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

ACE COMPANIES' POST-HEARING MEMORANDUM IN SUPPORT OF REQUEST FOR FINDINGS OF FACT AND RULINGS OF LAW

Respondents 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, Lovells and Orr & Reno P.A., hereby submit this Memorandum in support of their Request for Findings of Fact and Rulings of Law ("Findings of Fact").

I. SUMMARY OF ARGUMENT

The Liquidator's undisputed burden is to set forth a full factual record establishing by a preponderance of the evidence that the Agreement is objectively fair and reasonable. In addition, that factual record must be independently assessed by this Court. The Findings of Fact demonstrate that the Liquidator did not and cannot meet his burden of demonstrating that the Agreement is fair and reasonable. Any independent assessment of the evidence compels the conclusion that nothing was "settled" by the Agreement (as the Liquidator alleges), and the facts and the law underlying the so-called "threats" of litigation show that they were neither realistic nor credible.

Because the Agreement is neither fair nor reasonable, and because nothing was settled through it, the Court need not determine whether the Agreement was necessary (even assuming that the New Hampshire Supreme Court's order requires a consideration of necessity). Insofar as the Court considers the "necessity" of the Agreement, the Liquidator has not met his burden of

establishing that, without the Agreement, AFIA Cedents would not have filed and prosecuted claims in Home's estate. The evidence at the hearing overwhelmingly supports a finding that the AFIA Cedents would have filed and prosecuted claims even if the Agreement were not in place.[1]

II. PROCEDURAL HISTORY

On September 13, 2004, the New Hampshire Supreme Court, having considered the parties' briefs on appeal and this Court's Order dated April 29, 2004, issued an order (the "Supreme Court Order") remanding the matter to this Court for, *inter alia,* an evaluation of the Agreement for fairness and reasonableness based on a complete evidentiary record. (*See* Supreme Court Order at 1-2.)

In its Order on Remand dated October 8, 2004 (the "Order on Remand"), this Court acknowledged that it had an obligation to conduct an independent review to assess whether the Agreement was fair and reasonable based on the relevant facts and applicable law. (*See* Order on Remand at 11, 12.) The Court recognized that the parties are entitled to "conduct discovery limited to the necessity, reasonableness, and fairness" of the Agreement and instructed them to do so. (*Id.* at 13, 14.) The Findings of Fact are based upon the facts established at the evidentiary hearing conducted between July 25 and July 29, 2005 before this Court.

III. ARGUMENT

A. THE LIQUIDATOR BEARS THE BURDEN OF DEMONSTRATING THAT THE FULL FACTUAL RECORD SUPPORTS A FINDING THAT THE AGREEMENT IS OBJECTIVELY FAIR AND REASONABLE

The Liquidator must persuade this Court that the Agreement is objectively fair and reasonable by a preponderance of the evidence. *See, e.g., In re GHR Cos., Inc.,* 50 B.R. 925, 931

[1] In this Memorandum and in the Findings of Fact, the ACE Companies do not address the separate issue of whether, as a matter of law, the payments contemplated by the Agreement may be classified as "actual and necessary costs" under RSA 402-C:44, I. The Court has already made its findings of fact and rulings of law on administrative costs, and authorized an appeal on that issue. In the event the Court wishes to enter additional findings of fact regarding administrative costs, the ACE Companies have provided requested findings of fact and will continue to reserve their right to appeal. (*See* Findings of Fact at ¶ 169-72 and n. 6.) Thus, the discussion of necessity below relates to whether the Agreement is necessary, and not whether the payments made under the Agreement may be classified as administrative costs.

(Bankr. D. Mass. 1985) (citation omitted) ("The burden of persuading the court that the compromise should be approved rests with the parties proposing the compromise."); *In re Liquidation of American Mut. Liab. Ins. Co.*, 632 N.E. 2d 1209, 1216 (Mass. 1994) ("[The] receiver should demonstrate that the settlement ... is fair and reasonable."). The Liquidator has acknowledged that he bears that burden. (Transcript of Hearing, Vol. 1-A, at 19:3-8.)

The Liquidator may not carry his burden through conclusory statements; the full factual record must show that the Agreement is objectively fair and reasonable. *See Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc., v. Anderson*, 390 U.S. 414, 424 (1968); *In re American Mut.*, 632 N.E. 2d at 1217; In re Harvard Pilgrim Health Care, Inc., 76 N.E. 2d 513, 521-22 (Mass. 2001). Accordingly, the Court must reject the Agreement unless the facts prove up each particular element of the Liquidator's case. As detailed below in Section III.C., the Liquidator would have to establish the following facts in order to prevail:

- **The Liquidator has to prove by a preponderance of the evidence that the Agreement was a settlement of some dispute.** But the Liquidator has conceded, and the facts demonstrate, that the goal of the Agreement was to provide the AFIA Cedents with an incentive to file and prosecute their claims -- not to settle a dispute. The Findings of Fact detail why there was no actual dispute being settled here. (Findings of Fact, at ¶ I, page 42.)

- **The Liquidator has to prove by a preponderance of the evidence that there was an objectively realistic and credible threat that assets of Home would be "ring fenced" in the United Kingdom.** The credibility of this threat is best demonstrated by the Liquidator's decision to withdraw "ring fencing" as a justification for the Agreement. The Findings of Fact detail why ring fencing was never a credible or realistic threat. (Findings of Fact, at ¶¶ 95-105.)

- **The Liquidator has to prove by a preponderance of the evidence that there was an objectively realistic and credible threat that the AFIA Cedents would "cut through" to the ACE Companies.** But the facts conclusively demonstrate that there was no prospect of "cut through." It is not surprising, then, that the Liquidator also has withdrawn this "threat" as a justification for the Agreement. The Findings of Fact detail why there was never a credible or realistic threat of "cut throughs." (Findings of Fact, at ¶¶ 111-21.)
- **The Liquidator has to prove by a preponderance of the evidence that there was an objectively realistic and credible threat that a court would find an assumption by the ACE Companies of Home's liabilities to the AFIA Cedents via a "constructive" or "forced" novation.** The evidence demonstrates that all parties knew that such a novation could not be found; the Findings of Fact show why novation was never a realistic or credible threat. (Findings of Fact, at ¶¶ 106-110.)
- **The Liquidator has to prove by a preponderance of the evidence that there was an objectively realistic and credible threat that AFIA Cedents would negotiate "side deals" with the ACE Companies.** The evidence, as detailed in the Findings of Fact, dispels any claim that side deals were even raised by AFIA Cedents, let alone contemplated by the ACE Companies, so side deals could not have been realistic or credible threats. (Findings of Fact, at ¶¶ 122-56.)

  The Liquidator has placed great emphasis on the threat of side deals, particularly an alleged side deal between the ACE Companies and Equitas on the AFIA liabilities. However, the ACE Companies and Equitas never discussed such a deal, and no one ever told Home -- prior to the decision to pursue an agreement with the AFIA Cedents -- that the ACE Companies and Equitas were discussing an AFIA-related commutation. The only evidence cited to by the Liquidator at the evidentiary hearing was an alleged

"intimation" by Mr. Williams of Equitas that the ACE Companies and Equitas were in discussions. Mr. Bengelsdorf captured the glaring weakness of that evidence when he described the conversation as follows: "[Mr. Rosen] inferred that there was an intimation that Equitas might be talking to ACE. ...[t]hat's all it was[,] an intimation, a discussion heard of someone else that may have heard something." (Bengelsdorf, Vol. 3-B, at 145:8-11.)

B. THE COURT MUST INDEPENDENTLY ASSESS THE FAIRNESS AND REASONABLENESS OF THE AGREEMENT

As recognized in the Order on Remand, this Court is required to independently assess the grounds for the Liquidator's allegation that the Agreement is objectively fair and reasonable, rather than give undue deference to the Liquidator's assertions. The Court's role is "quasi-inquisitorial"; the 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." *In re Boston & Providence R.R. Corp.*, 673 F.2d 11, 12 (1st Cir. 1982) (emphasis added) (citing *Protective Comm.*, 390 U.S. at 424 (same)). The Court's independent analysis must be sufficiently detailed to allow a reviewing court to distinguish it from "'mere boilerplate approval'" of the Liquidator's purported justifications for the Agreement. *Id.*

C. THE AGREEMENT IS NOT FAIR OR REASONABLE UNDER THE STANDARD MANDATED BY THE SUPREME COURT ORDER

1. The Applicable Four Factor Test

The two cases cited by the Supreme Court, as well as other case law on point, set forth the standard to be applied to determine the fairness and reasonableness of the Agreement. *See In re Estate of Indian Motorcycle Mfg., Inc.*, 299 B.R. 8, 20 (D. Mass. 2003) (citing *Jeffrey v. Desmond*, 70 F.3d 183, 185 (1st Cir. 1995)); *see also In re Boston*, 673 F.2d at 12; *In re GHR*, 50 B.R. at 931. They require this Court to consider four factors underlying the Liquidator's allegations that litigations or other "threats" justify the Agreement:

- As a threshold matter, whether a reasonable liquidator would have believed that the

threatened litigations would even have taken place. The Findings of Fact detail why there was never a prospect of litigation over ring fencing, cut through, constructive novation, or side deals. (Findings of Fact, at ¶¶ 95-156.)

- Whether a reasonable liquidator would have believed that the threatened litigations would be complex. The Findings of Fact demonstrate that there was no risk of complicated litigation. (Findings of Fact, at ¶¶ 98-105, 107-109, 113-20, 124-27.)
- The costs and expenses that a reasonable liquidator would have believed the estate would incur. The Findings of Fact establish that Home never assessed the costs and expenses of litigation. (Findings of Fact, at ¶¶ 104, 109, 121, 122.)
- The likelihood that Home would prevail in such litigations, as perceived by a reasonable liquidator. With respect to each threatened litigation, the Findings of Fact detail why Home would have easily prevailed. (Findings of Fact, at ¶¶ 98-105, 107-109, 113-20, 124-27.)

In considering these factors, the Liquidator's actual, subjective belief is irrelevant; the reasonableness and fairness of the Agreement is held to an objective standard. *See, e.g.*, *In re Boston*, 673 F.2d at 12. That standard accords with United States Supreme Court precedent. *See Protective Comm.*, 390 U.S. at 424. Thus, the dispositive "state of mind" for determining the fairness and reasonableness of the Agreement is the state of mind of an objectively reasonable liquidator under the circumstances. (Vol. 1-A, at 97:21-23.)

2. Application of the Four Factor Test

As established in detail by the Findings of Fact, the facts before this Court demonstrate:

- None of the alleged litigations threatened by the Liquidator would have taken place. (Findings of Fact, at ¶¶ 95-156.) Rather than settling a dispute, the Agreement provides an incentive for the filing and prosecution of claims. (Findings of Fact, at ¶ I, page 42.)
- Any litigation that might have arisen would not have been complex because the

controlling precedent is unambiguous. (Findings of Fact, at ¶¶ 98-105, 107-109, 113-20, 124-27.)

- The costs of litigating the alleged threats by the AFIA Cedents would have been borne in large measure by the ACE Companies, who (i) had already litigated "cut throughs" up to the Sixth Circuit; and (ii) had no incentive to face double liability anyway. In any event, the Liquidator has never determined what those costs might be. (Findings of Fact, at ¶¶ 104, 109, 115-16, 121, 122, 126.)
- Home undoubtedly would have prevailed in any such litigation. (Findings of Fact, at ¶¶ 98-105, 107-109, 113-20, 124-27.)

Accordingly, the Agreement is neither fair nor reasonable, and it should be rejected by the Court.

D. THE ALLEGED NECESSITY OF THE AGREEMENT IS NOT BEFORE THIS COURT

The Supreme Court Order remanded to the Court to determine, *inter alia*, whether it has an "independent obligation to assess the fairness" of the Agreement. (*See* Supreme Court Order at 1-2.) The Supreme Court Order does not, however, require that the Court determine whether it has an obligation to determine whether the Agreement is necessary. Consistent with that mandate, the case law cited by the Supreme Court addressed only the fairness and reasonableness of proposed settlements, but not whether such settlements are necessary. *Id.* Although the Supreme Court Order mandated consideration of whether payments under the Agreement would be "necessary costs of preserving or recovering the assets of the insurer" under RSA 402-C:44, that portion of the Supreme Court Order relates to the administrative expense issue (which was decided by the Court in the Order on Remand). The Supreme Court Order does not even suggest that the "necessity" requirement for administrative costs bears any relation to the Court's "independent obligation to assess the fairness" of the Agreement. *Id.* Indeed, the Court's Order on Remand draws a distinction between the two issues, recognizing that payments under the

Agreement might be administrative expenses, but that the Agreement nonetheless might be unfair and unreasonable: "In sum, at this point the Court requests that the Supreme Court decide the legal issue, whether the payment to AFIA Cedents qualifies as an administrative expense, before the Court conducts any reasonableness/fairness hearing." (Order on Remand at 13.) Therefore, based upon the Supreme Court Order, the case law cited by the Supreme Court, and this Court's own Order on Remand, the fairness and reasonableness of the Agreement are before this Court, but its alleged necessity is not. Were it otherwise, any agreement that violates the law but brings in assets would be endorsable on the grounds of expediency. It would be an open invitation to collusion and, potentially, fraud.

Moreover, the Court need not reach the subsidiary issue of whether the Agreement is necessary because the Liquidator has not satisfied the threshold test of proving that the Agreement is fair and reasonable. Accordingly, the necessity issue is not before the Court.

E. EVEN IF THE ALLEGED NECESSITY OF THE AGREEMENT WERE RELEVANT HERE AND THE AGREEMENT IS FOUND TO BE FAIR AND REASONABLE, THE LIQUIDATOR HAS FAILED TO MEET HIS BURDEN OF PROVING THAT THE AGREEMENT IS NECESSARY

1. The Agreement Is "Necessary" Only If, in the Absence of the Agreement, the AFIA Cedents Would Not File and Prosecute Claims

The Liquidator cannot deny the plain and ordinary meaning of the term "necessary": "1. Being such in its nature that it must exist, occur, or be true; inevitable. 2. Absolutely needed to accomplish a desired result." *Webster's Concise Dictionary of the English Language*, p. 484 (Int'l Enc. Ed. 1998). Other courts have given the term "necessary" its ordinary dictionary definition. *See, e.g., United Savings Ass'n v. Timbers of Inwood Forest*, 484 U.S. 365, 375-76 (1988) (the term "necessary to an effective reorganization" in Section 362(d)(2) of the Bankruptcy Code means "essential for an effective reorganization"). Therefore, the question before the Court is not whether the Agreement is an expedient method of encouraging AFIA

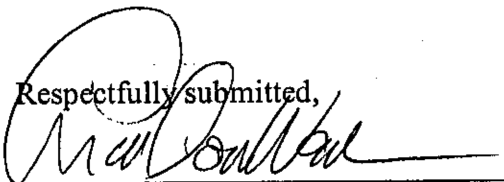
Cedents to file and prosecute claims. The question is whether, in the absence of the Agreement, the AFIA Cedents would have filed and prosecuted their claims.

2. The Agreement Is Not Necessary to Encourage AFIA Cedents to File and Prosecute Claims

As detailed in the Findings of Fact, the evidence shows that the AFIA Cedents would have filed and prosecuted claims even in the absence of the Agreement. (Findings of Fact, at ¶¶ 85-90, 157-68.) To find otherwise would turn upside down the practice in every insurance insolvency of a property and casualty company in the history of the United States. Thus, the Agreement is unnecessary and should be rejected by the Court.

WHEREFORE, the ACE Companies respectfully request that the Court approve the ACE Companies' Request for Findings of Fact and Rulings of Law and grant the ACE Companies such other and further relief as may be just and proper.

Respectfully submitted,



Lisa Snow Wade
ORR & RENO, Professional Association
One Eagle Square
P.O. Box 3550
Concord, New Hampshire 03302-3550
Telephone (603) 224-2381

-and-

Gary S. Lee
Karen Ostad
Pieter Van Tol
LOVELLS
900 Third Avenue, 16th Floor
New York, New York 10022
Telephone (212) 909-0600

Attorneys for Respondents Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company, and ACE American Reinsurance Company

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 August 12, 2005:

Paula T. Rogers, Esq.
Case Administrator
Office of the Liquidation Clerk
The Home Insurance Company
286 Commercial Street
Manchester, NH 03101

Suzanne M. Gorman, Esq.
Senior Assistant Attorney General
Environmental Protection Bureau
New Hampshire Department of Justice
Attorney General's Office
33 Capitol Street
Concord, NH 03301-6397

J. David Leslie, Esq.
Eric. A. Smith, Esq.
Rackemann, Sawyer & Brewster
One Financial Center
Boston, MA 02111

Andre Bouffard, Esq.
Downs, Rachlin, Martin, PLLC
199 Main Street
Box 190
Burlington, VT 05402

Eric D. Jones, Esq.
Downs, Rachlin, Martin PLLC
199 Main Street
Box 190
Burlington, VT 05402

Peter G. Callaghan, Esq.
Preti, Flaherty, Beliveau, Pachios & Haley, PLLP
57 North Main Street
PO Box 1318
Concord, NH 03302-1318

Martin P. Honigberg, Esq.
Sulloway & Hollis, PLLC
9 Capitol Street
P.O. Box 1256
Concord, NH 03302-1256

George T. Campbell, Esq.
Robert Stein & Associates, PLLC
One Barberry Lane
P.O. Box 2159
Concord, NH 03302-2159

David Steinberg, Esq.
Clifford Chance LLP
10 Upper Bank Street
Canary Wharf
London E14 5JJ
United Kingdom

Jack B. Gordon, Esq.
Fried Frank Harris Shriver & Jacobson LLP
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505

David M. Spector, Esq.
Dennis G. LaGory, Esq.
Kristy L. Allen, Esq.
Schiff Hardin LLP
6600 Sears Tower
Chicago, IL 6060

Andrew W. Serell, Esq.
Rath, Young and Pignatelli
One Capital Plaza
P.O. Box 1500
Concord, NH 03302-1500

Lisa Snow Wade

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