

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**

**REPLY OF ACE COMPANIES TO LIQUIDATOR'S OPPOSITION TO
MOTION TO STRIKE LIQUIDATOR'S OFFERS OF PROOF
AND FOR SANCTIONS AND RELATED RELIEF**

Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company and ACE American Reinsurance Company (collectively, the "ACE Companies"), by their attorneys, Orr & Reno P.A., respectfully submit this reply to the opposition (the "Opposition") to the ACE Companies' motion (the "Motion") for an order (i) pursuant to New Hampshire Rule of Evidence 408, striking and expunging from the Court's record the offers of proof dated April 28, 2005 and related affidavits and exhibits (the "Offer of Proof") filed by Roger A. Sevigny, Insurance Commissioner of the State of New Hampshire, as liquidator (the "Liquidator") of The Home Insurance Company ("Home") with respect to the Liquidator's motion (the "Liquidator's Motion") for approval of the Liquidator's proposed compromise with the AFIA Cedents (the "Proposed Agreement"), (ii) pursuant to N.H. Rev. Stat. Ann. § 507:15, granting sanctions against the Liquidator, including (a) awarding attorneys' fees and costs to the ACE Companies, (b) denying the relief sought by the Proposed Agreement in full, and (c) awarding such other sanctions and relief as the Court deems appropriate. Capitalized terms not defined herein shall have the meanings ascribed to such terms in the Motion.

I. EVIDENCE OF THE SEPTEMBER 30, 2003 MEETINGS AND FOLLOW-UP DISCUSSIONS, WHICH WERE ADMITTEDLY WITHOUT PREJUDICE, IS INADMISSIBLE.

1. The Liquidator concedes in the Opposition that "the statements during the September 30, 2003 meeting [referenced in the Offer of Proof] and follow up discussions were part of compromise negotiations." *See Opposition* ¶7. This important caveat, made only when ACE moved to strike portions of the Offer of Proof, was not referenced at all in the Offer of Proof itself. The Liquidator's attempts to absolve himself from the taint of offering such "without prejudice," and normally inadmissible, evidence by stating that the evidence is not being offered for its truth is belied by the Liquidator's own Offer of Proof wherein the Liquidator seeks to prove that (i) ACE's representatives made statements and/or engaged in activities which gave the Liquidator "concern" regarding possible cut-through discussions with AFIA Cedents, and (ii) the follow-up discussions regarding a potential comprehensive business resolution in October 2003 "did not meaningfully progress" due to ACE's behavior. *See Offer of Proof* ¶¶ 21, 31-34. Indeed, if the Liquidator were not seeking to offer these statements for their truth, the Liquidator would not have had any need to request that these very statements be admitted as facts by the ACE Companies in response to the Liquidator's Request for Admissions dated May 9, 2005.

2. Moreover, even if the Liquidator were offering evidence of the September 30, 2003 and October 2003 meetings (or any of the other meetings which the ACE Companies argue in the Motion were held without prejudice and are inadmissible) merely to establish the Liquidator's subjective state of mind in reaching the proposed agreement with AFIA Cedents, the Liquidator's state of mind is irrelevant to the matters before this Court on remand. The test of whether the Liquidator's proposed agreement is fair and reasonable is an objective test. *See In re*

Boston & Providence R.R. Corp., 673 F.2d 11, 12 (1st Cir. 1982) ("[T]he court ha[s] a duty to apprise itself of all facts necessary for an intelligent and *objective* opinion of the probabilities of ultimate success should the potential claims ... be litigated.") (emphasis added), *citing Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc., v. Anderson*, 390 U.S. 414, 424 (1968) (same).

3. Finally, Gareth Hughes, a co-Joint Provisional Liquidator for the Home and one of the participants in the September 30th meeting, has testified in his deposition that his understanding of a "without prejudice" meeting is that the information "should not be used in proceedings between the two parties." *Transcript of Deposition of Gareth Hughes, June 29, 2005 pp. 49-50 (copy of relevant pages attached)*. Clearly, Mr. Hughes' understanding of the term is closer to the understanding of Mr. Durkin who submitted an affidavit in support of the Motion. The Liquidator should be precluded from attempting to introduce evidence which representatives for both the Liquidator and the ACE Group understood to be inadmissible in any proceedings between them.

4. If Evidence Rule 408 is to serve its intended policy of encouraging free and open discussion towards settlement of disputes, the Court must find that the parties, in agreeing to meet to discuss their issues "without prejudice", created an implied-in-fact agreement not to use the contents of these discussions in future litigation. *See Hercules, Inc. v. United States*, 116 U.S. 417 (1996) (agreement will be implied-in-fact if there is a meeting of the minds, indicated by the parties' conduct); *Morgenroth & Assocs., Inc. v. Town of Northfield*, 121 N.H. 511 (1981) ("An implied in fact contract is a true contract that is not expressed in words; the terms of the parties' agreement must be inferred from their conduct."); *Perkins v. Concord R.R.*, 44 N.H. 223 (1862) (finding general rule was "that confidential overtures of pacifications ... expressly stated

to be made confidentially, or without prejudice, are excluded as evidence on grounds of public policy"). The fact that the settlement negotiations took place prior to any discussion of litigation does not negate the protections of this policy, since its purpose is to promote offers of compromise in order to avoid controversy and the expense of litigation. *See Gagne v. New Haven Road Const. Co.*, 87 N.H. 163 (1934).

II. EVIDENCE OF THE MEETINGS BEFORE AND AFTER THE SEPTEMBER 30, 2003 MEETING IS ALSO INADMISSIBLE.

5. The Liquidator's argument that the meetings which took place in the few weeks immediately prior and subsequent to the September 30, 2003 without prejudice meeting were "ordinary business discussions" is simply not credible based on the Liquidator's other statements. First, the Liquidator indicates that in "several September 2003 discussions with Michael Durkin of ACE INA Services... [representatives of the Liquidator] expressed concern over potential direct dealings between ACE and AFIA Cedents...." *See Offer of Proof* ¶24. Second, the Liquidator also indicates that there were "follow-up discussions...concerning the suggestion of a potential comprehensive business resolution during October 2003." This is hardly the small talk of an ordinary course business meeting and a clear indication that even the Liquidator believed there were disputes being discussed.

6. Third, and perhaps most significantly, Mr. Rosen concedes in his affidavit in support of the Opposition that Mr. Durkin "preceded every meeting and discussion with me with the comment that he construed our communications to be 'without prejudice' and under a full reservation of rights...." *See Rosen Affidavit* ¶4. It is clear that Mr. Durkin did not believe the meetings were "ordinary course" and he so states in his affidavit in support of the Motion. Mr. Rosen's affidavit then proceeds to state that "I merely noted that I heard what he said, that the concept of 'without prejudice' communications had a defined legal meaning, driven by the rules

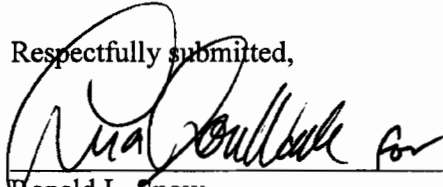
regarding inadmissibility of the communications at issue." *See Rosen Affidavit* ¶4. Again, Mr. Durkin (a non-lawyer) understood the without prejudice caveat to mean he could speak freely in order to attempt to resolve a dispute in good faith, in the belief (like that of Mr. Hughes) that such discussions are not admissible in a subsequent dispute between the parties. Mr. Durkin proceeded to continue the discussions on various occasions on the basis of his express reservation that his statements were inadmissible (a fact which is corroborated by Mr. Rosen); whereas, Mr. Rosen (a lawyer) seems to be creating a fine-hair distinction (which we believe bears no legal significance, even if true) that Mr. Rosen did not accept that the meetings were without prejudice but did not negate Mr. Durkin's express understanding of such precondition for the discussions, and Mr. Rosen did not get up to leave such discussions either. Having had his representatives voluntarily continue to proceed in "without prejudice" discussions with ACE representatives, the Liquidator should be estopped from now seeking to introduce any evidence of those discussions.

III. CONCLUSION.

In summary, the actions and statements of the Liquidator's own representatives, and the reasonable inferences to be drawn from them, indicate that representatives of the ACE Companies engaged in dispute resolution discussions with representatives of the Liquidator expressly under the "without prejudice" caveat. Representatives of the Liquidator acknowledged this caveat and should not now be permitted to stand Evidence Rule 408 on its ear with their contorted arguments about why discussions which were acknowledged to be inadmissible are now necessary to prove the Liquidator's state of mind, which is not even relevant to the issues on remand before this Court. Therefore, this Court should overrule the Opposition and grant the Motion in its entirety.

Dated: July 22, 2005

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing pleading has been served on Roger A. Sevigny, Commissioner of Insurance, Peter Bengelsdorf, Special Deputy, and the following counsel via First Class mail on July 22, 2005:

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THE STATE OF NEW HAMPSHIRE

SUPERIOR COURT

MERRIMACK 55

DOCKET NO. 03-0106

IN THE MATTER OF:

THE LIQUIDATION OF THE
HOME INSURANCE COMPANY

DEPOSITION OF GARETH HUGHES

Wednesday 29th June 2005

At: 9.00 am

Taken at the offices of:

Lovells
Atlantic House
Holborn Viaduct
London
United Kingdom

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10:14:04 1 amount. Therefore, again I can't remember the precise
 10:14:11 2 details, the directness of those comments or the direct
 10:14:16 3 implication of those comments was such that the creditors
 10:14:20 4 were raising the specter that they were unlikely to
 10:14:25 5 prosecute proofs of claim generally, save to the extent they
 10:14:28 6 have set-off rights, the reason for that being that if they
 10:14:33 7 did not prosecute those claims they would have to make those
 10:14:36 8 payments to the estate. So presumably it was in their
 10:14:40 9 interest to prosecute those claims up to and including the
 10:14:45 10 set-off amounts.
 10:14:46 11 Q. At or prior to the October 21st meeting with
 10:14:49 12 the ICC, had any AFIA cedant told you what the value of
 10:14:56 13 their set-off rights was?
 10:14:57 14 A. I can't recall.
 10:15:02 15 Q. Do you recall at any point after October 2003,
 10:15:09 16 through and including February of 2004, whether any AFIA
 10:15:15 17 cedant told you what the value of their set-off rights
 10:15:19 18 was -- strike that -- what the value of the set-off was?
 10:15:24 19 A. I cannot recall.
 10:15:31 20 Q. Did you see any communications from any AFIA
 10:15:36 21 cedant in which they indicated to you what they believed the
 10:15:41 22 value of their set-off rights might have been?
 10:15:47 23 A. I can't recall.
 10:15:48 24 Q. Did Ernst & Young attempt to determine the
 10:15:52 25 value of those set-off rights?

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10:15:54 1 A. I cannot recall.
 10:16:04 2 Q. As you sit here today, do you know the value
 10:16:10 3 of those set-off rights?
 10:16:11 4 A. No. In terms of my role generally on the
 10:16:14 5 provisional liquidation, I don't know details in relation to
 10:16:19 6 individual creditors' claims, including their set-off
 10:16:22 7 rights.
 10:16:23 8 Q. Based on your experience, at what point in
 10:16:28 9 time will the amount of those set-off rights be established?
 10:16:34 10 A. Again, I don't know the details of the outward
 10:16:41 11 protections on Home US's estate, and it will depend upon how
 10:16:44 12 that estate is conducted, but in the normal course the
 10:16:49 13 amounts that Home seeks from its reinsurers would be based
 10:16:55 14 either on the claims it receives or the claims it expects to
 10:17:00 15 receive. In relation to the latter categorisation,
 10:17:02 16 actuaries would determine, based on case reserves and IBNR,
 10:17:09 17 to the best of their ability, what individual reinsurers may
 10:17:15 18 be projected to owe to a certain estate.
 10:17:18 19 Q. At what point in time will that set-off number
 10:17:22 20 become fixed?
 10:17:23 21 A. With certainty, once the claims are
 10:17:29 22 adjudicated and admitted into the estate.
 10:17:32 23 Q. So at the time of the October 21st meeting is
 10:17:37 24 it fair to say no AFIA cedant knew what the amount of its
 10:17:41 25 set-off rights would be?

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10:17:42 1 MR LESLIE: Objection.
 10:17:43 2 A. I don't know that detail.
 10:17:45 3 Q. Had any AFIA cedant at that point in time had
 10:17:48 4 its claims admitted into the estate?
 10:17:51 5 A. I don't know that detail.
 10:17:54 6 Q. On October 21st do you know whether any claim
 10:17:57 7 had been admitted into the estate?
 10:17:59 8 A. I don't know that detail.
 10:18:01 9 Q. Did Equitas ever tell you what they thought
 10:18:07 10 their set-off number was?
 10:18:09 11 A. I have no detailed recollection, as I sit here
 10:18:15 12 today, but there were a number of conversations with
 10:18:18 13 Equitas. Again, I can't recall any precise numbers but I
 10:18:25 14 have a general recollection that Equitas were a significant
 10:18:29 15 creditor of the estate. To the extent Equitas is the
 10:18:34 16 run-off vehicle for Lloyd's from 1992 onwards, I am sure it
 10:18:39 17 would have had material reinsurances of Home, and figures
 10:18:44 18 may have been mentioned to me but if they were I can't
 10:18:47 19 recollect them, as I sit here today.
 10:18:48 20 Q. Do you have any general sense of what those
 10:18:50 21 figures were?
 10:18:51 22 A. No.
 10:18:51 23 Q. Did any AFIA cedant tell you what their
 10:18:56 24 set-off number was?
 10:18:57 25 A. I can't recall.

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10:19:04 1 Q. Did you yourself ever do any analysis of what
 10:19:07 2 you thought the set-off for AFIA cedants would be?
 10:19:11 3 A. No.
 10:19:11 4 MR LEE: When you want to take a break just say.
 10:30:36 5 (A short break)
 10:31:14 6 MR LEE: I am going to mark as Hughes 6 for
 10:31:15 7 identification a document dated November 28th, 2003. It is
 10:31:22 8 titled "The Home Insurance Company proposals at the UK
 10:31:27 9 Branch Creditors", A531 through A543.
 10:31:50 10 (Exhibit Hughes 6 marked for identification.)
 10:32:19 11 Mr Hughes, have you seen this document before?
 10:32:21 12 A. Yes, I have.
 10:32:22 13 Q. Who prepared it?
 10:32:24 14 A. I believe it was prepared by Sarah Ellis in my
 10:32:29 15 office.
 10:32:29 16 Q. Was it prepared at your instruction?
 10:32:32 17 A. Yes.
 10:32:33 18 Q. On the first page, bottom left-hand corner, it
 10:32:38 19 says: "Without prejudice and for settlement purposes only".
 10:32:42 20 Do the words "without prejudice" have any meaning to you?
 10:32:44 21 A. Well, they have general meaning and they are
 10:32:49 22 words that are used perhaps too often, but what they say,
 10:32:53 23 without prejudice to each parties' rights and for settlement
 10:32:57 24 purposes only.
 10:32:58 25 Q. What does that mean to you?

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10:33:00 1 A. In terms of this document should not be used
 10:33:07 2 in proceedings between the two parties.
 10:33:10 3 Q. If you can turn to page A539, did Ms Ellis
 10:33:32 4 prepare this slide?
 10:33:33 5 A. Yes.
 10:33:33 6 Q. And what does this slide represent?
 10:33:38 7 A. This slide is the culmination of a number of
 10:33:49 8 slides where Sarah Ellis was illustrating what assets could
 10:34:02 9 be available to creditors, based upon these examples, in
 10:34:12 10 terms of a sharing arrangement between creditors. I believe
 10:34:19 11 the slide you have pointed to, 539, is the summary of an
 10:34:30 12 amount of money which for these illustrative purposes is
 10:34:34 13 \$249 million, which would then be shared between the Home
 10:34:41 14 estate in the US and the UK creditors, the UK creditors
 10:34:50 15 sharing being subject to a formula.
 10:34:52 16 Q. There is a number here of \$20 million for
 10:34:57 17 legal and administrative costs of the scheme. What does
 10:35:02 18 that relate to?
 10:35:03 19 A. There were deductions in the proposals we were
 10:35:13 20 putting before the creditors then in terms of deductions for
 10:35:17 21 the cost of the provisional liquidation in the UK, I believe
 10:35:23 22 seeking court sanction and other aspects, and that
 10:35:29 23 20 million is presumably, again for illustrative purposes,
 10:35:33 24 what that deduction might amount to.
 10:35:36 25 Q. Am I right that \$20 million represents the

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10:35:44 1 estimate of the cost of the UK component of the scheme?
 10:35:49 2 A. I think it also encompasses -- again, I am
 10:35:59 3 acting from memory, but I think in terms of the proposals
 10:36:02 4 put before the creditors it encompassed the general costs of
 10:36:05 5 the joint provisional liquidation in the UK and in addition
 10:36:11 6 to that the costs of getting the approval of the proposals
 10:36:15 7 before the creditors, so I think it is more than the costs
 10:36:19 8 of the scheme.
 10:36:19 9 Q. Does it include anything else?
 10:36:23 10 A. Again, I would need -- I can't recollect as
 10:36:26 11 I sit here, but if I had a copy of the proposals to the
 10:36:33 12 creditors, there were four or five headings of detailed
 10:36:33 13 deductions.
 10:36:33 14 Q. And below that there is the number,
 10:36:37 15 a deduction for \$120 million for individual cedant set-offs.
 10:36:43 16 Did you calculate that number?
 10:36:45 17 A. No.
 10:36:45 18 Q. Did Ms Ellis calculate that number?
 10:36:48 19 A. Well, Ms Ellis clearly wrote the number in
 10:36:51 20 terms of preparing the slide. To the best of my belief and
 10:36:56 21 knowledge it is for illustrative purposes only. I have no
 10:36:59 22 recollection of seeing any detail to support that number.
 10:37:03 23 Q. So you do not know where the
 10:37:04 24 120 million-dollar figure came from?
 10:37:07 25 A. No, I don't.

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10:37:08 1 Q. Did you discuss with Ms Ellis the fact that
 10:37:14 2 she was putting into the slide \$120 million for cedant
 10:37:17 3 set-off?
 10:37:19 4 MR LESLIE: Objection.
 10:37:20 5 A. I would have reviewed the slides and discussed
 10:37:24 6 them with them. I have no detailed recollection of
 10:37:26 7 discussing in detail that particular line.
 10:37:28 8 Q. Did you discuss with Ms Ellis the reasons why
 10:37:45 9 AFIA cedants would need to file a proof of claim?
 10:37:48 10 A. Sorry, your question was with Ms Ellis?
 10:37:54 11 Q. Yes.
 10:37:55 12 A. We would have had a number of discussions over
 10:37:58 13 the course of the provisional liquidation of the need to
 10:38:02 14 file proofs of claim in the estate, yes.
 10:38:05 15 Q. Did you discuss with Ms Ellis whether or not
 10:38:07 16 there were tax reasons why AFIA cedants would need to file
 10:38:11 17 a proof of claim?
 10:38:11 18 A. I have a general recollection that there was
 10:38:20 19 some reference in discussions at some point in time that US
 10:38:27 20 creditors may need to file in US insolvent estates in order
 10:38:35 21 to obtain tax credits in terms of bad debts, or something of
 10:38:39 22 that nature.
 10:38:40 23 Q. Is the same true for UK cedants?
 10:38:43 24 A. I don't know. It is not within my expertise.
 10:38:48 25 Q. Do you know whether or not UK creditors lose

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10:38:53 1 tax write-offs if they don't file proofs of claim in the
 10:38:57 2 estates?
 10:38:58 3 A. No, it is not within my expertise.
 10:39:32 4 Q. Can we mark as Hughes 7 for identification
 10:39:37 5 minutes of the first meeting of the Informal Creditors
 10:39:44 6 Committee on October 21st 2003. The Bates number is H339
 10:39:52 7 through H346.
 10:40:04 8 (Exhibit Hughes 7 marked for identification)
 10:40:51 9 Have you seen this document before?
 10:40:52 10 A. Yes, I believe it to be the minutes of the
 10:40:54 11 first Informal Creditors Committee meeting.
 10:40:56 12 Q. Do you know who prepared these minutes?
 10:40:58 13 A. They would have been prepared by one of the
 10:41:02 14 members of my team. I believe that was likely to be either
 10:41:07 15 Sarah Ellis or Benjamin Cairns.
 10:41:10 16 Q. Were these minutes approved by you?
 10:41:12 17 A. Yes, they were.
 10:41:13 18 Q. Is Clifford Chance counsel to the joint
 10:41:17 19 provisional liquidators?
 10:41:19 20 A. Yes.
 10:41:19 21 Q. Does Mr Hertz represent the joint provisional
 10:41:22 22 liquidators?
 10:41:23 23 A. Yes.
 10:41:23 24 Q. He is a partner of Clifford Chance?
 10:41:24 25 A. Yes.