THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

LIQUIDATOR'S SUPPLEMENTAL 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 supplemental reply to the objections of the ACE Companies and Benjamin Moore & Co. ("BMC" together with the ACE Companies the "Objectors").[1] The Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents (the "Motion") should be granted because the Agreement is lawful and the Liquidator has shown that the Agreement is reasonable and in the best interests of the Home's policyholders. The Court should accordingly exercise its supervisory authority under RSA 402-C:25 to approve the Agreement. The objections should be overruled because the legal arguments brought to the Court's attention concerning authority and priority are wrong and the factual issues advanced are inconsequential to determining the reasonableness of the Liquidator's decision to endorse the Agreement.

In response to the Court's request at the April 9, 2004 status conference concerning the amounts involved in the operation of the Agreement, the Liquidator

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

has prepared a chart illustrating the anticipated operation of the Agreement based upon AFIA losses reported by ACE/INA to the United Kingdom regulatory authorities as of December 31, 2002. *See* Affidavit of Jonathan Rosen ¶ 4. That chart is attached as Exhibit "A".

I. THE AGREEMENT IS LAWFUL

A. The Liquidator Has Authority To Enter The Agreement Under RSA 402-C:25.

The Liquidator's task in this matter is to collect assets and administer the liquidation so as to achieve "enhanced efficiency and economy of liquidation," and to "minimize legal uncertainty and litigation." 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 doing so the Liquidator is exercising the Court's equitable power to preserve the property of Home. The Court's power in this regard, includes the power to compromise "rather than take a chance and suffer the hazard of a prolonged proceeding demanding the full amount." 2 Ralph Ewing Clark, A TREATISE ON THE LAW AND PRACTICE OF RECEIVERS, § 366 (3d ed. 1959) ("Clark on Receivers").

As set forth in the Liquidator's reply (at 13-21), the Liquidator has clear statutory (and common law) 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 "collect 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 Liquidator shall have full powers and authority given the Liquidator under RSA 402-C . . . , and under provisions of all other applicable laws, as are reasonable and necessary to fulfill the duties and responsibilities of the Liquidator under RSA 402-C . . ., and under the Order, specifically including, but not limited to, each and every power and authority bestowed upon the Liquidator under RSA 402-C:25 I-XXII . . ..."). These powers have long been recognized in the law of receiverships. *See* Clark on Receivers, § 355 (enumerating several independent sources of receiver's powers.)

Clearly, the Liquidator has very broad power —with this Court's approval— to do what is necessary to collect, conserve, and protect Home's assets for the benefit of its policyholders.

B. The Absolute Priority Rule Does Not Make The Agreement Unlawful.

The Objectors argue that the Liquidator violates RSA 402-C:44 with the Agreement because the effect is to pay some amounts to certain class V creditors before class II and other class V creditors. In entering the Agreement, however, the Liquidator has done nothing to upset the priority rules because the Agreement contemplates the realization of an asset and not asset distribution. Indeed, the priority rules expressly provide that costs of administering the estate be paid first, before distributions are effected in relation to the claims of policyholders and lower priority

creditors such as AFIA Cedents and PEIC. *See* RSA 402-C:44, I. The priority rules do not require that administrative expenses all wait until distribution day for payment. If that were the case, the Liquidator would find it impossible to retain employees, hire counsel, or pay for other necessary services and supplies for the liquidation. As explained in the Liquidator's reply (at 8-12), the cost of the Agreement constitutes an expense of recovering an asset of the estate. Such "costs of preserving or recovering the assets of the insurer" are properly paid first under RSA 402-C:44, I. *See* Liquidator's reply at 14-15. The priority rules do not contain any limitation on the size or scale of a particular administrative expense, which is why the Liquidator has brought this matter before the Court. *See* Clark on Receivers at § 406.

Indeed, there is not a requirement of success in an asset recovery endeavor to have the associated cost be an allowable administrative expense. Consider, for example, litigation. The Liquidator could reasonably embark on a suit against a third party for recovery of money that proves unsuccessful, yet the costs of the suit would nonetheless be administrative expenses. *See* In re Taxman Clothing Co., 49 F.3d 310, 315 (7th Cir. 1995) (reasonable judgments that later prove to have been mistaken will not be second guessed). Instead the fees would be covered as an administrative expense. *See* In re Computer Learning Centers, Inc., 272 B.R. 897, 907-908 & n.9 (Bankr. E.D. Va. 2001) (trustee entitled to fees when pursuing apparently worthwhile assets that fail to materialize). The Liquidator's job is to recover the net assets of the estate and he must do a reasonable calculation to determine whether the costs of the pursuit are worth the anticipated recovery. *See* In re Taxman Clothing Co., 49 F.3d at 315. The Liquidator in this case believes that the Agreement is a reasonable means to

collect an asset of the estate and has explained and supported how the Agreement will benefit the estate. That there might be a perceived substantial cost is not disqualifying because without the expense the asset realized by the estate will have significantly less value. As a result, the attendant costs should be allowed as administrative expenses and paid as negotiated under the Agreement. *See* Clark on Receivers at § 637 ("When a fund is realized or produced or brought into court for distribution among claimants, those who by their exertions and activities have brought this fund into court are entitled to be paid out of the fund before it is distributed. The actual expenses of preserving the property and the realization of the assets are frequently considered together as belonging to the same priority category.")

A holding that the Agreement violates the priority rules would jeopardize the Liquidator's ability to make any substantial agreement to realize assets or otherwise conduct the business of the liquidation that might require some payment or performance by the estate. The remedial nature of the statute, the broad equitable powers of the Court and the broad authority of the Liquidator to collect assets and make compromises would thus all be thwarted by the pinched view espoused by the Objectors. Clearly the statute should not be interpreted so restrictively. *See* In re Denton, 147 N.H. 259, 260 (2001) (all reasonable doubts in statutory construction should be resolved to give the broadest reasonable effect to its remedial purpose); Appeal of Dell, 140 N.H. 484 (1995) (construe statute to give effect to its clearly stated underlying purposes); RSA 402-C:1, III (statute to be liberally construed).

The Liquidator has shown that there are no legal impediments to the approval of the Agreement. To the contrary, the Act is replete with support for the approval.

A denial of approval, on the other hand would not be consistent with the Act's purposes and would not be in the best interests of policyholders but would yield a substantial windfall to the ACE Companies.

II. THE AGREEMENT IS IN THE BEST INTERESTS OF HOME POLICYHOLDERS AND IS REASONABLE IN THE CIRCUMSTANCES.

The question then turns to whether the Court should approve the Liquidator's endorsement of the Agreement as a reasonable exercise of that authority in the best interests of policyholders. The Liquidator urges the Court to find that:

1. The Agreement is in the best interests of the policyholders because, without the Agreement, there would be significantly smaller recovery from Century and CIRC.
2. The Agreement is reasonable in the circumstances because AFIA Cedents had made clear that, without the Agreement, they would be unlikely to file and prosecute (except possibly to the extent necessary to preserve offset rights against claims by Home) their claims against Home, would consider seeking to "cut through" or bypass the estate, and had indicated they were investigating earmarking UK assets for UK creditors.

A. Standards

This proceeding is an *in rem* proceeding in which the Court, through the Liquidator, has taken control of Home for purposes of liquidation. *See* RSA 402-C:21, I; Liquidation Order ¶ (f), (g). The Liquidator's motion is not an adversary

motion against an opposing party but instead a request for the Court to approve the Agreement in its supervisory capacity under RSA 402-C:25. *See* Rand v. Bank, 86 N.H. 351 (1933) (under statute providing for winding up of banks by bank commissioner as receiver appointed by court, court can authorize borrowing of money as it has custody of and administers estate through the commissioner). As set forth in the Liquidator's reply, the standard to be applied by the Court is the best interests of Home's policyholders. Here, the Liquidator has shown that this standard is satisfied and that there is reasonable support for the Liquidator's entering into the Agreement and that there is no violation of any of the provisions of RSA 402-C in the making or execution of the Agreement. Thus, the Liquidator seeks this Court's approval of the Agreement as a matter of law.

The Objectors have brought certain legal and factual assertions to the attention of the Court. The Liquidator has accordingly explained why the Objector's legal arguments are wrong and provided additional factual materials to further demonstrate that the Agreement is in the best interests of Home policyholders and reasonable in the circumstances. The issue is not whether there are any uncertainties (as there inevitably are in complex circumstances such as this) but whether it is reasonable to address them as the Liquidator proposes. The Objectors have not demonstrated that the Liquidator's decision to proceed with the Agreement was unreasonable. Indeed, while the summary judgment standards applicable in adversary proceedings do not apply here, the Objectors can do no more than raise "metaphysical doubts" about whether the Liquidator acted reasonably in making the Agreement that would not suffice even in that context. *See* Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,

475 U.S. 574, 586 (1986). In a case such as this, where the objections make little economic sense (given that the Agreement is a *benefit* to creditors such as BMC and PEIC, and the remainder of the ACE Companies are *debtors* to the estate whose self-serving objections must be taken with more than a little salt), they would have to "come forward with more persuasive evidence to support their claims than would otherwise be necessary." Matsushita, 475 U.S. at 587. Instead of specific facts and more persuasive evidence, the Objectors present general denials and metaphysical doubts.

B. The Liquidator's Affidavits Establish The Benefit To The Estate And Policyholders And Support The Reasonableness Of His Judgment

The Liquidator has presented a host of affidavits supporting his assertion that without the Agreement significant AFIA Cedents would not be willing to file and prosecute substantial claims in the estate. *See* Affidavit of Gareth Howard Hughes at ¶ 13; Affidavit of Gernot Warmuth, Esq. at ¶ 8; Affidavit of Rhydian Williams at ¶¶7 –10; Affidavit of Jonathan Rosen at ¶ 6; and Affidavit of Peter A. Bengelsdorf at ¶ 8. Indeed, the AFIA Cedents that have subscribed to the Agreement represent over 75 percent of the AFIA Cedents' claims in value. The Liquidator has also submitted affidavits showing that he had powerful reasons to believe that AFIA Cedents were exploring other alternatives to doing business with the liquidation estate. Moreover, AFIA Cedents notified the Liquidator and his advisors that they would consider dealing directly with ACE and thereby bypass the indemnity obligation to the estate. They also indicated they would attempt to keep assets in England for distribution to creditors there in the hope that because of the relatively small number of ostensibly

affected creditors they might stand a chance at a dividend on their claims out of an English proceeding. *See* Affidavit of Gareth Howard Hughes at ¶¶ 14 & 15; Affidavit of Gernot Warmuth, Esq. at ¶¶ 9-10; Affidavit of Rhydian Williams at ¶ 12; Affidavit of Jonathan Rosen at ¶¶ 7 & 9; and Affidavit of Peter A. Bengelsdorf at ¶¶ 8 & 22. The Liquidator also received advice from English insolvency professionals which indicated that while the ring fence ploy was unlikely to succeed in the end, the legal process for it would be time consuming and costly. *See* Affidavit of Robin Knowles, QC at ¶¶ 10-13. Based on these facts, the Liquidator reasonably determined that the best way to realize the fund of the AFIA pool indemnity recoverables "as rapidly and economically as" he could was through a commercial resolution, not litigation. *See* Clark on Receivers at § 366 (court can compromise claim recovery instead of taking on hazards of litigation).

The Joint Provisional Liquidators and the Liquidator engaged in intensive negotiations with AFIA Cedents over the Agreement. The effect of the negotiation for the estate's protection includes the following:

- Recovery of indemnity proceeds in the approximate and estimated amount of $145.5 million (based on ultimate exposures for AFIA losses reported by ACE/INA)(see Exhibit "A"). This includes the benefits of:
    - Reimbursement from the proceeds of Century/CIRC AFIA recoveries of all the liquidator's incidental and transaction costs, as well as the entire cost of the UK provisional liquidation and the costs of collection from the ACE Companies;

- Recovery from the proceeds of all the estate's claims against AFIA Cedents that are the subject of offset by those cedents;

- Quietude for the Liquidator in foreign jurisdictions over issues between Home and AFIA Cedents;
- Avoidance of significant UK branch related litigation costs;
- Resolution of other complex international law issues such as the potential applicability of English rules of distribution to property such as the BAFCO Reinsurances that might be deemed UK assets.

Thus, the Agreement is far more certain than litigation — as it is structured, the Agreement will produce real and significant value to the estate and "pays its own way."

C. The Objectors' Metaphysical Doubts Do Not Impugn The Reasonableness Of The Liquidator's Judgment.

The Objectors' submissions only attack the third and least of the reasons for the Agreement: the concern that attempts to segregate UK assets could lead to expensive and time-consuming litigation. The Objectors do not substantively challenge the problem that AFIA Cedents would not file claims (reducing Home's recoverables and providing the ACE Companies with a windfall) or would seek to circumvent the liquidation through cut-through arguments or separate agreements (with the ACE Companies). Their affidavits only deny and doubt whether the ring fencing ploy is allowed in England and regardless of whether it is, whether any of the indemnity recoverables are subject to English law. *See* Affidavit of Richard Daniel Hacker, QC at ¶¶ 8-10, 29-40. But even Barrister Hacker concedes that if there were

"compelling reasons" English creditors could conceivably convince an English court to ring fence. Hacker Affidavit at ¶¶ 26 & 40.[2] Furthermore, the Liquidator has shown the reasonableness of his determination that there was a concern that some of the assets in question could be determined to be "English." *See* Affidavit of Gareth Howard Hughes at ¶¶ 7-11. A difference of opinion over the uncertainty, time and expense to obtain dismissal of a ring fence attempt in English Courts does not negate the reasonableness of the Liquidator's decision to avoid this problem through the Agreement. These differences of opinion also do no harm to the reasonableness of the Liquidator's determination to avoid these complex issues through the Agreement and certainly do not impugn the overall reasonableness of the decision to proceed with the Agreement.

[2] Obviously, the Liquidator was not anxious to see what well-financed proceedings to decide whether such circumstances existed in this case would look like.

CONCLUSION

The Liquidator has carried his burden of showing a reasonable basis for the Agreement and that it is lawful. The Court should therefore grant the Liquidator's motion and enter an order approving the Agreement in the form previously submitted by the Liquidator.

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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