**THE STATE OF NEW HAMPSHIRE**

**MERRIMACK, SS** **SUPERIOR COURT**

**Docket No. 03-E-0106**

**In the Matter of the Liquidation of**
**The Home Insurance Company**

**LIQUIDATOR'S SUR-REPLY IN OPPOSITION TO CIC'S MOTION TO LIFT STAY AND TO COMPEL ARBITRATION**

Roger A. Sevigny, Commissioner of Insurance for the State of New Hampshire, as Liquidator ("Liquidator") of The Home Insurance Company ("Home"), submits this Sur-reply to address new arguments raised in the Reply Memorandum of Century Indemnity Company in Further Support of Motion to Lift Stay and to Compel Arbitration ("Reply"). Specifically, this Sur-reply addresses CIC's attempt to draw an artificial distinction between its purported claim in arbitration and the liquidation, CIC's assertions regarding an alleged agreement to reserve the issue, and CIC's contentions regarding the Howsam decision. For the reasons set forth below, CIC's arguments should be rejected.

**1. CIC's Proposed Arbitration Is A Direct Attack On And Seeks To Nullify The Approval Order And The Public Policy Of The Act.**

In its reply, CIC attempts to portray its purported claim in arbitration as separate from the liquidation process and the Approval Order. Reply at 6-9. However, the issue CIC seeks to arbitrate – whether the incentive for AFIA Cedents for prosecute claims provided by the AFIA Agreement breaches the Assumption Agreement (see Reply at 4) – only arises because Home became insolvent. It is the application of the liquidation statute in the context of the Home liquidation that removed the usual incentive (payment) for AFIA Cedents to pursue claims with the result that CIC could avoid paying claims it would have paid if Home remained solvent. This is the windfall – an "unexpected piece of luck" (Reply at 10) from CIC's perspective – that CIC

is trying to preserve. The AFIA Agreement partially restored the AFIA Cedents' incentive to pursue valid claims by providing for some payment from net proceeds to the Cedents.

Having opposed approval of the AFIA Agreement based in part on the argument that this incentive is not permissible, CIC now seeks to make the same argument in the guise of a contractual right. This directly challenges the actions of the Liquidator (not of "Home" as CIC repeatedly suggests) that were approved by the Court in the Approval Order, attacks the policy of full collection of reinsurance in liquidations found in RSA 402-C:36 and RSA 405:49, I, and seeks to nullify the Court's approval of the AFIA Agreement as lawful and necessary to collect an asset of the estate (reinsurance under the Assumption Agreement).[1]

CIC's own letters contradict its assertion that the relief requested would not nullify the Approval Order because the relief is only prospective, not restitutionary. Reply at 22. The April 1, 2008 arbitration demand requests a declaration that "any claim" submitted pursuant to the AFIA Agreement "is not reinsured by CIC" and adds that CIC "will also seek other related relief from the Panel." CIC Ex. E at 1-2. It does not suggest that payments made by CIC prior to the declaration are excluded, and the phrase "related relief" logically includes restitution. If there were any doubt, CIC's April 1, 2008 letter to the Liquidator plainly advises that all CIC payments are subject to being clawed back. It states that the March 2008 claim payment "as well as any other payments that will be made by CIC on future approved claims, is made under a full reservation of rights by CIC." Liq. Ex. 4 at 3. In any event, even if CIC were now to agree that payments made during the pendency of arbitration were final, the Approval Order would be

[1] The Liquidator has not addressed the merits of CIC's asserted contractual right under the Assumption Agreement because there is no need to reach it due to the preliminary matters raised in the Liquidator's Objection. The Liquidator notes, however, that CIC fails to point to any provision of the Assumption Agreement as supporting its position. Reply 4. The only provision that addresses liquidation is the insolvency clause (paragraph 6), which provides that in the event of the insolvency of Home the INA (now CIC) reinsurance is to be paid to Home's liquidator "without diminution because of the insolvency." CIC Ex. A ¶ 6 (at page 5). Perhaps because of this lack of textual support, CIC frames its argument in terms of "utmost good faith," but none of the "utmost good faith" cases it cites is remotely on point or even involves an insolvency.

effectively nullified if CIC were to prevail in arbitration because those payments are small compared to the ultimate amounts projected to be collected. See Approval Order at 32-33.

### 2. Res Judicata Is Proper Because CIC Could Have Presented Its Claim In The Earlier Proceedings, And Neither The Court Nor The Liquidator Agreed To Reserve The Issue.

CIC opposed approval of the AFIA Agreement in part on the ground that the incentive provided by the agreement was impermissible under the Act. CIC now asserts that it could not argue that the incentive was impermissible under the Assumption Agreement because it was required to arbitrate. Reply at 14-15. An arbitration clause, however, does not preclude litigation. If that were the case, there would never be litigation over a contract with an arbitration clause or a waiver of arbitration rights. CIC had a choice. It could have either (1) participated in the approval proceedings and expressly raised the issue, (2) participated in the proceedings and also demanded arbitration, in which case the proper relationship between the court and arbitrator would have been long ago resolved, or (3) not participated at all. The option CIC did not have was to intervene as a party while sitting on its asserted arbitration claim only to raise the matter years after the adverse result in litigation.[2]

The Liquidator previously showed that a unilateral reservation of rights, as originally contended by CIC, is insufficient to avoid res judicata. Liq. Mem. at 20-21.[3] In its reply, CIC asserts that the Court reserved CIC's right to arbitrate in approving the Claims Protocol, that the

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[2] CIC's assertion that the presence of BMC and the AFIA Cedents in the approval proceedings prevented arbitration (Reply at 15) is mistaken. Neither BMC (a policyholder) nor the AFIA Cedents (who participated only as witnesses and in responding to ACE third party discovery requests) are necessary parties to a proceeding over CIC's claim that the Liquidator breached the Assumption Agreement (to which they are not party). In any event, CIC could not have demanded arbitration of the Liquidator's motion for approval of the AFIA Agreement.

[3] Even if the reservation could be effective, CIC modified it by subsequently choosing to assert debtor interests and contend that the negotiation of the AFIA Agreement and the agreement itself was unfair to ACE. See Berenson v. Nat'l Fin. Serv., LLC, 485 F.3d 35, 43-44 (1st Cir. 2007).

Liquidator agreed to this in the Claims Protocol, and that the Liquidator "acquiesced" in CIC's splitting of its claim. Reply at 18-21. None of these assertions withstands scrutiny.

The Court's order only approved the Claims Protocol. Liq. Ex. 14. The Court did not "expressly reserve" [CIC's] "right to maintain" any action or arbitration as required for this exception to res judicata. Restatement (Second) of Judgments § 26(b) and comment b (1982). See Apparel Art. Int'l, Inc. v. Amertex Enterprises, Inc., 48 F.3d 576, 586 (1st Cir. 1995) (looking to whether "the court in an earlier action expressly reserves the litigant's right to bring those claims in a later action"). Nor did the Liquidator agree in the Claims Protocol that CIC could later assert a breach of contract. The paragraph cited by CIC merely states that "[n]othing in this letter shall be construed so as to prejudice, negate or otherwise interfere with the rights of CIC . . . ." Claims Protocol ¶ 7.2 (CIC Ex. D).[4] It provides only that the Claims Protocol itself will not limit CIC's rights under other agreements, not that the Liquidator agrees that CIC may later assert claims or defenses under those agreements that otherwise would be barred by res judicata. Cf. In re Bankvest Capital Corp., 375 F.3d 51, 59, 70 (1st Cir. 2004) (confirmed liquidating plan expressly reserved right to litigate cause of action).

Finally, the Liquidator did not "acquiesce" in CIC's separate assertion of its present arguments. The acquiescence exception applies where a party "is simultaneously maintaining separate actions based upon parts of the same claim" and the other does not object. Restatement

[4] Paragraph 7.2 provides in its entirety: "Nothing in this letter shall be construed so as to prejudice, negate or otherwise interfere with the rights of CIC, CIRC or any other company within the ACE group of insurance [sic] undertakings as against HICIL whether under the Agreements or otherwise including the right to assert that neither CIC nor CIRC has any contractual obligation to indemnify HICIL with respect to AFIA Liabilities or AFIA License Business, and in particular, but without derogating from the generality of the foregoing: (i) if and to the extent that HICIL takes any action (or fails to take any action) the effect of which, subject to paragraph 2.8, is to undermine or interfere with defenses raised by CIC to a Claim, CIC reserves all of its rights in relation to any reinsurance or other indemnity or payment obligation (including pursuant to this letter agreement) regarding that Claim; and (ii) the payment obligations stated in this letter agreement are predicated upon (and are not separate and independent from) a payment obligation under the Agreements and, accordingly, CIC reserves all its rights to argue that any action taken (or not taken) by HICIL and/or the Liquidator that would vitiate the payment obligation under the relevant Agreement does vitiate that obligation and such shall apply equally to vitiate the corresponding obligation under this letter agreement." CIC Ex. D at 10-11 (emphasis added).

(Second) of Judgments § 26 comment a (1982). See Rosado v. Gen. Elec. Circuit Breakers, Inc., 805 F.2d 1085, 1087 (1st Cir. 1986) ("While the two actions were pending against defendant, defendant did not complain that plaintiff was splitting his cause of action and forcing defendant to defend in two forums."); Cowan v. Ernest Cordelia, P.C., 149 F. Supp.2d 67, 76 (S.D.N.Y. 2001) (defendants "did not at any time object" to splitting of claims into simultaneous federal and state court actions). Here, CIC did not bring an arbitration proceeding. The Liquidator could not "acquiesce" in duplicative proceedings that did not exist. CIC's argument that the AFIA Agreement breached the Assumption Agreement is barred by res judicata.[5]

### 3. The Howsam Decision Does Not Prevent The Court From Determining Issues Arising From Litigation Before The Court.

CIC contends that the Court may not consider whether its claim is barred by res judicata, collateral estoppel or laches in light of the Supreme Court's decision in Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79 (2002). Reply 12. Howsam is not on point, however, and its rationale does not extend to this case. It addressed the question whether the application of a time limit found in the National Association of Securities Dealers ("NASD") Code of Arbitration Procedure should be determined by a court or by an NASD arbitrator. Id., 537 U.S. at 82-83. The Supreme Court noted that certain "gateway" questions of arbitrability are for the courts "where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the courts avoids the risk of forcing parties to arbitrate a matter they may well not have agreed to arbitrate." Id. at 83-84. In holding that application of the NASD time limit did not fall in this class, the Supreme Court

[5] The Supreme Court's decision in Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 105 S. Ct. 1238 (1985), held only that a motion to compel arbitration of arbitrable claims may not be denied because a lawsuit also includes non-arbitrable claims. It did not suggest that preclusion of "intertwining" arbitrable claims can be avoided where the party with such claims makes no effort to have them arbitrated.

noted that NASD arbitrators, "comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it." Id. at 85. It was accordingly "reasonable to infer," given the silence of the arbitration agreement, that the parties intended it to reflect that understanding. Id. The Supreme Court concluded "for the law to assume an expectation that aligns (1) decisionmaker with (2) comparative expertise will help better to secure a fair and expeditious resolution of the underlying controversy—a goal of arbitration systems and judicial systems alike." Id.

CIC attempts to sweep res judicata, collateral estoppel and laches (but not public policy) within Howsam based on that decision's references to a "presumption" that waiver, delay, or like defense to arbitrability are for an arbitrator, id. at 84, and its quotation of a comment to the Revised Uniform Arbitration Act that "issues of procedural arbitrability, *i.e.*, whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for arbitrators to decide." Id., quoting RUAA § 6, comment 2, 7 U.L.A. at 13 (2005). The courts, however, have not uncritically applied these dicta. For instance, the First Circuit has held that the issue of waiver of arbitration by litigation-related activity should be determined by the courts, notwithstanding the reference to waiver in Howsam. Marie v. Allied Home Mortgage Corp., 402 F.3d 1, 12-14 (1st Cir. 2005).[6] The First Circuit identified "important policy reasons" why a court and not an arbitrator should decide waiver issues arising from litigation: the court has "power to control the course of proceedings before it and to correct abuses of those proceedings." Id. at 13. The "comparative expertise" considerations stressed in Howsam "argue for judges to decide this issue": judges are "well trained to recognize abusive forum shopping." Id. This inquiry "heavily implicates '*judicial*

[6] CIC does not seriously contend that the Court should not address waiver issues. See Reply at 29 & n.13. If the Court concludes that CIC waived its asserted right to arbitrate, then the Court need not address Howsam or the issues regarding the permissibility of arbitration under the Act, the FAA, and the McCarran-Ferguson Act.

procedures,' which Green Tree [Fin. Corp. v. Bazzle, 539 U.S. 444 (2003)] suggests should be an important factor in presuming that an issue is for the court." Id.[7]

These considerations also support the determination by the court, and not arbitrators, of res judicata, collateral estoppel and laches issues arising from prior litigation in the court. See Bryan County v. Yates Paving & Grading Co., 281 Ga. 361, 362-64 & n.2 (2006) (court must determine res judicata as part of its "gatekeeping role to determine if any arbitrable claim had been presented"; Howsam "does not compel a different result").[8] The issues here arise from the lengthy litigation between CIC and the Liquidator before the Court and the New Hampshire Supreme Court. The Court is better positioned than arbitrators to determine whether its Approval Order bars CIC's claim respecting the Liquidator's actions and whether CIC's conduct before the Court reflects unreasonable and prejudicial delay. The Court should also remain free to control the conduct of the parties to the proceedings before it and determine whether CIC can seek to nullify the Court's orders. The issues plainly implicate judicial procedures, as they involve years of prior litigation in the Court.

Where the Court is comparatively more expert about its own orders and the litigation before it, it is "reasonable to infer," in the absence of a statement to the contrary, that the parties to the Assumption Agreement intended the agreement to "reflect that understanding." See Howsam, 537 U.S. at 85. Nothing in the arbitration clause provides for arbitrators to determine

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[7] Accord, Ehleiter v. Grapetree Shores, Inc., 482 F.3d 207, 217-18 (3d Cir. 2007). State courts holding that the court and not arbitrators should determine litigation-related waiver issues have also focused on comparative expertise and emphasized that the matter arises from proceedings before the court. See Good Samaritan Coffee Co. v. LaRue Distributing, Inc., 275 Neb. 674, 681-84 (2008) (the court already involved in proceedings "is better positioned to determine whether such conduct amounts to a waiver under applicable law" and "should remain free to 'control the course of proceedings before it and to correct abuses"; furthermore, as the issue "necessarily involves matters occurring in the judicial forum, it is reasonable to believe the contracting parties would expect a court to decide" it.).

[8] See also W. Dow Hamm III Corp. v. Millenium Income Fund, LLC, 237 S.W.3d 745, 755 & n.11 (Tex. Ct. App. 2007) (noting that res judicata effect of prior-court-judgment is for court because "a court is inherently empowered to protect the integrity and finality of its own prior judgment, and this policy outweighs even the strong policy in favor of arbitration"; not deciding "what effect, if any," Howsam may have).

the effect of prior litigation between the parties. See CIC Ex. A, ¶ 7 (providing for arbitration of disputes between the parties "with reference to [the Assumption Agreement's] interpretation or their rights under it"). Indeed, it appears that the parties did not intend that matters concerning the liquidation of one of them would be arbitrated at all. The Assumption Agreement provides that it "shall be governed by and construed and enforced in accordance with the laws of the State of New York." Id. ¶ 10. Such a choice of law clause applies to the interpretation of the arbitration provision. See Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 109 S. Ct. 1248 (1989) (where contract with arbitration clause contained choice of law provision choosing California law, and that law did not require arbitration in a particular situation, arbitration not required under the FAA). At the time the Assumption Agreement was executed in 1984, it was already well established under New York law that the liquidator of an insolvent insurer could not be required to arbitrate. Matter of Knickerbocker Agency, Inc., 4 N.Y.2d 245, 251 (1958). The Assumption Agreement itself specifically refers in the insolvency clause to the New York Insurance Law provision concerning payment of reinsurance in the event of a Seller's liquidation. CIC Ex. A ¶ 6 (at page 6). In these circumstances, the Court is the proper forum for determination of the res judicata, collateral estoppel and laches issues.[9]

[9] CIC's reliance on Klay v. United Healthgroup, Inc., 376 F.3d 1092 (11th Cir. 2004), is misplaced. The Eleventh Circuit there only held that the district court improperly considered the justiciability (the existence of a "case or controversy") of a claim that the district court had already concluded was arbitrable. Id. at 1109-10. Klay did not involve the res judicata effect of any prior judgment. The Eleventh Circuit's discussion of that issue is dicta, and it did not address the considerations that the courts in Bryan County or in Marie and the other waiver cases discussed above found persuasive.

## CONCLUSION

For the reasons stated, the Court should deny CIC's motion.

Respectfully submitted,

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June 10, 2008.

## Certificate of Service

I hereby certify that a copy of the foregoing Liquidator's Sur-reply in Opposition to CIC's Motion to Lift Stay and to Compel Arbitration was sent, this 10th day of June, 2008, by overnight mail and email to counsel for CIC and by first class mail to all other persons on the attached service list.

Eric A. Smith

THE STATE OF NEW HAMPSHIRE

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