

Exhibit B

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****AFFIDAVIT OF DOUGLAS A. HARTZ,
SENIOR COUNSEL – FINANCIAL AND INSOLVENCY REGULATION, FOR
THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS**

I, Douglas A. Hartz, hereby depose and say:

1. I am Senior Counsel – Financial and Insolvency Regulation, for the National Association of Insurance Commissioners (“NAIC”) and the NAIC staff member principally responsible for supporting the efforts of the Insurers Receivership Model Act Revision Working Group of the Insolvency Task Force (“Working Group”). The Working Group has been working for over a year on in the process of drafting an updated Insurer Receivership Model Act. This effort is still very much a “work in progress”. Generally, any NAIC model act will require approval by the chief insurance regulators constituting the membership of the NAIC before it will be submitted for adoption by the legislatures of the various states. The Insurer Receivership Model Act will not be considered adopted by the NAIC until June 2005.


2. I have read the Motion for Reconsideration of Order on Remand filed on February 28, 2005 by Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company and ACE Reinsurance Company (the “ACE Companies”).

3. The ACE Companies’ characterization of the Working Group’s consideration of the proposed amendment discussed in their motion is incorrect and in

fact misstates the position of the NAIC on the AFIA Settlement - administrative expense question before this Court. The NAIC expressed its position on that question--to support the Liquidator's interpretation of the law--in the amicus brief it filed last year with the New Hampshire Supreme Court. A copy of that brief is attached to this affidavit.

4. I participated in the Working Group meeting that considered the subject amendment to the draft Model Act. The sense of the Working Group at that meeting was that since the proposed amendment merely reiterated the proper application of present law that it was unnecessary. It is incorrect to assert that the Working Group "rejected" the proposed amendment or to imply that its members disagreed with the provisions of the amendment on the merits. In fact, the contrary is true.

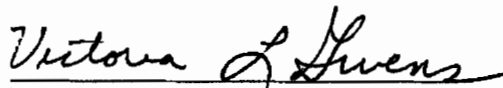
Signed under the penalties of perjury this 2nd day of March 2005.



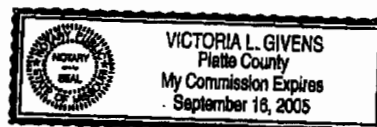
Douglas A. Hartz

STATE OF Missouri
COUNTY OF Jackson

Subscribed and sworn to, before me, this 2 day of March, 2005



Notary Public/Justice of the Peace



THE STATE OF NEW HAMPSHIRE
SUPREME COURT

No. 2004-0319

IN THE MATTER OF THE LIQUIDATION OF
THE HOME INSURANCE COMPANY

**RULE 7 MANDATORY APPEAL OF FINAL DECISION ON THE MERITS OF
AN ORDER FROM THE SUPERIOR COURT FOR MERRIMACK COUNTY**

BRIEF OF *AMICUS CURIAE*
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS
IN SUPPORT OF RESPONDENT ROGER A. SEVIGNY,
INSURANCE COMMISSIONER OF THE STATE OF NEW HAMPSHIRE,
AS LIQUIDATOR OF THE HOME INSURANCE COMPANY

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I. INTEREST OF AMICUS CURIAE

A. Identity of Amicus Curiae

Amicus curiae National Association of Insurance Commissioners ("NAIC"), is a Delaware non-profit corporation whose membership consists of the chief insurance regulatory officials of each state, the territories and insular possessions of the United States, and the District of Columbia. Created in 1871, it is the nation's oldest association of state government officials.

Only a member may request that the NAIC file an amicus curiae brief. A request requires the approval of the Executive Committee of the NAIC, which is the association's governing body of 16 members comprised of the officers and three representatives of the four geographical zones. Bylaws of the National Association of Insurance Commissioners Art. IV (2004).¹

The mission of the NAIC as set out in its Certificate of Incorporation is:

to assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals . . . : Protect the public interest; Promote competitive markets; Facilitate the fair and equitable treatment of insurance consumers; Promote the reliability, solvency and financial solidity of insurance institutions; and Support and improve state regulation of insurance.

NAIC Mission Statement.²

NAIC members promote the objective of solvent insurance institutions in their two distinct capacities as the chief insurance regulators in each state and as the officer of each state charged with handling insurer receiverships³ for that state. The NAIC's members as liquidators

¹ See Appendix pages 36 to 44.

² See Appendix page 86.

³ Insurer receivership is a collective term that refers to the regulatory control, supported by judicial order and review, of a troubled insurance company. This regulatory control may take the form of rehabilitation or liquidation. In this brief, receivership and liquidation are used interchangeably.

of insolvent insurers need broad statutory authority to take appropriate action to marshal assets to pay claims. "A system of effective solvency regulation provides crucial safeguards for America's insurance consumers [Such a system] requires that regulators have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs." NAIC Financial Regulation Standards and Accreditation Program at 4 (June 2004).⁴ For a state insurance department to be accredited by the NAIC, its laws must contain a framework as set forth in the NAIC's Insurers Rehabilitation and Liquidation Model Act for the conduct of insolvent company receiverships by the insurance commissioner. *Id.* at 10.

The NAIC submits this brief because the central issue on appeal is the scope of the liquidator's authority to enter agreements to preserve and collect assets of the estate, and to pay necessary administrative expenses. In particular, the outcome of this appeal has the potential to limit the liquidator's ability to collect on the obligations of reinsurers under their agreements with the insolvent insurer. The appellants contend that the New Hampshire liquidator lacked authority to enter an agreement approved by the court-supervising the liquidation because it results in payments that violate the priority of distribution. Contrary to appellant's contention, this case is primarily about the liquidator's ability to agree to pay administrative expenses.

As the New Hampshire statutes at issue are essentially the same as provisions in the NAIC Insurers Rehabilitation and Liquidation Model Act ("Model Act") and insurer liquidation statutes in other states, the NAIC as *amicus curiae* will provide this Court unique factual information about the national impact of the Court's decision. The NAIC has a particular interest in the construction of state insurer receivership statutes because these statutes are based on the Model Act, which is an integral part of our national system of state based regulation of

⁴ See Appendix pages 64 to 85.

insurance. In addition, the NAIC can supply information about the historical influences underlying the statutory provisions under scrutiny.

In essence, this challenge to the liquidator's authority, if successful, would provide precedent for debtors to attack any agreement to preserve and collect estate assets that involve the payment of administrative costs to creditors who happen to also have a lower priority claims against the estate. Such a limitation on the broad authority of insurance commissioners as liquidators of insolvent insurers would conflict with the fundamental purposes of insurer liquidations. The NAIC recently expressed to Congress that the purpose of statutory insurer receiverships is to provide "assurance that claims are paid to protect consumers and maintain confidence in the industry." *Modernizing the Insurance Regulatory Structure: The NAIC Framework For a National System of State-Based Regulation* at 19.⁵

Appellants seek to prevent the payment of a necessary administrative expense by mischaracterizing the expense as a preferential distribution. To endorse the appellants' position would create a windfall for them and sharply decrease the assets that would otherwise be available to pay policyholder claims. The NAIC accordingly submits this brief in support of the position of the Insurance Commissioner of the State of New Hampshire as Liquidator of the Home Insurance Company.

The NAIC adopts the Liquidator's statements of The Questions Presented for Review, Statutes Involved, Statement of The Case and Statement of The Facts.

B. Purposes of Statutory Insurer Receivership

To ensure claim payment, the NAIC has promulgated a comprehensive and exclusive statutory framework for insurer receiverships in several versions of the Model Act over many

⁵ See Appendix pages 45 to 63.

years. See 3 NAIC Model Laws, Regulations and Guidelines 555-1 to 555-62 (2004).⁶ Since 1936, progressively more complete versions of the Model Act have served as a guide for NAIC members in promulgating laws that govern the conduct of statutory insurer rehabilitations and liquidations.

In 1936, the NAIC adopted an early draft of the Uniform Insurance Liquidation Act ("UILA"), 13 U.L.A. 321 (1986), as the Model Act. 1 Proc. of the Nat'l Ass'n of Ins. Comm'rs 29 (1936).⁷ In 1969, the NAIC adopted the Wisconsin Insurers Rehabilitation and Liquidation Act ("Wisconsin Act"), 1967 Wis. Laws c. 89, § 17 (codified as amended at Wis. Stat. §§ 645.01 to 645.90), as the model act instead of the UILA. 1 Proc. of the Nat'l Ass'n Ins. Comm'rs 168, 241, 271 (1969).⁸ The Wisconsin Act was the basis for the current Model Act. Every state has adopted a version of the Model Act.⁹ The New Hampshire Insurers Rehabilitation and Liquidation Act ("New Hampshire Act"), R.S.A. §§ 402-C:1-61, at issue here is based on the 1967 Wisconsin Act, and it is substantially the same as the Model Act.¹⁰

The Model Act, like the New Hampshire Act, provides that its purpose is "the protection of the interests of insureds, claimants, creditors and the public generally." Model Act § 1(D); R.S.A. 402-C:1, IV.¹¹ It is notable that the protection of debtors to the insurer's estate is not within this purposes section. This purpose is more fully described in the comment to § 645.01 of the Wisconsin Act.¹² The comment provides:

The priority system has been structured to make the insurance institution do its job better and to apportion loss equitably. Provisions relating to fraudulent conveyances and preferential transfers and liens are carefully tailored to maximize equity in the distribution of the limited assets. See especially ... [the section entitled Priority of Distribution].

⁶ See Appendix pages 87 to 148.

⁷ See Appendix pages 180 to 185.

⁸ See Appendix pages 186 to 189.

⁹ The dates and citations for state adoptions of the Model Act are shown in Appendix pages 247 to 251.

¹⁰ The provisions of the Model Act cited in this brief are excerpted in Appendix pages 24 to 35.

¹¹ The provisions of R.S.A. 402-C cited in this brief are excerpted in Appendix pages 2 to 12.

¹² The comments to sections of the Wisconsin Act cited in this brief are excerpted in Appendix pages 13 to 23.

Equitable apportionment does not mean that a court sitting in equity determines what is equitable and apportions payments accordingly. Nor does it mean that all unsecured creditors will share equally. Rather, it means that creditors will share based on the equities reflected by the statutory system. This is more fully explained in the introductory comment to the Wisconsin Act priority of distribution section. Key portions of the comment are provided as follows because of the importance of this section in the Model Act, its function of working equity on a mass scale, and how that relates to the statutory purpose:

When an insurer must be liquidated, the outcome is often tragic. While many of the losers will merely be inconvenienced, others may suffer losses or delays in receiving payment that will subject them at least to hardship and may even deprive them of the necessities of life. It becomes apparent that claims that are socially more important need to be paid ahead of those that are less important. Recognition of such social equities is commonplace in the law relating to insolvency and bankruptcy.

In an effort to minimize the harm done by liquidation, and especially to lessen it for those persons least able to bear it, much thought and consultation went into the structuring of the priority system....

This section is designed to establish a complete system of priorities among unsecured creditors, based on the relative social and economic importance of the claims likely to be asserted against an insurer. The system is more intricate than any list of priorities provided elsewhere. It would be possible to simplify the system by having fewer categories. This is what the traditional priority system does, for it generally gives priority only to a few kinds of claims - indeed, the traditional pattern is no system at all. Its crude simplicity does crude injustice and fails to carry out sound public policy by minimizing the damage done to the insured community when an insurer fails. The insurance enterprise should be made to do its proper job in the social organism, so far as that is possible with the limited assets that remain in a liquidation.

1967 Wis. Laws c. 89, § 17, (codified as amended at Wis. Stat. § 645.68).

C. Background of the Priority of Distribution

The significance of the priority of distribution in this appeal is not whether the order of priority has been violated. Of significance in any liquidation, and especially in this liquidation, is the recognition, plain on the face of the statute, that administrative expenses must be paid in order to collect the assets, including reinsurance, so that distributions on claims under policies can be made.¹³

One major change in the order of the priorities in the Model Act has been made in response to the holding in *United States Dept. of Treasury v. Fabe*, 508 U.S. 491 (1993). This decision determined that only administrative expenses and policy-related claims have higher ranks in the priority of distribution than claims of the federal government in insurer receivership proceedings. The holding recognizes that administrative expenses and policy-related claims may supercede federal claims without violating 31 U.S.C. § 3713,¹⁴ which strictly requires that federal claims must be paid before general claims in receiverships. After *Fabe*, the Model Act was amended to place general claims in a priority below the claims of the federal government. 2 Proc. of the Nat'l Ass'n of Ins. Comm'rs 14, 20, 593-94, 596-634 (1994).¹⁵

If the Court were to mischaracterize the administrative expense payment at issue as a distribution of general claims, the ruling in the instant case could have the additional unfortunate consequence of creating an apparent violation of 31 U.S.C. § 3713 in the event that federal claims go unpaid. The payment at issue is an administrative expense because it is necessary to cause the cedents to pursue their claims, which allows the Liquidator to pursue the recovery of

¹³ As stated in the parties' briefs submitted to date, the priority of distribution in R.S.A. § 402C:44 is, in pertinent part: (1) administration costs, (2) policy related claims, (3) claims of the federal government, (4) wages, (5) residual classification.

¹⁴ See Appendix page 1.

¹⁵ See Appendix pages 190 to 246.

reinsurance premium.

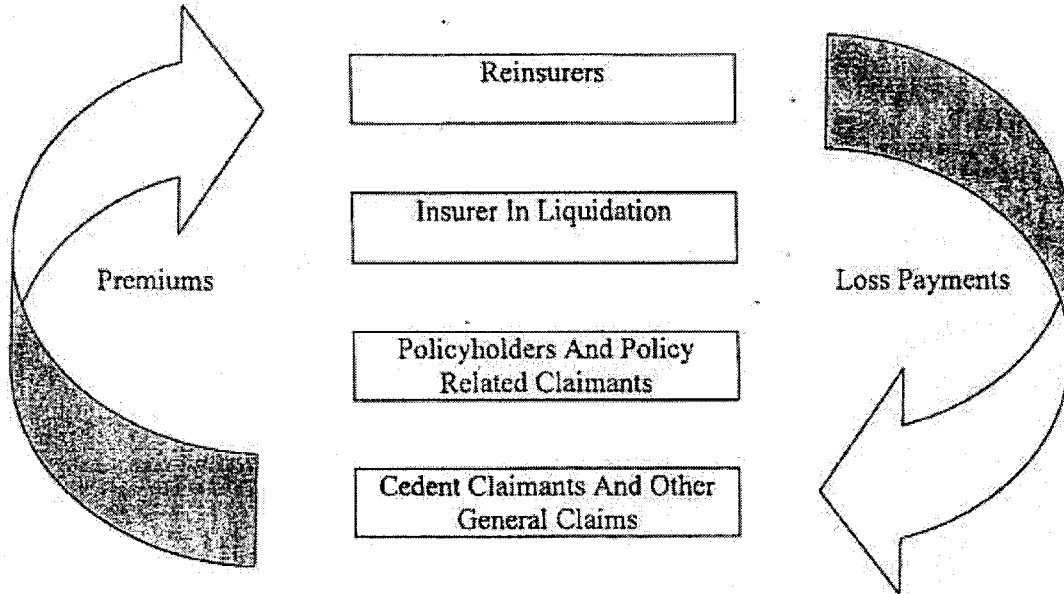
The holdings in *Fabe* underscore two matters of importance in this appeal: the liquidator's ability to pay administrative expenses to collect assets and the statutory purpose of protecting policyholders. "We hold that the Ohio priority statute escapes pre-emption to the extent that it protects policyholders. Accordingly, Ohio may effectively afford priority, over claims of the United States, to the insurance claims of policyholders and to the costs and expenses of administering the liquidation." *Fabe*, 508 U.S. at 493. "We also hold that the preference accorded by Ohio to the expenses of administering the insolvency proceeding is reasonably necessary to further the goal of protecting policyholders. Without payment of administrative costs, liquidation could not even commence." *Id.* at 509. The liquidator in this case is paying administrative costs to further the goal of protecting policyholders.

D. Receivership and Reinsurance – The Structural Problem

The statutory priority of distribution presents a structural problem when applied to the context of reinsurance. This issue is common to many insurer liquidations. This structural problem becomes evident when claimants in insurer liquidation seek direct access to reinsurance. This activity is commonly referred to as a “cut through.” The issue is also observable when claims are not filed or pursued against the liquidation estate, which allows reinsurers to avoid their obligations to the estate. To collect reinsurance, liquidators are compelled to pay administrative costs to cedent claimants because: (1) there is some risk of the cedent claimants seeking to obtain a cut through directly to the reinsurance and (2) due to the position of the cedent claimants in the priority of distribution, it is either certain or very likely that the cedent claimants will not file and pursue claims against the liquidation estate, which ultimately produces a windfall for the reinsurer. Liquidators are caught between claimants and reinsurers.

Figure 1 below is provided to help explain how this structural problem puts liquidators at the mercy of reinsurers demanding that claims be pursued by claimants that have or perceive no interest in pursuing those claims, how much of the money needed to pay policyholder claims in insurer liquidations ends up in the reinsurers hands and how reinsurers may favor cut throughs because such may allow them to pay much less and also establish or continue business with ongoing insurers.

Figure 1.



While an insurer such as the Home Insurance Company is ongoing, premiums flow up the structure outlined in Figure 1. Premiums are paid from the policyholders and cedents to the insurer and then ceded premiums are paid up to the reinsurers. Loss payments flow in the opposite direction – the insurer pays the claims of policyholders and cedents, and the reinsurers pay the reinsurance claims of the insurer. The insurer's reinsurance claims are based on the payments the insurer made to policyholders and cedents or, of great import in this context, what the insurer would have paid had it remained solvent. While all the entities in the structure remain ongoing, the funds flow in a circular pattern. Every period, loss payments by insurers and reinsurers flow down to policyholders and cedents and premiums, whether direct from policyholders, assumed from ceding insurers or ceded to reinsurers, flow up the structure. In this circular pattern, reinsurers are at the pivot point where premium payments stop flowing up and loss payments start flowing down.

After the insurer goes into liquidation the premium flow stops. The insurer stops collecting direct and assumed premium from policyholders and cedents, respectively, and it stops paying ceded premium to the reinsurers. Because of their role as the pivot point, reinsurers in this circular pattern are in the position where, when the flow stops, they hold much of the premium that has flowed into the structure. In the case of a 100% cession from the insurer, the reinsurer holds the entire premium.

While the premium flow stops after liquidation of the insurer, the flow of loss payments must continue, to the extent possible. Loss payments to policyholders embody the critical function of insurance, as previously noted. Loss payments to policyholders must continue in order to maintain consumer confidence in the industry, upon which all the premium flow in this circular pattern depends. In most insurer liquidations the insurer assets – the largest portion of which is frequently reinsurance owed to the estate – are not sufficient to pay all of its liabilities. Thus, despite policyholders' priority of distribution being second only to administrative expenses of the receivership estate, loss payments to policyholders might be impaired.

Because cedents are in the residual classification, which is fifth in the priority of distribution, the loss payments to cedents are more likely to be impaired. Cedents are aware of the structure depicted in Figure 1 and may believe that they have nothing to gain by pursuing their claims in the liquidation estate. If the cedents pursue their claims, it is likely that the only beneficiaries of their efforts will be policyholder claimants, who are above them in priority.

Both cedents and reinsurers are insurance industry insiders and may be expected to be sympathetic to each other's interests. This means they may also be reasonably expected to work together to advance those interests. A reinsurer would have an interest in paying something less than what would be owed the liquidator directly to the cedents if it would cause the cedents not

to pursue their claims in the liquidation and thereby make it impossible for the liquidator to prove its claims against the reinsurer.

When an insurer goes into liquidation, that insurer's reinsurers have only one interest in regard to the liquidation estate - pay as little as possible to the liquidator. There is no prospect of future profit to the reinsurer from an ongoing relationship with an insurer in liquidation. The reinsurer can decrease its obligations to the insolvent insurer by working against any incentive for cedents to file claims in the estate or by providing incentives for cedents to not file claims. Thus, it is predictable that the reinsurer will argue that an administrative expense payment, absolutely needed to ensure the collection of reinsurance, is actually a distribution on the cedent's claims. If the reinsurer were successful in mischaracterizing the payment as a distribution in violation of the statutory order of priority, then the liquidator would not be able to collect the reinsurance. At the other end of the circular pattern in Figure 1, the cedent might hold the filing of their claims for ransom. They might not file unless the liquidator pays them an administrative expense to ensure their action. Thus, the liquidator is caught between the proverbial rock and a hard place, between the reinsurer and the cedents.

Both reinsurers and cedents are essential, respectable participants in the insurance industry. Ultimately, they recognize the importance of the receivership statutes' goal of insuring policyholder claims are paid. In the short term, however, they might exploit any opportunity the statutory structure presents to decrease their obligations to or increase their benefits from the liquidation estate.

In this appeal, the appellants could possibly pay the AFIA Cedents less than the over \$140 million owed to the Liquidator, if the AFIA Cedents were able to cut through directly to the appellants' reinsurance. The liquidator could pursue litigation on the basis that such a cut

through is legally impermissible and that, even if a cut through were achieved, the appellants would still be liable to the Liquidator. But, there is no guaranty that the Liquidator would be successful on either count. If, due to his limited resources and the uncertainty of the result, the Liquidator were to forego pursuit of the reinsurance proceeds, the reinsurer would obtain a windfall and the liquidation estate would be diminished by more than \$140 million.

II. ARGUMENT

A. The Primary Purpose of Insurer Liquidation Is to Minimize Harm from the Insolvency by Paying Policy Claims to the Fullest Extent Possible

The primary purpose of insurer liquidation proceedings is to pay the greatest amount possible on claims, in particular on claims under insurance policies. The agreement at issue in this case serves that primary purpose. The Model Act, like the New Hampshire Act, provides that its purpose is "the protection of the interests of insureds, claimants, creditors and the public generally." Model Act § 1(D); R.S.A. 402-C:1, IV. In fulfillment of this public purpose, the chief insurance supervisory official of the state in which a troubled insurer is domiciled is to be appointed as rehabilitator and, if necessary, liquidator of the insurer. Model Act §§ 17, 20; R.S.A. 402-C:16, 21.

In the context of a liquidation, the liquidator is "vested by operation of law with the title to all of the property, contracts and rights of action" of the insurer, Model Act § 20(A), and he has broad authority "[t]o collect all debts and moneys due and claims belonging to" the insurer. Model Act § 24(A)(8); R.S.A. 402-C:25. The assets collected are ultimately to be distributed to the creditors of the insurer. Where the insurer is insolvent, however, there must be an "[e]quitable apportionment of any unavoidable loss." Model Act § 1(D)(4); R.S.A. 402-C:1, IV(d). Primarily, this is accomplished through the priority of distribution.

Although priority statutes vary in details, they represent the legislative determination that certain creditors' claims are more worthy of payment if, because of insolvency, not all can be paid. The Model Act, like the New Hampshire Act and other states' laws, recognizes the social role of insurance in protecting the public and providing for payment of claims by and against policyholders.

The Model Act typifies insurer priority statutes by providing first priority to "costs and expenses of administration," which include the "actual and necessary costs of preserving or recovering the assets of the insurer." Model Act § 47(A); R.S.A. 402-C:44, I. Payment of such expenses is necessary so that the liquidation may be conducted and assets marshaled.¹⁶ The next class to receive distributions is "claims under policies." Model Act § 47(C); R.S.A. 402-C:44, II. "This class contains the claims central to the social role of insurance," 1967 Wis. Laws c. 89, § 17 (codified as amended at Wis. Stat. § 645.68(3)), and the priority serves the public purpose of protecting policyholders and claimants under policies. Other claims are assigned lower priorities.

B. The Statutes Provide Liquidators with Broad Power to Take Necessary Steps to Protect and Collect Assets

To achieve the purpose of paying the greatest distribution to policyholder level creditors, a liquidator needs broad and flexible authority to conduct the liquidation, including authority to take appropriate action to collect assets, even if appropriate action entails the payment of administrative expenses. The Model Act provides the needed degree of authority through the provisions of section 24. In relevant part, this section provides that a liquidator has the authority

¹⁶ The Model Act now also provides a second administrative expense priority for the administrative expenses of guaranty funds, the statutory entities that handle "covered claims" under policies when an insurer is placed in liquidation. Model Act § 47(B).

"[t]o collect all debts and moneys due and claims belonging to the insurer, wherever located, and for this purpose: ... [t]o do such other acts as are necessary or expedient to collect, conserve or protect its assets or property." Model Act § 24(A)(8); R.S.A. 402-C:25, VI. The flexibility of this broadly permissive language is emphasized by Model Act section 24(B), which provides that:

The enumeration, in this section, of the powers and authority of the liquidator shall not be construed as a limitation upon the liquidator, nor shall it exclude in any manner the right to do such other acts not specifically enumerated or otherwise provided for, as may be necessary or appropriate for the accomplishment of or in aid of the purpose of liquidation.

See R.S.A. 402-C:25, XXII. The Model Act thus authorizes liquidators to devise appropriate means to preserve and collect assets of insolvent insurers in the many varied, complex and difficult to foresee situations that may arise in liquidating the business of insurers, so long as the means chosen serves, or is "in aid of," the purpose of liquidation.

C. Liquidators Have the Authority to Make Payments to Lower Priority Claimants as Administrative Expenses to Increase Amounts Available to Pay Policy Claims

A liquidator's broad powers necessarily include the authority to enter an agreement to aid in the collection of an otherwise unavailable asset (such as reinsurance) by paying an administrative expense to an entity that also may have a claim as a lower priority creditor. Generally, an entity may pursue a claim against an insurer liquidation estate only if it files a claim against the estate.

The payment of an administrative expense that results in increasing the assets available for distribution to policyholders and other high priority creditors does not contravene the priority of distribution. As previously described, the costs of collecting assets are administrative expenses of the liquidation entitled to first priority. Model Act § 47(A)(1); R.S.A. 402-C:44, I.

The payments to the AFIA cedents in this case are an administrative expense to cause the cedents to file their claims against the liquidation estate. If the cedents have not filed claims, then the payments cannot be a distribution on their claims. The Liquidator may pay administrative expenses, however, to cause the cedents to file claims so that reinsurance due the estate may be collected.

A contrary interpretation would frustrate the policyholder protection purposes underlying the liquidation process and the priority of distribution itself. As previously discussed, the purpose of the priority statute is to protect policyholders and other claimants under policies by distributing the limited assets of an insolvent insurer to them before other creditors. The statutory priority provision "carries out sound public policy by minimizing the damage done to the insured community when an insurer fails." 1967 Wis. Laws c. 89, § 17 (codified as amended at Wis. Stat. § 645.68).

The purpose is further advanced where an expense payment permits the liquidator to collect an otherwise unavailable asset so that distributions to policy level creditors will be increased. If an administrative expense payment to an entity with a lower priority claim were not permissible where it would aid in the collection of otherwise unavailable assets, then the purposes of the priority of distribution would be frustrated. That provision is intended to require distributions of available assets to pay administrative expenses and claims under policies first, not to deny lower priority creditors an administrative expense payment where it benefits policy-level creditors.

The Model Act uses an absolute priority rule by providing that "[e]very claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment," Model Act § 47; R.S.A. 402-C:44, and that "[n]o claim by a

shareholder, policyholder or other creditor shall be permitted to circumvent the priority classes through the use of equitable remedies.” Model Act § 47. This language seeks to prevent lower priority creditors from reducing assets available for distribution to the higher priority classes. It does not prevent an administrative expense payment that increases assets available for distribution.

D. The Insolvency Clause Reinforces the Concept that the Liquidator is Entitled to Collect Reinsurance that Would Have Been Paid to the Insurer but for its Insolvency

Any suggestion that the priority statute was intended to reduce cedents' claims against the insolvent insurer and thus to reduce the reinsurers' obligations to the insolvent insurer flies in the face of the insolvency clause. N.H. RSA 402-C:36. The insolvency clause is a statutory dictate that permits a liquidator to recover the full amount of reinsurance due the cedent in receivership, even if the reinsurance contract provides otherwise and if reinsurance is paid directly to the cedent. The section text and comment on the insolvency clause from the Wisconsin Act provide:

The amount recoverable by the liquidator from a reinsurer shall not be reduced as a result of [liquidation] proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provided for direct coverage of an individual named insured and the payment was made in discharge of that obligation.

This section in effect makes the standard insolvency clause a rule of law. ... An insolvency clause [in a contract of reinsurance] and this section prevent use of insolvency as a defense in an action on a reinsurance agreement. The last sentence is intended to prevent what might in effect be a preferential transfer. Only if the reinsurance contract is for the direct coverage of named insureds should the reinsurer be able to make direct payment without going through the liquidator.

1967 Wis. Laws c. 89, § 17(codified as amended at Wis. Stat. § 645.58).

The insolvency clause emerged following the case *Fidelity Deposit Co. of Md. v. Pink*, 302 U.S. 224 (1937). In *Pink*, the Court held that a reinsurer would owe the liquidator based on only the amounts the liquidator actually paid on the underlying claims for which the reinsurance was provided. Thus, in liquidations that could pay nothing to policy claimants, the liquidator could collect no reinsurance. This created a conundrum since most of the assets needed to pay claims had to be collected from the reinsurers. If the liquidator could not collect the reinsurance needed to pay claims, then the liquidator could not pay claims that in turn provided the means to bill the reinsurers. In short, any insurer liquidation would result in a windfall to the reinsurers because no claims could be paid and no reinsurance could be billed.

States corrected this by enacting laws requiring that reinsurance contracts contain an insolvency clause that provided essentially that the reinsurance was payable in accordance with the insurer's liability, "without diminution because of the insurer's insolvency or because the liquidator or statutory receiver failed to pay all or a portion of the underlying claims reinsured." This is not a provision aimed at protecting reinsurers, as has been contended. As noted previously, absent the statutory insolvency clause, the liquidation of an insurer would be virtually impossible. Liquidation would have the effect of awarding massive windfalls to the insurer's reinsurers, whereby the reinsurers would keep the entire ceded premium collected while the insurer was ongoing and, after the liquidation, pay little or nothing on the claims under policies of insurance.

By 1985, *Pink* had been statutorily overruled and courts had recognized this fact. See *Arrow Trucking v. Cont'l Ins. Co.*, 465 So. 2d 691, 700 (1985) ("[*Pink*] ... has been statutorily overruled to the extent that by statute the reinsurance is payable to the liquidator even without the reinsured's having first sustained a loss"). Today, all states must have enactments

substantially similar to the Model Law's insolvency clause provision for their insurance departments to be accredited by the NAIC for their regulation of insurers' solvency. NAIC Financial Regulation Standards and Accreditation Program at 13 (June 2004). In addition, an insurer may not take credit for reinsurance, which is frequently necessary for the insurer to meet minimum capital requirements to remain in operation, unless its reinsurance contracts contain an acceptable insolvency clause. NAIC Statements Of Statutory Accounting Principles 62-4 (2004).¹⁷

The process of liquidation is not intended to reduce the obligations of those indebted to the insolvent insurer. To the contrary, a liquidator should seek to collect amounts due the insolvent insurer under reinsurance and other agreements for the benefit of creditors generally. The Model Act encourages collection efforts "by extending the scope of personal jurisdiction over debtors of the insurer outside of this state." Model Act § 1(D)(5). See Model Act § 4(C)(2), (5) (extending personal jurisdiction to "an insurer or reinsurer who has at any time entered into a contract of reinsurance with" the insolvent insurer and to a person "obligated to the insurer in any way whatsoever"); R.S.A. 402-C:1, IV(e), C:4, V(b)(e). It also provides that the "amount recoverable by the liquidator from reinsurers shall not be reduced as a result of the [liquidation] proceedings, regardless of any provision in the reinsurance contract or other agreement." Model Act § 36(A); *cf.* R.S.A. 402-C:36.

¹⁷ See Appendix pages 149 to 179

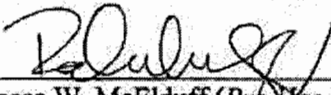
III. CONCLUSION

For the reasons stated, the Court should hold that the New Hampshire Act authorizes agreements that provide for payments to lower priority creditors to assist in the collection of an asset of the insolvent insurer.

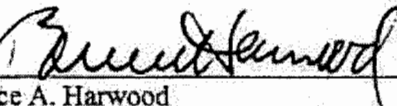
DATED: July 7, 2004

Respectfully submitted,

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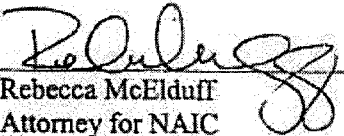
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