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

CENTURY INDEMNITY COMPANY'S REPLY TO LIQUIDATOR'S OBJECTION TO MOTION FOR STAY OF ARBITRATION OF KWELM CLAIMS AGAINST HOME AND CROSS-MOTION TO COMPEL ARBITRATION

Century Indemnity Company ("CIC"), by its undersigned counsel, hereby submits its reply to the Liquidator's objection to CIC's motion for stay of the arbitration of KWELM claims against Home demanded by the Liquidator and the Liquidator's cross-motion to compel arbitration.

1. The Liquidator's objection simply reinforces the point made by CIC in its motion for a stay: the Liquidator is attempting to accomplish through arbitration what Judge McGuire, in her ruling on the Liquidator's Report and Recommendation on the KWELM Proofs of Claim, said he may not do—seek allowance of the KWELM claims outside the Protocol.[1] Judge McGuire in the July 27 Order made it clear that the Liquidator must submit KWELM claims for consideration and adjustment in accordance with the Protocol in order to seek their allowance against the Home estate. Judge McGuire could not have been more explicit on that point. And although the Liquidator invokes Paragraph 2.5 of the Protocol in demanding arbitration of the KWELM claims, he has leap-frogged over the pre-requisite steps in Paragraphs 2.2 and 2.3. The

[1] Unless otherwise noted, all defined terms herein have the same meaning ascribed in CIC's motion for stay of arbitration of KWELM claims against Home, dated December 15, 2006.

Liquidator has not properly submitted anything for CIC to consider and adjust under the Protocol and the Liquidator's arbitration demand is plainly premature.

2. Although the Liquidator asserts it with mantra-like repetitiveness, CIC does not contend that the Protocol doesn't apply to the KWELM claims, but only that the Liquidator has not yet presented CIC with any claims to consider under the Protocol. This is a very different position and one the Liquidator tries to gloss over by arguing that CIC is estopped from preventing arbitration.

3. The Liquidator would have this Court believe that it has adequately presented and substantiated the KWELM claims to CIC for review. This Court, however, has already determined that the setoff assessments issued by the KWELM Scheme Adjudicator may not be admitted as allowed claims against Home because the procedures employed under the KWELM Scheme are not equivalent to the Court-approved Protocol and this Court's Claims Procedures Order, which together exclusively govern the submission, adjustment and adjudication of AFIA liabilities against Home's estate. The Liquidator, however, wholly disregards this Court's order and demands arbitration of the KWELM "claims" without first having submitted them to CIC for review and adjustment as required by the Protocol.

4. As CIC stated before this Court at the hearing on the Liquidator's Report, and as it has done in practice, CIC is fully prepared to review KWELM claims if submitted to it as required by the Protocol. Indeed, since issuance of the July 27 Order, the Liquidator has presented additional KWELM claims to CIC for consideration and adjustment and CIC has approved allowance of more than $400,000. Unless the claims are presented to CIC in the

manner of these agreed claims, however, this Court has already ruled in the July 27 Order that they may not be allowed against the Home estate.

I.
THE JULY 27 ORDER REQUIRES SUBMISSION OF THE KWELM CLAIMS PURSUANT TO THE PROTOCOL

5. CIC does not "fundamentally misconstrue" the July 27 Order, as the Liquidator would have this Court believe. It is not CIC's position that the July 27 Order requires denial of the KWELM claims, but rather that it mandates that any KWELM claims against Home's estate be presented for consideration and adjustment in accordance with the Protocol. In the July 27 Order, Judge McGuire noted that CIC and the Liquidator had "carefully considered and agreed upon detailed procedures to address anticipated disputes over AFIA claims in the Home Liquidation" and that "[a] lengthy protocol governing the handling of AFIA related claims was submitted to the Court for review and approval [that] included protocols for disputes involving contracts implicating English law." July 27 Order at 5. Based on the submissions of the parties and argument at the hearing, Judge McGuire found that "the Court is unable to conclude that the procedures used to establish KWELM companies' setoff entitlements meaningfully correspond to the procedures and protocol addressing AFIA related claims in the Home estate, nor is the Court able to find a compelling reason for setting those procedures and protocols aside for this discrete set of claims." Id.

6. CIC seeks to stay the Liquidator's arbitration demand not because it is made under the Protocol, but because the Liquidator seeks to arbitrate claims that have not yet been properly presented to CIC under the Protocol. In the July 27 Order, Judge McGuire told the Liquidator to go back to the Protocol and follow it if he wants to seek allowance of the KWELM claims. There is nothing in the July 27 Order which supports the Liquidator's skipping straight to arbitration of

the KWELM claims without first submitting them for adjustment pursuant to Paragraphs 2.2 and 2.3 of the Protocol. As Judge McGuire said, the Court is unable "to find a compelling reason for setting those procedures and protocols aside for this discrete set of claims." July 27 Order at 5

7. Because CIC is not asserting that the Protocol does not apply, the Liquidator's arguments regarding estoppel are inapplicable. The Protocol does apply—*all of it*, not just the arbitration provision that the Liquidator clearly views as the most convenient and efficacious way of seeking allowance of the KWELM claims in the face of the July 27 Order. For this reason, the Liquidator's argument regarding CIC's estoppel from arguing that the KWELM claims are not properly arbitrable under the Protocol is ill-conceived. CIC argues only that the KWELM claims are not arbitrable *now*, prior to proper submission, consideration and adjustment under the Protocol. If, after proper submission and review pursuant to the Protocol, the Liquidator and Home disagree on allowance of the claim, arbitration may be commenced under Paragraph 2.5 of the Protocol.

II.
CIC HAS AGREED KWELM CLAIMS WHEN PROPERLY PRESENTED UNDER THE PROTOCOL

8. CIC made it clear at the June 2, 2006 hearing on the Liquidator's Report that it would consider KWELM claims if and when properly presented under the Protocol. As CIC's counsel stated:

> "KWELM has been very active in filing its claims, and indeed I understand that ACE has adjusted and agreed about $1.7 Million of the $3.9 Million in claims. In other words, the claims that we don't dispute, we've already agreed, and not only have we agreed them, they've all been admitted. They've all gone through the Protocol, they've all gone through the adjustment process, and we've agreed them, okay?
>
> ...

> And they've [the $1.7 Million in agreed claims] been admitted, I think, in front—they've been admitted into the estate because everybody recognized that's the only way to do it. … When we see claims we agree, we agree them. $1.7 Million is not an insignificant amount out of 3.9."

See June 2, 2006 Hearing Transcript at 16, lines 13-20; 17, lines 12-14, 24-25, and 18, line 1, attached as Exhibit A.

9. In fact, since issuance of the July 27 Order, the Liquidator has presented KWELM claims to CIC for consideration and adjustment under the Protocol, and CIC has recommended allowance of $420,000 (in addition to the approximately $1.7 Million in KWELM claims agreed to by AISUK in accordance with the Protocol prior the KWELM Scheme Adjudicator's setoff assessment).

10. CIC's consideration and agreement to KWELM claims when properly presented under the Protocol belies the Liquidator's insistence that CIC seeks to ignore the Protocol. Even more, CIC's on-going agreement to properly presented KWELM claims highlights the alarmist hyperbole of the Liquidator's claim that CIC seeks to avoid the Protocol and reap a windfall at the expense of Home's policyholders and other creditors. *See* Liquidator's Objection at ¶ 24. That is a scare tactic designed to distract this Court from CIC's real and continuing agreement to consider, adjust and admit properly presented KWELM claims.

III.
LIQUIDATOR HAS NOT YET PRESENTED KWLEM CLAIMS FOR CONSIDERATION UNDER THE PROTOCOL

11. The Liquidator incorrectly maintains that it has already submitted the KWELM claims for review by CIC in accordance with the Protocol. Liquidator's Objection at 7. What the Liquidator provided to CIC, and what he contends satisfies the procedural requirements of

Paragraph 2.2 of the Protocol, were nothing more than KWELM proofs of claims presented to the KWELM Scheme Adjudicator for setoff purposes and the KWELM Scheme Adjudicator's setoff assessment—and which were, in fact, the same materials before this Court in the Liquidator's Report that Judge McGuire said could not form the basis of an allowed claim against Home. *See* Liquidator's Objection, Exhibit B.

12. The Liquidator, however, has not provided CIC with any of the underlying substantiating information required by CIC to adequately consider and adjust claims. And the self-same KWELM Scheme documentation supplied by the Liquidator once again, was recognized by Judge McGuire in the July 27 Order to be inadequate given that she was "unable to conclude that the procedures used to establish KWELM companies' setoff entitlements meaningfully correspond to the procedures and protocol addressing AFIA related claims in the Home estate." July 27 Order at 5.

13. In its opposition to the Report and at the June 2, 2006 hearing thereon before Judge McGuire, CIC made it very clear that the KWELM Scheme Adjudicator's non-judicial process for assessment of setoff balances bore no resemblance to New Hampshire's exclusive procedure for the adjustment, adjudication and allowance of claims against Home's estate under New Hampshire RSA §§ 402-C:37 and C:38 (the "RSA"), the Protocol and the Claims Procedures Order. The KWELM setoff assessment process, which provides no opportunity to make oral argument or advocate positions, no reasonable deadlines or time periods for addressing complex issues and no rights of arbitration or appeal, are aimed only at arriving at "rough justice" setoff balances. The KWELM process makes no attempt at determining debtor balances whatsoever, let alone in a manner consistent with New Hampshire law.

14. For these reasons, Judge McGuire found that Section 304 did not compel recognition of the KWELM Scheme Adjudicator's setoff assessments because the KWELM Scheme does not meaningfully correspond to the procedural protections of the New Hampshire liquidation statute. As Judge McGuire stated, "the Court is unable to conclude that the procedures used to establish KWELM companies' setoff entitlements meaningfully correspond to the procedures and protocol addressing AFIA related claims in the Home estate." July 27 Order at 5. That is, however, precisely what the Liquidator seeks to do here without the review that Judge Mcguire required.

15. CIC moves to stay the arbitration demanded by the Liquidator not because it may incur some irreparable injury if it us compelled to arbitrate, but to enforce compliance with the July 27 Order and the Protocol. The Court has made it clear that there is only one way for the Liquidator to gain allowance of AFIA-related claims against Home's estate, and that is to follow the Protocol. The Liquidator's premature arbitration demand, therefore, must be stayed.

IV.
CONCLUSION

Accordingly, CIC respectfully requests that the Court enter an Order:

A. Staying arbitration demanded by the Liquidator under ¶ 2.5 of the Protocol of the KWELM companies' setoff assessments as claims against Home's estate;

B. Directing the Liquidator to submit KWELM claims, if at all, in accordance with the Protocol and Claims Procedures Order;

C. Denying the Liquidator's cross-motion to compel arbitration; and

D. Granting such other and further relief as this Court deems just and proper.

Dated: January 10, 2007

Respectfully submitted,

By: ______________________

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CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing document has been served on Roger A. Sevigny, Commissioner of Insurance, Peter Bengelsdorf, Special Deputy, and the following counsel via First Class mail on January 10, 2007:

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EXHIBIT A

1 THE STATE OF NEW HAMPSHIRE

2 MERRIMACK, S.S.

COPY

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4 *

5 IN THE MATTER OF THE LIQUIDATION OF THE HOME INSURANCE COMPANY

6 DOCKET NO. 03-E-0106

7 *

8 MOTION HEARING

9 TRANSCRIPT OF MOTION HEARING, ELECTRONICALLY RECORDED AT THE

10 MERRIMACK COUNTY SUPERIOR COURT, CONCORD, NEW HAMPSHIRE, ON

11 JUNE 2, 2006 BEFORE THE HONORABLE KATHLEEN A. MCGUIRE,

12 PRESIDING JUSTICE

13

14 Appearances:

15 For the Petitioner: J. David Leslie, Esq.

16 Eric Smith, Esq.

17 J. Christopher Marshall, Esq.

18 For the Respondent: Lisa Snow Wade, Esq.

19 Matthew P. Morris, Esq.

20 Gary Lee, Esq.

21 Court Monitor: Janet Labbe

22 Transcriber: Glusker Reporting Service

23 44 S. Chestnut St.

24 Augusta, ME 04330

25 (207) 622-0842

1 THE BAILIFF: Ladies and gentlemen, please rise for
2 the Honorable Court.
3 THE COURT: Good morning.
4 ALL REPLY: Good morning.
5 THE BAILIFF: Merrimack County Superior Court is now
6 reconvened. You may be seated.
7 THE COURT: It's been a calm week. Okay. This is
8 the Liquidator's motion. Mr. Leslie?
9 MR. LESLIE: Your Honor, if it please the Court, the
10 Liquidator has a motion before the Court, which was filed in
11 March for the allowance of KWELM's claim against Home in the
12 amount of $3,910,842. The amount of that claim is based on a
13 determination made by the scheme adjudicator in KWELM's U.K.
14 scheme proceedings, and so the $3,910,000 is the number the
15 scheme adjudicator determined after a proceeding there. In
16 our view, the scheme, the U.K. scheme, has the force of law in
17 the United States pursuant to the section 304 order entered by
18 the U.S. bankruptcy court for the southern district of New
19 York. We believe that -- contrary to ACE's assertion, we
20 believe that 304 order applies to the scheme in its entirety
21 to U.S. creditors. It's not a mere channeling order but, in
22 fact, the procedures, the practice, the application of the
23 scheme apply to U.S. creditors pursuant to that 304 order, and
24 I think the plain language of the order reflects that, and
25 we've provided that in our papers to the Court. We further

1 the scheme administrator's letter stating they don't intend to
2 do anything further doesn't really prove anything. It doesn't
3 prove anything because the brokers continue to present and
4 prosecute the bundled HS Weavers claims for the solvent
5 companies, and, in fact, what we've been getting as recently
6 as the end of March this year is a letter from the broker or
7 from KMS talking about a specific claim, and on five or
8 different sheets of paper you've got the policyholder, and
9 then you've got the name of each one of the different HS
10 Weavers companies underneath it, breaking down their
11 percentages, pushing claims through, as recently as March. I
12 think another fact worth bearing in mind, Your Honor, is, in
13 fact, $3.7 million is not what's in dispute here. KWELM has
14 been very active in filing its claims, and indeed I understand
15 that ACE has adjusted and agreed about $1.7 million of the
16 $3.9 million it claims. In other words, the claims that we
17 don't dispute, we've already agreed, and not only have we
18 agreed them, they've all been admitted. They've all gone
19 through the protocol, they've all gone through the adjustment
20 process, and we've agreed them, okay? So now, all of a
21 sudden, there's this full stop.
22 THE COURT: There's this what?
23 MR. LEE: This full stop in the process.
24 THE COURT: Full stop?
25 MR. LEE: Yes. Complete stop in the process.

1 Everybody understands you've got to follow the protocol,
2 everybody understands you've got exclusive jurisdiction,
3 everybody understands the claims procedures order is the only
4 way for a foreign creditor to prove in the New Hampshire
5 liquidation of Home, and they've been doing it. We've gotten
6 halfway through their claims already.
7 THE COURT: So are you saying the -- that actually
8 that's not 3.9 million but 2.2 million?
9 MR. LEE: That's correct, Your Honor.
10 THE COURT: Because you've gone through the protocol
11 on 1.7 million?
12 MR. LEE: And they've been admitted, I think, in
13 front -- they're admitted into the estate because everybody
14 recognized that's the only way to do it. So if we understand
15 that until February of this year, you had exclusive
16 jurisdiction over the way in which claims came through into
17 this estate, then the question is whether or not the
18 assessment that took place suddenly deprives you of exclusive
19 jurisdiction of the way in which claims get presented,
20 adjusted, prosecuted in New Hampshire because that's
21 effectively what it does; it deprives you of your
22 jurisdiction, and now if we'd agreed to all of these claims,
23 obviously we wouldn't be here, Your Honor, but the reason
24 we're here is we didn't agree to these claims. When we see
25 claims we agree, we agree them. $1.7 million is not an

1 insignificant amount of money out of 3.9. I think it would
2 also be helpful for -- perhaps the Court's already heard
3 enough on what happens in the U.K., but I think it's important
4 to understand when the scheme is -- when the scheme was
5 approved, it put in place the person who is a scheme
6 adjudicator, and this is not a lawyer; it's not a judge, and
7 what happens is that both sides, basically, get an opportunity
8 to submit papers on, you know, what they think the overall
9 process at set off should be. So Home thinks they're owed
10 ten; KWELM thinks they're owed ten, and, you know, basically
11 he works it out; he does rough economic justice to what he
12 thinks the net number should be, and there's no oral arguments
13 in front of this non-lawyer, obviously. He's not an
14 adjudicator in that sense, and he's not looking at the
15 contracts. He's not trying to interpret the contracts. He's
16 not trying to interpret as a matter of --
17 THE COURT: What does he base the -- his judgment on
18 then?
19 MR. LEE: It's effectively a very high level
20 numerical wash, Your Honor. Most of the disputes go to what
21 I've described as things other than the claim-by-claim
22 analysis. What they really are is a high level analysis of
23 outstandings, claims that haven't really matured, that sort of
24 thing. I mean, that's really where most of the assessment
25 takes place. It doesn't really take place on an individual