid or delay this outcome. Their papers make clear that they intend to "pursue all available remedies" in England and object in this Court so that "complex, protracted and costly litigation is assured." ACE Mem. at 15. The Court should not permit the ACE Companies to advance their debtor interests here, as those interests are not within the policyholder protective purpose of the liquidation. Moreover, the Agreement causes them no injury. It does not change the ACE Companies' position from what it was pre-liquidation. Century and CIRC will only be obligated to pay on valid AFIA Cedents' claims, just as they were before.

The two creditor objectors, BMC and Pacific Employers Insurance Company ("PEIC"), appear to misunderstand the effect of the Agreement. The Agreement does not disadvantage them but places them in a better position by increasing the assets of the Home estate. The Agreement makes it more likely that the AFIA Cedents will submit and prosecute all of their claims. If those claims are not made and pursued, then neither Century nor CIRC will pay indemnity with respect to them to the Liquidator. If the claims are pursued and allowed, Century and/or CIRC will be obligated to indemnify the Liquidator against them. The indemnity collected (after deduction of costs such as the payments to the AFIA Cedents) will benefit the estate and increase the distributions to be made to creditors, first to policyholders like BMC and, depending on the ultimate assets, then to lower priority creditors like PEIC. The Agreement only helps BMC and PEIC.

The Agreement does not conflict with the statutory priorities. Contrary to BMC's assumption, the Agreement was not entered as a compromise of the AFIA Cedents'

claims against the estate but as a necessary and expedient step to collect an asset of the estate – the INA Agreement and/or the BAFCO Reinsurances – that otherwise would have reduced value because of the liquidation. Such steps are clearly authorized by RSA 402-C:25, 29, the Liquidation Order and longstanding equitable principles. The Agreement does not distribute existing assets of the estate in violation of the priority statute but rather serves to increase the value of estate assets capable of distribution. The costs of collecting assets, such as the payment of a portion of the proceeds to the AFIA Cedents, are properly paid as administrative expenses within RSA 402-C:44, I ("actual and necessary costs of preserving or recovering the assets of the insurer").

The Agreement should be approved even if payment of a portion of the proceeds of the INA Agreement and/or BAFCO Reinsurance resulting from the AFIA Cedents' claims were viewed as a distribution to class V creditors. The fundamental standard of review is whether the Agreement is in the best interests of the estate and the policyholders and other creditors. Where the Agreement enables the Liquidator to realize value for the estate that otherwise would not be obtained, it clearly benefits the estate and its creditors as a whole. In these circumstances, it should be approved.

The objectors' caselaw is not to the contrary. Most of the cases cited do not involve review of compromises but unilateral creditors' efforts to circumvent the priorities by equitable remedies producing no benefit to the estate. Of the few cases concerning settlements, none consider agreements that add value to an estate, but some recognize that such agreements could be approved if, like this one, they did add value.

A. THREE OF THE ACE COMPANIES ARE NET DEBTORS WHOSE INTERESTS ARE ADVERSE TO THE ESTATE.

In their objection, the ACE Companies assert that they are creditors of Home. What they do not tell the Court, however, is that the claims of the Liquidator against Century, ACE Property and Casualty Insurance Company and ACE American Reinsurance Company vastly exceed (by over $260 million) the claims of those companies against Home. See Affidavit of Jonathan Rosen ("Rosen Aff.") ¶ 3. Only PEIC has net claims against Home, and those claims total approximately $25,000. The largest obligation of the ACE Companies to Home is the INA Agreement.[2] Under that agreement, Century's predecessor, INA, agreed to indemnify Home and pay and handle the claims of AFIA Cedents on Home's behalf. In the event of Home's insolvency, however, INA agreed to pay amounts on those claims to Home's liquidator "without diminution" because of the insolvency. Rosen Aff. ¶ 5; INA Agreement ¶ 6, second unnumbered paragraph (Affidavit of Michael Durkin, Ex. A). The latest amount reported to the UK regulatory authorities by ACE INA Services U.K. Limited, a member of the ACE group of companies, as ultimate claims under the AFIA Treaties is $231 million. Rosen Aff. ¶¶ 4, 6; Hughes Aff. ¶ 8. Century thus stands to benefit if the AFIA Cedents do not submit and prove up claims because that will reduce Home's indemnity entitlements. Rosen Aff. ¶ 5. It is accordingly in Century's self-interest to block the Liquidator from being able to effectively pursue the INA Agreement.

[2] Another member of the ACE Group, CIRC, has obligations to Home under reinsurance agreements of its predecessor BAFCO Reinsurance Company, Ltd. (the "BAFCO Reinsurances"). Hughes Aff. ¶ 7; Rosen Aff. ¶ 9. Home estimates that, based on ACE Group's filing for Home concerning the AFIA business ultimate liabilities, Home's reinsurance claim against CIRC under the BAFCO Reinsurances would, after set-off, amount to approximately $211 million. Hughes Aff. ¶ 8. (The BAFCO Reinsurances and the indemnity provided by the INA Agreement appear to overlap to a significant extent. Id. ¶ 9.)

As net debtors, the arguments of ACE Companies other than PEIC against the Liquidator's motion should be given little credence. See Malnati v. State, 148 N.H. 94, 98 (2002); Roberts v. General Motors Corp., 138 N.H. 532, 535 (1994); Silver Brothers, Inc. v. Wallin, 122 N.H. 1138, 1140 (1982). Debtors' interests do not fall within the statutory area of concern. The Legislature has specified that the purpose of the Insurers Rehabilitation and Liquidation Act ("Act"), RSA 402-C, is "the protection of the interests of insureds, creditors, and the public generally." RSA 402-C:1, IV. Debtors' interests are not included. Indeed, that section refers to debtors only in facilitating collection of their obligations by extending "the scope of personal jurisdiction over debtors of the insurer outside this state." RSA 402-C:1, IV(f).

The ACE Companies are attempting to preclude claims against one of their own. New Hampshire, however, has approved the "settled" rule that "a debtor to the estate of a deceased person [cannot] interpose an appeal from a decree granting administration upon the estate, and thus indirectly postpone or defeat the assertion of a claim against himself." Worthen v. New York C. & H. R.R., 77 N.H. 520, 522 (1915). The ACE Companies' interests as debtors are adverse to the estate, and their purpose in advancing their objection is not to further administration of the estate but to reduce or prevent claims against themselves. Indeed, the debtor ACE Companies suffer no injury as creditors because, as net debtors, any legitimate claims they may have are likely to be effectively "paid" in full through setoff. See RSA 402-C:34 ("Mutual debts or mutual credits between the insurer and another person . . . shall be set off and the balance only shall be allowed or paid" subject to three exceptions) The debtors' objections should be dismissed.

B. THE AGREEMENT IS CONSISTENT WITH LAW AND SHOULD BE APPROVED AS IN THE BEST INTERESTS OF THE LIQUIDATION AND HOME'S POLICYHOLDERS AND OTHER CREDITORS.

The objectors' contentions fail to acknowledge the statutes under which the Liquidator acts or the applicable standard of review, and disregard the fundamental purpose of the Act: the protection of policyholders. The Agreement properly serves that purpose, accords with a harmonious reading of the Act, and is consistent with equitable principles. It should be approved.

1. The Applicable Standard Is The Best Interests Of The Liquidation And The Policyholders And Other Creditors As A Whole.

The objectors advocate piecemeal review of the Agreement and focus on the payments to AFIA Cedents that will result. In determining whether to approve the Agreement, however, the Court should consider whether it is in the best interests of the liquidation and the policyholders and other creditors as a whole. In equity receiverships, "[t]he only justification for the compromise of claims is that it is done for the best interests of the receivership and the estate under the control and possession of the court." Clark on Receivers § 655 at 1148 (3d ed. 1992). In light of the purpose of the Act to protect the interests of policyholders, creditors and the public generally, RSA 402-C:1, IV, the fundamental standard here should be whether the Agreement is in the best interests of the estate and the policyholders and other creditors. This subsumes other matters. See In re Executive Life Ins. Co., 32 Cal. App. 4th 344, 370-380, 38 Cal. Rptr. 2d 453 (2d Dist. 1995). In evaluating the matter, the Court should consider that the Liquidator is the Commissioner, the disinterested public official charged with administering the insurance laws. See RSA 402-C:21, I.

2. The Agreement Is In The Best Interests Of The Estate And The Policyholders and Other Creditors.

The Agreement benefits the liquidation and the Home's policyholders and other creditors by increasing assets available for distribution and resolving disputed positions without the need for protracted and expensive litigation. It is noteworthy that the NCIGF Subcommittee (representing guaranty funds holding the principal policyholder level claims) has authorized the Liquidator to state that it has reviewed the objectors' submissions and continues to have no objection to the Liquidator's motion. Further, in a letter dated March 26, 2004, the Financial Services Authority, the UK insurance regulator, expressed its "non-objection" and offered the view that the Agreement "envisages a better outcome for creditors compared with the potential availability of assets if a scheme is not approved." Hughes Aff. Ex. GHH1 at 1.

The Agreement addresses three problems referenced in the Special Deputy Liquidator's Affidavit, Bengelsdorf Aff. ¶ 8, and further described below:

1. Several AFIA Cedents had made it clear that they would be most unlikely to file and prosecute claims (except possibly to the extent necessary to preserve any right of set-off they might have) because they would not want to incur the time and expense of prosecuting claims where they would not receive payment.

2. Certain AFIA Cedents had made it clear that they were considering methods of "cutting through" or negotiating a direct agreement with ACE group and bypassing the Home estate.

3. AFIA Cedents had indicated that they would investigate whether UK assets could be earmarked for the exclusive benefit of UK creditors.

These issues warrant the Agreement to facilitate collection of recoveries under the INA Agreement and BAFCO Reinsurances, avoid side agreements and consequent litigation,

and preempt attempts to prevent transfer of assets to the New Hampshire estate.[3] The ACE Companies might prefer that the Liquidator (1) let the June 13, 2004 claim filing deadline pass so that their obligations might be minimized, (2) wait for side agreements between the AFIA Cedents and Century and/or CIRC to be reached so that litigation over them could rage, and (3) simply hope that no AFIA Cedent would seek to "wall off" UK assets. The Liquidator is charged, however, with collecting assets and administering the liquidation so as to achieve "[e]nhanced efficiency and economy of liquidation," "minimize[d] legal uncertainty and litigation," and "cooperation between states in the liquidation process." RSA 402-C:1, IV(c), (e). See RSA 402-C:29, II (Liquidator shall reduce assets to liquidity "as rapidly and economically as he can.") In the circumstances, the Liquidator would be remiss to wait for the filing deadline to pass and positions to crystallize through litigation because he is obligated to resolve problems as they arise to foster an orderly, fast and economically successful liquidation.

a. The Agreement preserves the value of significant assets.

The central problem addressed by the Agreement is that the value of the INA Agreement and/or BAFCO Reinsurances depends on the AFIA Cedents' claims that are proved and allowed in the liquidation. As class V claimants, the AFIA Cedents have a disincentive to file and prosecute claims in the liquidation because they are unlikely to benefit except by offset to the limited extent that the Liquidator has claims against them. The objectors make the unsupported assertion that such cedents "typically" file claims, ACE Mem. at 16, but filing is insufficient. A claimant must also <u>prove</u> its claims,

[3] The objectors attempt to create factual disputes to create doubt and justify broad and time-consuming discovery to derail the Agreement because, of course, that serves their self-interest. The existence of the non-filing problem and related disputes, however, is amply demonstrated. The Liquidator has accordingly objected to the objectors' requests for an evidentiary hearing and discovery.

including proceeding through the claim determination process under RSA 402-C:41 and the Claims Procedures Order.

The AFIA Cedents are not obligated to undertake these tasks, and their unwillingness to do so had been expressed. Several of the AFIA Cedents had made it clear that they would be most unlikely to file and prosecute claims (save possibly to the extent necessary to preserve any right of set-off they might have) because they would not wish to incur the time and expense of prosecuting claims where they would not receive payment. Hughes Aff. ¶ 13; Rosen Aff. ¶ 6. These cedents included Equitas Limited ("Equitas"), Agrippina Versicherung AG ("Agrippina"), Unionamerica Insurance Company ("Unionamerica"), Excess Insurance Company Ltd. ("Excess") and Continental Insurance Company New York ("Continental"). Hughes Aff. ¶ 13. See Rosen Aff. ¶ 6. Indeed, two of them, Agrippina (now Zurich) and Equitas, have confirmed this point by affidavit. See Affidavit of Gernot Warmuth ("Warmuth Aff.") ¶¶ 8, 10 ("I am mystified as to why the ACE Companies believe that an AFIA Cedent like Zurich would wish to incur the time and expense of pursuing a proof of claim in the absence of the proposed scheme."); Affidavit of Rhydian Williams (Williams Aff.") ¶¶ 7-10. This issue needed to be addressed before the June 13, 2004 claim filing deadline. The Liquidator properly dealt with it in the Agreement.

The ACE Companies assert that AFIA Cedents who are also debtors of Home would have an incentive to file claims to preserve offset rights. ACE Mem. 16-17. However, the AFIA Cedents would only have an incentive to pursue claims up to the value of Home's claims against them. This is a relatively small percentage (estimated at 25%) of the value of the AFIA Cedents' total claims. Rosen Aff. ¶ 6. Further, the AFIA

Cedents' do not in any event share in the proceeds arising from those claims. Under the Agreement, to the extent that AFIA Cedents' claims are offset by Home's claims against the cedents, the corresponding recoveries from Century will be paid entirely to Home. Those amounts are excluded from the "Proceeds" and thus from the "Net Recoveries" that are partly allocated to AFIA Cedents. Agreement ¶ 1.3.4.

b. The Agreement avoids efforts to circumvent the liquidation.

The Agreement also addresses the potential for the ACE Companies and AFIA Cedents to enter individual side agreements to circumvent the liquidation. Agreement ¶ 1.5.1. Under such an agreement, the ACE Companies would agree to make a payment directly to the AFIA Cedent, and the AFIA Cedent would agree not to file claims with the Liquidator, thus preventing the Liquidator from seeking to recover on the claims from the indemnitees. See Warmuth Aff. ¶ 9; Williams Aff. ¶ 12(b). Certain AFIA Cedents – specifically Equitas, Agrippina and Excess – had made it clear that they were considering methods of "cutting through" or negotiating a direct agreement with ACE Group and bypassing the Home estate. Hughes Aff. ¶ 14; Rosen Aff. ¶ 7; Warmuth Aff. ¶ 10; Williams Aff. ¶ 12. Indeed, the Liquidator and Joint Provisional Liquidators felt compelled to advise Century that such agreements would in their view be unlawful in a letter dated September 26, 2003. See Rosen Aff. ¶ 8, Ex. A.

The ACE Companies respond not by denying that they would do such a thing (indeed, they implicitly suggest they have the right to), but by saying the Liquidator should wait to see if it happens. ACE Mem. at 17 & n.13. This is disingenuous, as the parties to such an agreement would want to keep it from the Liquidator. Further, if ACE and various AFIA Cedents entered side agreements, the Liquidator would need to bring

actions (or – in ACE's view- arbitrations, see ACE Mem. 17 n.13) to set them aside. Such proceedings could be expected to involve complex factual and legal issues that would involve considerable time and cost. See Affirmation of Robin Knowles QC ("Knowles Aff.") ¶ 13. Side agreements thus presented a serious and imminent threat to the Liquidator's ability to collect under the INA Agreement that was "rapidly and economically" addressed by the Agreement. See RSA 402-C:29, II.

c. The Agreement addresses disputes over turnover of UK assets.

Finally, the Informal Creditors' Committee members indicated that they wanted to investigate whether UK assets could be earmarked for the exclusive benefit of UK creditors. Hughes Aff. ¶ 15; Rosen Aff. ¶ 9; Warmuth Aff. ¶ 9; Williams Aff. ¶ 12(a). As the ACE Companies note, the Liquidator and Joint Provisional Liquidators agree that UK assets should not be "walled off." The issue, however, would still be costly and time-consuming and require a full hearing (and potentially appeal) to resolve if it were litigated. Knowles Aff. ¶¶ 10-12. Further, contrary to the assertions of the ACE Companies, the issue matters because there are significant assets in the United Kingdom that could be the subject of such an argument – the BAFCO Reinsurances. Hughes Aff. ¶ 7; Rosen Aff. ¶ 9. Those contracts have an estimated value, after set-off, of $211 million. Hughes Aff. ¶ 8. There is a substantial UK nexus between Home and CIRC, the ACE Group obligated party under the BAFCO Reinsurances. The BAFCO Reinsurances contracts are subject to English law, and they have historically been used to pay the AFIA Cedents on Home's behalf. Hughes Aff. ¶¶ 9-10.[4]

[4] The ACE group has previously asserted that the BAFCO Reinsurances were allegedly assigned to INA in 1984. The Liquidator and Joint Provisional Liquidators do not accept this analysis; Home was expressly party to an amendment entered in 1985, and one of ACE Group's predecessors advised the UK regulator later in 1985 that the BAFCO Reinsurances protected Home. See Hughes Aff. ¶ 11 and GHH1 pages 5-7.

C. THE AGREEMENT DOES NOT VIOLATE THE INSURER LIQUIDATION STATUTES.

The New Hampshire insurer liquidation statutes do not compel disapproval of an agreement that obtains assets for distribution to priority creditors merely because a cost of obtaining the assets is a sharing of the collections with certain lower priority creditors.

1. The Agreement Is Authorized By The Insurer Liquidation Statutes As An Appropriate Action To Assist In The Collection And Preservation Of Assets For The Home Estate.

The Liquidator has clear statutory power to take necessary and expedient steps to collect debts and maximize the estate. The Act expressly authorizes the Liquidator, subject to the Court's control, to "[c]ollect all debts and monies due and claims belonging to the insurer" and to "do such other acts as are necessary or expedient to collect, conserve or protect its assets or property, including sell, compound, compromise or assign for purposes of collection, upon such terms and conditions as he deems best, any bad or doubtful debts." RSA 402-C:25, VI. The Liquidator is also authorized to do other acts "as are necessary or expedient for the accomplishment of or in aid of the purpose of liquidation." RSA 402-C:25, XXII. The Liquidation Order confirms these powers. See Liquidation Order ¶ (aa). The fundamental purpose of the liquidation is to protect policyholders. See RSA 402-C:1, IV (purpose of RSA 402-C is "the protection of the interests of insureds, creditors, and the public generally"). To that end, the Liquidator is to reduce assets to a degree of liquidity "that is consistent with the effective execution of the liquidation as rapidly and economically as he can." RSA 402-C:29, II.

The Agreement falls well within these statutory powers. It is an effort to untangle a web of problems arising in connection with efforts to collect the indemnity under the INA Agreement and/or the BAFCO Reinsurances. These contracts (which Home and

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

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

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

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

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

by the objectors are not to the contrary. See ACE Mem. 11-12; BMC Mem. 4-5. In Commercial Nat'l Bank v. Superior Court, 14 Cal. App. 4th 393, 17 Cal. Rptr. 2d 884 (2d Dist. 1993), the court observed that a different treatment may be justified "to preserve the rights of all policyholders." Id. at 412. While the court there disapproved a rehabilitation plan because it treated policyholders within the same class differently, it expressly noted that no one claimed "that the system is necessary to a successful rehabilitation plan." Id. at 410. The California court has since held that a receiver has discretion to settle disputes concerning priority, and that such a settlement was warranted where it avoided "considerable expense" and rendered litigation "more manageable." In re Executive Life Ins. Co., 32 Cal. App. 4th at 374-376, 379.[7] The other state cases cited by the objectors do not concern approvals of compromises but unilateral attempts by creditors (opposed by liquidators) to circumvent priorities through equitable remedies. These cases did not involve any benefit to the estate as a whole and do not address the situation at hand.[8]

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[7] In Executive Life, the court noted that this was an issue of first impression under the state insurance law, and that bankruptcy precedent was "conflicting, to say the least." 32 Cal. App. 4th at 375. The bankruptcy cases cited by BMC that touch on priority recognize that there is no absolute rule, In re American Reserve Corp., 841 F.2d 159, 162 (7th Cir. 1987) ("Properly viewed then, the 'fair and equitable' analysis – that is, comparing claims' relative priorities – is just one factor for the bankruptcy judge to consider in determining whether a settlement is in the estate's best interest."), or that the issue is benefit to the estate, see Matter of AWECO, Inc., 725 F.2d 293, 299 (5th Cir.)(expressing concern that a settlement with a junior creditor "depletes the estate" to the detriment of senior creditors), cert. denied, 469 U.S. 880 (1984); In re C.P. del Caribe, Inc., 140 B.R. 320, 326 (Bankr. D.P.R. 1992)(proponents were unable to show why one claimant's claim should be paid before those of others of equal rank).

[8] See In re Liquidation of Security Cas. Co., 127 Ill. 2d 434, 537 N.E.2d 775 (1989) (comprehensive priority scheme precludes constructive trust); In re Liquidation of Coronet Ins. Co., 298 Ill. App. 3d 411, 698 N.E.2d 598 (1st Dist. 1998) (retaining lien); Northwestern Nat'l Ins. Co. v. Kezer, 812 P.2d 688 (Colo. App. 1990) (equitable lien); State v. Interstate Cas. Ins. Co., 120 N.C. App. 743, 464 S.E.2d 73 (1995)(common fund doctrine). The rationale for these cases is that the proposed remedies would harm preferred creditors by preventing the distribution of assets to them. See Security Cas., 127 Ill. 2d at 447 ("Such a recovery by shareholders diminishes the pool of assets available for distribution to other claimants."). The cases did not involve efforts to increase the assets of the estate for the benefit of preferred creditors. In re Conservation of Alpine Ins. Co., 318 Ill. App. 3d 457, 741 N.E.2d 663 (1st Dist. 2000), rejected a rehabilitation plan that merely shifted the burden of the insolvency to policyholders who held policies with other insurers.

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

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

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

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

company liquidation sits in equity and exercises considerable equitable power to further the statutory scheme set forth in RSA 402-C. See RSA 402-C:5, I, (c), (k); RSA 402-C:25. Equitable doctrines grounded in the obligation of the receiver to maximize the estate for the benefit of creditors supplement the Act. See RSA 402-C:25, XXI, XXII. The ACE Companies and BMC cite the absolute priority rule, which says, in effect, that a junior class of claimants can receive nothing on account of their claims in that class until claimants in a senior class have been paid in full. Significantly, the absolute priority rule is designed to guard against a problem not even faced in this case. It was designed to prevent the collusion of senior bondholders and shareholders to retain management and squeeze out creditors. See, e.g., Bank of America Nat'l Trust & Sav. Assoc. v. 203 North LaSalle Street Partnership, 526 U.S. 434, 444-45 (1999) (rule designed to guard against arrangements that may "turn out to be too good a deal for the debtor's owners"); Northern Pac. Ry. Co. v. Boyd, 228 U.S. 482, 502 (1913); Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co., 174 U.S. 674, 683-84 (1899). There is no effort to squeeze out anybody here; quite the contrary. The Liquidator is using his powers to improve the lot of the primary creditors, the thousands of disappointed policyholders, by bringing in a valuable asset that might otherwise be lost. That the ACE Companies might find it objectionable, should be of no moment because they are class V claimants that in all likelihood will get nothing either way. Their objection is the pretext; not the Agreement.

The first of the two doctrines allows a receiver to make payments out of the ordinary course to parties that he thinks are necessary to accomplish the goals of the

receivership—maximization of assets and protection of policyholders. The other enables creditors to receive value to the extent that they bring in something of value.

a. The Agreement is appropriate and permissible under the Necessity of Payment Doctrine.

Equity courts in insolvency cases have long recognized that sometimes it is necessary for the receiver to spend some of the senior creditors' money in order to make the receivership work for the benefit of all the creditors and the public interest. See Miltenberger v. Logansport C. & S.W.R.Co., 106 U.S. 286, 311-312 (1882) ("Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay [debts out of order of priority] out of the earnings of the receivership or even out of the corpus of the property."); Fosdick v. Schall, 99 U.S. 235, 252-53 (1878); Dudley v. Mealey, 147 F.2d 268, 271 (2nd Cir. 1945) (Hand, J.).[9] The necessity of payment doctrine has been used in large Chapter 11 proceedings (e.g., Owens Corning, Polaroid, Service Merchandise and Enron) to make payments to critical vendors to the debtor. These vendors often are foreign creditors who feel less than compelled by the orders of the insolvency forum and exert tremendous economic leverage over the estate. Such payments are based on the principle that equity receivers have the discretion to seek from the court the authority to pay creditors outside normal priorities when it is "necessary and indispensable" to the receivership and for the ultimate benefit of all creditors. See Union Trust Co. of N.Y. v. Illinois Midland Ry. Co., 117 U.S. 434, 455-58 (1886). This is exactly what the

[9] See also In re Chateaugay Corp., 80 B.R. 279 (S.D.N.Y. 1987) (necessity doctrine can be used to pay self insured claims when cost of insurance would be undue burden on the estate), app. dismissed, 838 F.2d 59 (2d Cir. 1988); but see In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004) (in light of enactment of 1978 Bankruptcy Code, necessity doctrine may be justifiable as use of property out of ordinary course only if in fact no other alternatives exist to solve critical supply problem).

Liquidator is seeking here: the approval of his exercise of discretion to endorse the Agreement because it serves to efficiently and effectively bring in the value of recoverables from Century and/or CIRC. See RSA 402-C:25, IV, VI, IX, XI, XXI, XXII (powers of liquidator to incur expenses, deal in property, enter into agreements, and do what is necessary to conduct liquidations); RSA 402-C:29, II (mandate to liquidate rapidly and economically).

b. The Payments to AFIA Cedents are also appropriate under the New Value Corollary to the Absolute Priority Rule.

Included in the absolute priority rule referred to by the objectors is the notion that a creditor bringing needed new value to the receivership will be entitled to a superior participation in the estate in recognition of this contribution. See Mason v. Paradise Irrigation Dist., 326 U.S. 536, 543 (1946) ("he who furnishes new capital to a distressed enterprise has long been accorded preferred treatment"); Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 121-22 (1939); Kansas City Term. Ry. Co. v. Central Union Trust Co. of N.Y., 271 U.S. 445, 455 (1926) ("Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless [lower priority claim holders] are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights."). These principles are alive and well in New Hampshire. See In re Beauchesne, 209 B.R. 266, 270 (Bankr. D.N.H. 1997)(applying New Value Corollary); In re Waterville Valley Town Square Assoc., 208 B.R. 90, 98-99 (Bankr. D.N.H. 1997)(same); RSA 402-C: 25 IV, VI, IX, XI, XXI, and XXII (broad powers of liquidators to incur expenses, manage property

and exercise discretion with court approval to liquidate assets); accord RSA 402-C:44, I (first level priority for costs of "preserving or recovering the assets of the insurer").

c. Payments to the AFIA Cedents do not disturb priorities.

Payments to AFIA Cedents resulting in benefit of the policyholders of Home will not create impermissible priority confusion. This is because the payments are not an entitlement of those creditors but instead are an exercise of the Liquidator's discretion and as such do not, as a matter of law, offend priority principles. See, e.g., Gregg v. Metropolitan Trust Co., 197 U.S. 183 (1905) (rejecting a creditors claim of entitlement to discretionary necessity payments of receiver); In re Boston & Maine Corp., 634 F. 2d 1359, 1382 (1st Cir. 1980) (necessity of payment is not a rule conferring a right of recovery on a claimant but instead is a rule of exculpation protecting the receiver who paid a necessary claim under economic duress); B&W Enterps., Inc. v. Goodman Oil Co. (In re B&W Enterps., Inc.), 713 F.2d 534, 537 (9th Cir. 1983); Carbon Fuel Co. v. Chicago, C.& L.R. Co., 202 F. 172, 175 (7th Cir. 1912). Consequently, the objectors' complaint that the Agreement creates a new priority is wrong as a matter of law. There is no new priority or subclass, only a discretionary payment by the Liquidator to further the interests of the estate in the same way that he pays other costs of the liquidation. The power to do that is express in the New Hampshire scheme.

D. THE LIQUIDATOR GAVE PROPER NOTICE OF THE MOTION, AND THE OBJECTORS' DUE PROCESS ARGUMENTS HAVE NO MERIT.

The Liquidator – a public official charged with liquidating Home to protect the interests of policyholders and other creditors – gave appropriate notice of the motion by service on those who have appeared in the liquidation proceeding (which has itself been

the subject of broad mailing and publication notice) and posting the motion on the New Hampshire Insurance Department website.

1. Since they had actual notice, the objectors suffered no injury from and cannot challenge the notice given as to themselves. See Malnati v. State, 148 N.H. 94, 98 (2002). The ACE Companies were provided with copies of the Liquidator's motion directly, and BMC obviously learned of the motion (although it does not say how), and they were afforded ample time to respond.

The objectors also cannot attack the sufficiency of notice to other persons. The general rule is that a person "has standing to raise a constitutional issue only when his own personal rights have been or will be directly and specifically affected." Petition of Burling, 139 N.H. 266, 272 (1994). The objectors' attempt to raise the alleged rights of others should be rejected. See id.; Nottingham v. Bonser, 146 N.H. 418, 424 (2001).

2. There is no merit to the objectors' broad claims. They assert that "[e]ach creditor of Home is potentially affected by the Motion and has a right to be heard with respect to it." ACE Mem. at 21 (emphasis added). However, it is not the law that speculative effects require repeated notice to all creditors of Home. There is no statutory requirement for notice to creditors of motions during the liquidation, and the Liquidator gave appropriate notice by (1) serving the motion on counsel for all persons who have intervened in this proceeding, and (2) posting the motion and supporting papers on the New Hampshire Department of Insurance website in accordance with the Order

Establishing Procedures for Review of Certain Agreements to Assume Obligations or Dispose of Assets ¶ 4 (December 19, 2003).[10] Due process required no more.

First, procedural due process only becomes an issue where proposed state action will adversely affect a person's legally protected property interests. See Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478, 488 (1988); Dime Savings Bank of New York, FSB v. Pembroke, 142 N.H. 235, 238 (1997). As set forth at pages2-5 above, the Agreement does not deprive the creditors of Home of anything; it benefits them by bringing additional assets into the estate. There is thus no basis for a due process requirement that potential creditors of Home be notified of the motion.[11]

Second, due process only requires that notice be reasonable under the particular circumstances. Tulsa, 485 U.S. at 484, citing Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950); Berube v. Belhumeur, 139 N.H. 562, 567 (1995) ("The decisive question is whether the notice was fair and reasonable in the circumstances."). This includes consideration of "the fiscal and administrative burdens that additional or substitute procedural requirements would entail." Riblet Tramway Co., Inc. v. Stickney, 129 N.H. 140, 149 (1987). The objectors seek to require mail notice to "Home's policyholders and other creditors (*e.g.*, reinsureds)" of the motion on the ground that they are "potentially affected." ACE Mem. at 21, 22. This is unreasonable.

[10] As a matter of practice, the Liquidator also provided copies of the motion to the NCIGF Subcommittee concerning the Home liquidation, the ACE Companies, and—through the Joint Provisional Liquidators—the members of the UK Informal Creditors' Committee.

[11] None of the cases cited by the objectors concern notice of motions filed in a liquidation. The only decision that addressed due process rights of creditors of an estate is Tulsa, 485 U.S. 478. That case concerned notice of a filing deadline whose adverse impact on a protected property interest was "all too clear" – the effect of the nonclaim statute was "to forever bar untimely claims" such that the appellants' claim had been "completely extinguished." Id. at 488. The motion here has no such impact.

The costs of the objectors' proposed notice would likely exceed $250,000 for each motion. The Liquidator provided notice to potential creditors of the liquidation order and claim filing deadline under RSA 402-C:26 and the Order Approving Notice (June 11, 2003). That notice involved the mailing of over 330,000 notices/proof of claim forms to potential claimants, including policyholders and reinsureds that reasonably could be identified, and publication of notice in 94 newspapers and a trade publication to cover the states and countries where Home did business. Liquidator's First Report ¶¶ 5, 9, It entailed external costs of approximately $276,000. Affidavit of Michael Averill ("Averill Aff.") ¶¶ 3, 4, Ex. A-C. Under the objectors' view of due process, the same type of mailing and publication would be required for the motion (the publication notice to give notice to potential creditors not reached by mail.)

This is not required. The pendency of the liquidation and the availability of information on the website has been broadcast widely, see Liquidator's First Report ¶ 10, Ex. C (instructions for proof of claim); Order Approving Notice Ex. 3 (publication notice), and interested persons have had an opportunity to seek to intervene in the proceeding. In these circumstances, it is reasonable to provide notice of motions by serving them on persons that have intervened and placing them on the website. Cf. Appeal of Catholic Medical Center, 128 N.H. 410, 416 (1986) (due process not violated where plaintiffs could have taken advantage of procedure for requesting notice of decisions). Especially where a disinterested public official administers the liquidation proceeding to further the interests of policyholders and other creditors, the notice provided was reasonable and sufficient.

CONCLUSION

For these reasons and those set forth in the motion, the Court should grant the Liquidator's motion and enter the proposed order approving the Agreement.

Respectfully submitted,

ROGER A. SEVIGNY, INSURANCE COMMISSIONER OF THE STATE OF NEW HAMPSHIRE, SOLELY IN HIS CAPACITY AS LIQUIDATOR OF THE HOME INSURANCE COMPANY,

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April 2, 2004

STATE OF NEW HAMPSHIRE

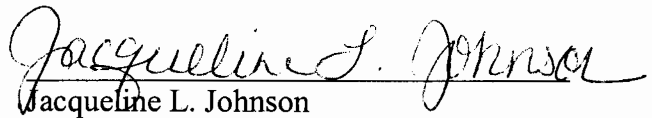
MERRIMACK, SS. SUPERIOR COURT

In the Matter of the Liquidation of
The Home Insurance Company
Docket No. 03-E-0106

CERTIFICATE OF SERVICE

I, Jacqueline L. Johnson , do hereby certify that on April 2, 2004, I served a true copy of the foregoing upon the attached Service List, by first class mail, postage prepaid.

Dated: April 2, 2004



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