THE STATE OF NEW HAMPSHIRE
SUPREME COURT

In the Matter of the Liquidation of
The Home Insurance Company

No. 2005-0740

Appeal from the Final Decision of the
Merrimack County Superior Court

BRIEF FOR APPELLANTS CENTURY INDEMNITY COMPANY, ACE PROPERTY AND CASUALTY INSURANCE COMPANY, PACIFIC EMPLOYERS INSURANCE COMPANY AND ACE AMERICAN REINSURANCE COMPANY

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QUESTIONS PRESENTED FOR REVIEW

1. Did the Superior Court err in ruling that the Liquidator of The Home Insurance Company ("Home") was authorized, pursuant to the general provisions of RSA 402-C:1 and RSA 402-C:25, to enter into an agreement (the "Proposed Agreement") with a subclass of Class V creditors (the "AFIA Cedents") whereby the AFIA Cedents, contrary to the mandatory provisions of RSA 402-C:44, would receive claims distributions before the claimants in prior classes have been paid in full and in an amount different from the rest of the Class V creditors? (Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents (the "Motion"), Jt. App. at 67-69, ¶¶ 12-15; Objection and Response of ACE Companies to the Motion (the "ACE Companies' Objection"), Jt. App. at 101-104, ¶¶ 3-4, 7, 11.)

2. Did the Superior Court err in ruling that the payments to the AFIA Cedents under the Proposed Agreement, which are indisputably distributions and settlements directly related to pre-liquidation claims, would qualify as administrative costs pursuant to RSA 402-C:44, I? (Motion, Jt. App. at 72, ¶ 21; ACE Companies' Objection, Jt. App. at 105, ¶ 14.)

3. Did the Superior Court err in failing to evaluate the fairness and reasonableness of the Proposed Agreement in accordance with the multi-factor test set forth in the cases cited by this Court in the Order of September 13, 2004? (Motion, Jt. App. at 64-65, ¶ 7 and 71, ¶ 21; ACE Companies' Objection, Jt. App. at 103-105, ¶¶ 8-10, 13; Liquidator's Offer of Proof, Jt. App. at 502-510, ¶¶ 75-95; ACE Companies' Request for Findings of Fact and Rulings of Law (the "Proposed Findings of Fact and Rulings of Law"), Jt. App. at 609-615, ¶¶ A-CC.)

4. In determining whether the Proposed Agreement is fair and reasonable, did the Superior Court err in giving undue deference to the Liquidator's "business judgment" regarding the Proposed Agreement, where the controlling cases state that the Superior Court must play a "quasi-inquisitorial" role and the Liquidator's assessment of the fairness and reasonableness of the Proposed Agreement is contrary to the weight of the evidence? (Motion, Jt. App. at 64-65, ¶ 7 and 71, ¶ 21; ACE Companies' Objection, Jt. App. at 103-105, ¶¶ 8-10, 13; Liquidator's Offer of Proof, Jt. App. at 502-510, ¶¶ 75-95; Proposed Findings of Fact and Rulings of Law, Jt. App. at 610-15, ¶¶ D, H-CC.)

5. Did the Superior Court err in focusing on the reasonableness of the Liquidator's determination that the Proposed Agreement is necessary under RSA 402-C:25 rather than objectively examining whether the AFIA Cedents, in the absence of the Proposed Agreement, would have filed and prosecuted their claims in Home's estate? (Motion, Jt. App. at 64, ¶ 7 and 71, ¶ 21; ACE Companies' Objection, Jt. App. at 104, ¶ 12; Liquidator's Offer of Proof, Jt. App. at 502-510, ¶¶ 75-95; Proposed Findings of Fact and Rulings of Law, Jt. App. at 615, DD-II.)

STATUTES INVOLVED

The statute at issue in this appeal is the New Hampshire Insurers Rehabilitation and Liquidation Act (the "Act") and, specifically, the provisions of the Act in RSA 402-C:1, RSA 402-C:25 and RSA 402-C:44. (*See* Jt. App. at 1-8.)

STATEMENT OF THE CASE

Appellants Century Indemnity Company ("Century"), ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company, and ACE American Reinsurance Company (collectively, the "ACE Companies") appeal from an Order of the Merrimack County Superior Court (McGuire, J.), dated September 22, 2005 (the "September 2005 Order"), and a related Order on Remand, dated October 8, 2004 (the "Order on Remand") (collectively, the "Orders"), granting the Motion. (*See* September 2005 Order, Jt. App. at 25-59; Order on Remand, Jt. App. at 11-24.)

In the Orders, the Superior Court approved the Proposed Agreement between Home and a group of Class V creditors known as the AFIA Cedents, which contemplates the establishment of a novel "scheme of arrangement" for Home under English law (the "Scheme"). Pursuant to this unprecedented Scheme, the AFIA Cedents — who cede risk to Home under reinsurance agreements (the "AFIA Treaties") — would receive what the Liquidator has described as "incentive" payments in the range of $72 million in exchange for filing and prosecuting their pre-liquidation reinsurance claims against Home. The Liquidator has conceded that the incentive payments are distributions tied directly to the AFIA Cedents' claims against Home. (*See, e.g.*, Motion, Jt. App. at 65-72, ¶¶ 8, 10-15, 18 and 21; Proposed Agreement, Jt. App. at 77-78, ¶¶ 1.5.2; 1.9.1; Ellis Test., Vol. 2-B, at 135:10-136:18.)

This is the second time that the Court has considered the legality of the Proposed Agreement. In an order dated September 13, 2004 (the "September 2004 Order"), the Court reversed the Superior Court's initial approval of the Proposed Agreement and remanded the case to the Superior Court. The Court stated that on remand the Superior Court must decide several issues related to the Proposed Agreement based on a more fully developed record. The September 2004 Order specifically established the legal standard for the determination of the issue of whether the Proposed Agreement is fair and reasonable. (*See* Jt. App. at 335-337.) In the Orders, the Superior Court disregarded this Court's standard for assessing the fairness and reasonableness of the

Proposed Agreement, and it made rulings on the remanded issues that violate the applicable law and contradict the evidentiary record that was developed at the July 2005 hearing. Accordingly, the ACE Companies filed this timely appeal.

STATEMENT OF FACTS

I. Overview

The facts below demonstrate that the Orders are contrary to the Court's September 2004 Order, the applicable law and the undisputed evidence in this case.

The Superior Court, in entering the Orders, simply reaffirmed its earlier holding that the Liquidator has the authority under his general powers to enter into the Proposed Agreement, even though the claims distributions to the AFIA Cedents pursuant to the Scheme would violate the specific order of priority provisions in RSA 402-C:44. The ACE Companies demonstrated in the initial appeal that there is no basis for such a deviation from the statute's mandatory provisions, which prohibit payments to a subset of Class V creditors before higher priority creditors or creditors in the same class have been paid. For that reason alone, the Orders should be reversed.

The Superior Court, recognizing that the proposed claims payments to the AFIA Cedents would violate the order of priority, also accepted the Liquidator's argument that the payments may be recast as "costs of administration" under RSA 402-C:44, I. This too was error. No other court has permitted such a reclassification of claims distributions and, to the contrary, the applicable case law (which was ignored by the Superior Court) shows that a liquidator's settlement of pre-liquidation claims cannot be passed off as costs of administering the estate. Indeed, on the earlier appeal, this Court was skeptical of the Liquidator's attempt to circumvent the priority statute by arguing that the proposed claims payments are nothing more than administrative expenses.

The Superior Court compounded its erroneous interpretation of RSA 402-C:44 by holding that the Proposed Agreement is necessary, fair and reasonable. The Superior Court disregarded the

legal standard for fairness and reasonableness that this Court established in the September 2004 Order, and instead gave undue deference to the Liquidator's assessment of whether the Proposed Agreement is fair and reasonable. As discussed more fully below, the Liquidator attempted to justify the Proposed Agreement as a response to alleged threats by the AFIA Cedents to (a) commence litigation based on certain theories of direct recovery from Century or (b) attempt to limit Home's access to reinsurance by not filing and prosecuting their claims. The evidence in the record shows that these "threats" were neither realistic nor credible, and that the Proposed Agreement was not an objectively fair and reasonable response under the circumstances.

The Superior Court further erred in ruling that the Proposed Agreement is "necessary" under RSA 402-C:25. The Superior Court created its own legal standard for necessity and, in so doing, revived an equitable doctrine that was rejected in the Order on Remand. Moreover, there is no support for the Superior Court's holding in the evidentiary record, which clearly demonstrates that the AFIA Cedents would have filed and prosecuted their claims against Home even in the absence of the Proposed Agreement.

II. ACE Companies' Initial Appeal And Order On Remand

The Liquidator first requested the Superior Court's approval of the Proposed Agreement in the Motion, which was filed in February 2004. The Liquidator sought to justify the Proposed Agreement by alleging that the AFIA Cedents had no reason to file and prosecute proofs of claim in Home's liquidation (except to preserve potential offset) because their claims would be given Class V priority under RSA 402-C:44 and as such were unlikely to be paid. (*See* Motion, Jt. App. at 62-65, ¶¶ 6-7.) Also, according to the Liquidator, certain AFIA Cedents were (a) exploring "alternative means of realizing recovery," including a "possible circumvention of Home by entering into side arrangements with ACE Group"; and (b) threatening to seek a "walling off" of certain U.K. assets for their benefit to the exclusion of the estate. (*Id.* at 64-65, ¶ 7.) Supporting affidavits submitted by the Liquidator elaborated on the "alternative means of recovery" referred to in the Motion. In

addition to the alleged "side arrangements," the affidavits alleged that certain AFIA Cedents were considering "cut throughs" to Century, the reinsurer of Home, and an argument that there had been a novation of Home's obligations under the AFIA Treaties to Century (which would, in their view, permit a direct recovery from Century). (*See* Williams Aff., Jt. App. at 214, ¶ 12, Warmuth Aff., Jt. App. at 181-182, ¶ 9.)

Both the ACE Companies and co-appellant Benjamin Moore & Company ("Benjamin Moore") filed objections to the Motion. (*See* Jt. App. at 100-108; 151-164.) The ACE Companies pointed out that the distributions under the Proposed Agreement would violate the mandatory order of distribution provisions in RSA 402-C:44, which state, in relevant part:

> The order of distribution of claims from the insurer's estate ***shall*** be as stated in this section. ... [E]very claim in each class shall be paid in full or adequate funds retained for the payment before the members of the next class receive ***any*** payment. ***No subclasses shall be established within any class.***
>
> I. Administration Costs. The costs and expenses of administration, including but not limited to the following: the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the litigation; any necessary filing fees; the fees and mileage payable to witnesses; and reasonable attorney's fees.
>
> II. Policy Related Claims. All claims by policyholders ..., beneficiaries, and insureds arising from and within the coverage of ... insurance policies and insurance contracts issued by the company .... .
>
> V. Residual Classification. All other claims ... not falling within other classes under this section. ...

RSA 402-C:44 (emphasis added). The ACE Companies noted that the Proposed Agreement is unlawful because it would provide distributions to a small subclass of Class V creditors before higher classes of creditors were paid in full, and before similarly situated Class V creditors were paid in a like amount. (ACE Companies' Objection, Jt. App. at 101-102, ¶ 4.) The ACE Companies further argued that the Liquidator lacks the authority to circumvent, through a

"compromise" with the AFIA Cedents, the mandatory order of distribution established by the New Hampshire Legislature (the "Legislature") in RSA 402-C:44. (*Id.*, at 103, ¶ 7.)

On April 29, 2004, the Superior Court issued an order (the "April 2004 Order") holding that the Proposed Agreement "is authorized under the broad array of powers granted the Liquidator under RSA 402-C:25 and is consistent with the goals and purposes of the statute to protect the interests of the insureds and creditors. RSA 405 [sic, 402]-C:1, IV." (Jt. App. at 319.) The ACE Companies and Benjamin Moore appealed.

On appeal, the Liquidator attempted to justify the Superior Court's reliance on the general language of the Act as authority for the Proposed Agreement. The Liquidator also argued that the proposed payments to the AFIA Cedents could be classified as "administration costs" under RSA 402-C:44, I, and that the Proposed Agreement may be approved under the "equitable doctrines" of "necessity" and "new value," which, according to the Liquidator, "authorize a receiver to make payments of the estate's property out of the ordinary course when doing so is in the best interests of the creditors of the estate." (Liquidator's Br. at 25.)

Following the oral argument on July 15, 2004 (at which several Justices expressed reservations about the Liquidator's arguments), the Court issued the September 2004 Order in which it vacated the April 2004 Order and remanded the case to the Superior Court for the consideration of several issues. The Court ordered the Superior Court to determine whether it had an obligation to "assess the [Proposed Agreement's] fairness through fact-finding proceedings." (Jt. App. at 335.) The September 2004 Order cited several analogous bankruptcy court cases and set forth the standard for assessing the Proposed Agreement's fairness. (*See id.* at 335-336.) In addition, the Court ordered the Superior Court to consider "whether the payment to the AFIA Cedents qualifies as an administrative expense under RSA 402-C:44, I" and whether the necessity doctrine or some other equitable doctrine permits a variation from the mandatory priorities. (*Id.* at 336.) The Court further stated that the Superior Court, in considering the administrative expense

issue and other remanded issues, "shall support its determination ... with factual findings, as appropriate." (*Id.*)

On remand, the Superior Court — without taking any further evidence to support its findings — ruled that the proposed payments to the AFIA Cedents could be classified as costs of administration. (Order on Remand, Jt. App. at 18-20.) The Superior Court reaffirmed its previous holding in the April 2004 Order that the Liquidator had the authority to enter into the Proposed Agreement and stated that, in so ruling, "the Court necessarily found that the payments to the AFIA Cedents are administrative expenses." (*Id.* at 20.) The Superior Court also ruled that (a) the equitable doctrines raised by the Liquidator do not override RSA 402-C:44; (b) it had an independent obligation to assess the fairness of the Proposed Agreement; (c) the parties could take discovery on the "necessity, reasonableness and fairness of the agreement"; and (d) it would schedule an evidentiary hearing on those issues. (*Id.* at 20-24.)[1]

III. July 2005 Evidentiary Hearing

The evidentiary hearing took place in July 2005. At the hearing, counsel to the Liquidator conceded that the Liquidator had abandoned one of the main points advanced as a rationale for the Proposed Agreement, which was the alleged threat of a "walling off" of U.K. assets for the benefit of the AFIA Cedents. (*See* Vol. 1-A, 56:7-18; 4-B, 163:19-20.) The hearing instead focused on the other "threats" that the Proposed Agreement allegedly addresses, such as cut-through litigation, side deals and the AFIA Cedents' purported plan not to file and prosecute claims. As shown below, each of these "threats" was non-existent.

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[1] The Superior Court also held in the April 2004 Order that the ACE Companies and Benjamin Moore have standing to contest the Proposed Agreement, and the New Hampshire liquidation proceeding should not be stayed pending the completion of any regulatory or judicial proceedings that may occur in the U.K. (*Id.* at 14-16, 21.)

A. Filing And Prosecution Of Claims By AFIA Cedents

The evidence from the July 2005 hearing completely undermined the Liquidator's principal justification for the Proposed Agreement, which is that the AFIA Cedents would not file and prosecute their claims in the absence of an incentive payment.

Several witnesses testified without contradiction that it is standard procedure for reinsurance creditors who are in the same class as the AFIA Cedents to file proofs of claim in insurance liquidations. (Proposed Findings of Fact and Rulings of Law, Jt. App. at 605-606, ¶ 158.) The ACE Companies presented expert testimony, which was supported by the testimony of other witnesses, that there has been no other liquidation proceeding where creditors received an incentive payment to file and prosecute their claims. (*See* Rosen Test., Vol. 1-B, at 175:11-14; Hughes Test., Vol. 3-A, at 16:22-17:7; Williams Test., Vol. 4-A, at 113:1-8; Durkin Test., Vol. 4-B, at 196:1-4; Craig Test., Vol. 5-A, at 107:18-21.)

It was uncontroverted at the July 2005 hearing that creditors will file the largest claim possible, typically in excess of the potential setoff. Indeed, several non-AFIA Cedents who are also Class V creditors — but are not signatories to the Proposed Agreement — have submitted proofs of claim well in excess of their potential setoff in this liquidation. (Proposed Findings of Fact and Rulings of Law, Jt. App. at 606, ¶ 159.) Even before the Liquidator introduced the concept of an "incentive" payment in the fall of 2003, several AFIA Cedents indicated that they would be filing proofs of claims. During this period, the AFIA Cedents also submitted claims information to Home that clearly included amounts beyond their potential setoff. (*Id.* at ¶ 160.)

It was undisputed that creditors who are asserting setoff, including the AFIA Cedents who have setoff positions, will prosecute their claims at least up to the amount of the setoff. Counsel for the Joint Provisional Liquidators ("JPLs") in Home's U.K. proceedings described setoff as a "strong incentive" for the AFIA Cedents to present claims. (*Id.* at ¶ 161.) Home's representatives also identified other reasons why the AFIA Cedents would file claims against Home. Peter Bengelsdorf,

the Home's Special Deputy Liquidator, noted in a September 17, 2003 meeting that the AFIA Cedents would file claims because the "estate return could be good" and for "tax preservation purposes." (*Id.* at ¶ 162.) One of the JPLs, Gareth Hughes, explained at the evidentiary hearing that several of the AFIA Cedents are U.S. companies and it was his understanding that they would need to file claims in order to take advantage of bad-debt tax relief under U.S. law. (*Id.* at ¶ 163.) Mr. Bengelsdorf testified that uncertainty about the eventual distribution by the estate is a further reason to file claims. Home's representatives conceded that the assets and liabilities of the estate were uncertain at the time of the discussions regarding the Proposed Agreement in the fall of 2003 and thereafter. (*Id.* at 606-607, ¶ 164.)[2]

The ACE Companies presented evidence at the July 2005 hearing that, as a practical matter, the AFIA Cedents would not be able to stop prosecuting their filed claims once the level of their setoff is reached. Home's representatives conceded that the amount of setoff will not be known until claims are admitted into the estate, which is likely to be many years in the future. (*Id.* at 607, ¶ 165.) As a result, it would not be clear when, if ever, setoff had been achieved and therefore the AFIA Cedents would simply continue to have their claims prosecuted. The evidence also showed that the prosecution of claims is neither difficult nor costly. Much of the burden is handled by brokers, who have already been paid an upfront fee to present the claims. (*Id.* at ¶ 166.) Moreover, the claims submitted by the AFIA Cedents to Home are often the same claims that have been submitted to other reinsurers on the risk, further evidencing the lack of anything other than an illusory burden here. (*See id.* at 576-577, ¶¶ 33-35 and 607, ¶ 166.) Also, once claims are presented to Home, an agreement entered into between Home and Century (the "Claims Protocol") places most of the responsibility for adjudicating any disputed claims on the Liquidator, and it sets forth a streamlined claims determination process. (*See id.* at 607, ¶ 166; Claims Protocol, Jt. App.

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[2] The Superior Court granted the proposed findings of fact in paragraphs 158 through 164. (*See* September 2005 Order, Jt. App. at 58-59.)

at 323-334.)[3] Only one AFIA claim has been disputed in the entire proceeding; all other claims have been determined without invocation of the claims determination process.

Finally, the evidence showed that the Liquidator does not have to depend on the AFIA Cedents voluntarily providing the information necessary for the prosecution of the claims. The Liquidator's representatives acknowledged at the evidentiary hearing that the Liquidator has the statutory power (*see* RSA 402-C:25, V and RSA 402-C:38, II) to compel the production of information from the AFIA Cedents via subpoena. To the extent that the AFIA Cedents claim they are beyond the Superior Court's jurisdiction, the JPLs have the same power of compulsion in England. (Jt. App. at 607, ¶ 167.)[4] Accordingly, the Liquidator and JPLs each conceded they could themselves simply "obtain" the information necessary to prosecute the claims.

B. Alleged Threats By AFIA Cedents To Bypass Home's Estate

As noted above, the Liquidator cited several alleged threats as a rationale for the Proposed Agreement. At the hearing, the evidence on those "threats" did not materialize.[5]

1. Constructive Or Forced Novation

In affidavits offered by the Liquidator in support of the Motion, Rhydian Williams (representing AFIA Cedent Equitas) and Gernot Warmuth (representing AFIA Cedent Agrippina) contended that without the Proposed Agreement there was a threat of "constructive novation"

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[3] The Superior Court granted the proposed finding of fact in paragraph 33, did not grant or deny the proposed findings of fact in paragraphs 34-35 and 165, and denied the proposed findings of fact in paragraph 166. (*See* Jt. App. at 58-59.)

[4] The Superior Court granted the finding of fact in paragraph 167. (*See* Jt. App. at 58-59.)

[5] The evidence from the July 2005 hearing which demonstrates that the alleged threats did not exist is too voluminous to be discussed at length here, but further details are found in the Proposed Findings of Fact and Rulings of Law at paragraphs 94 through 156. (Jt. App. at 590-605.) The ACE Companies have omitted any detailed discussion in this brief of the "walling off" (or "ring fencing") threat, even though it was one of the major justifications for the Proposed Agreement in the Motion and was cited in the Liquidator's earlier appellate brief. The Liquidator has conceded that this argument lacks any merit, and the ACE Companies pointed out to the Superior Court that the Liquidator's withdrawal of the "walling off" argument casts a shadow on his credibility (and that of the witnesses who referred to ring fencing in their affidavits, i.e. Mssrs Williams and Warmut, Jt. App. at 181-82, ¶9 and 214, ¶12).

against Century based on the fact that Century, through an agent, made payments directly to the AFIA Cedents. (*See* Williams Aff., Jt. App. at 214, ¶ 12; Warmuth Aff., Jt. App. at 182, ¶ 9.) Mr. Warmuth also claimed in his affidavit that Century could be forced to accept a novation based on certain commitments made in 1984 in connection with the purchase of the AFIA business by Century's predecessor. (Jt. App. at 182, ¶ 9.) This, they argued, would allow AFIA Cedents to bypass the Home and seek payments directly from Century. The Liquidator was supposedly justified in trying to avoid any such "threat" by providing an incentive to the AFIA Cedents to submit their claims in the Home estate rather than seek direct payment from Century. The Liquidator was unable to support this rationale at the July 2005 hearing.

The evidence showed that past claims payments made by Century's agent to AFIA Cedents were clearly on behalf of Home, which retained the obligation under the AFIA Treaties. (Proposed Findings of Fact and Rulings of Law, Jt. App. at 593, ¶ 107.) Mr. Williams testified at the July 2005 hearing that the advice he received on the novation argument was that it had very little likelihood of success. (*See id.*, ¶ 108.) Mr. Warmuth also testified that he gave no consideration to the novation issue after Home entered into liquidation and never discussed it with Home or ACE during that time. (*See id.* at 594, ¶ 110.) Thus, the evidence from the July 2005 hearing demonstrated that there was no realistic or credible threat of novation.[6]

2. Cut-Through Litigation

At various points in this proceeding, the Liquidator has argued that he entered into the Proposed Agreement to prevent the AFIA Cedents from pursuing litigation on the theory that they may "cut through" to the reinsurance agreement between Home and Century (the "Assumption Agreement") and thereby obtain a direct recovery from Century. At the July hearing, the Liquidator conceded that such cut-through litigation was ***no longer*** a basis for the Proposed Agreement. (Vol.

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[6] The Superior Court accepted several of the ACE Companies' findings of fact on novation. (*See* Jt. App. at 58-59 (granting ¶¶ 107, 109, neither granting nor denying ¶ 108, denying ¶ 110).)

5-A, at 23:4-8.) The Superior Court nevertheless referred to the potential for cut-through litigation as a justification for the Proposed Agreement. (*See, e.g.*, September 2005 Order, Jt. App. at 41-43, 45, 54.) Even without the Liquidator's withdrawal of this rationale, there was no evidence in the record to support the Superior Court's finding.

In fact, this finding is directly contradicted by the evidence at the hearing, which was summarized in several of the ACE Companies' findings of fact that the Superior Court ***accepted***. The evidence showed that the Assumption Agreement forbids a cut through. In particular, the "insolvency clause" in the agreement states that any post-liquidation payments under the AFIA Treaties must be made to Home or the Liquidator. (*See* Jt. App. at 594-595, ¶ 114; September 2005 Order, Jt. App. at 58-59 (granting ¶ 114).) Representatives of Home concluded by the fall of 2004 that the AFIA Cedents could not cut through to the Assumption Agreement. (*See* Jt. App. at 595-596, ¶ 118; September 2005 Order, Jt. App. at 58-59 (granting ¶ 118).) The AFIA Cedents had also received legal advice concluding that such a cut through was impermissible under controlling New York law. (Jt. App. at 596, ¶ 119; September 2005 Order, Jt. App. at 58-59 (granting ¶ 119.)[7]

3. Side Deals Between AFIA Cedents And ACE

The Superior Court devoted much of the September 2005 Order to the alleged threat to Home posed by "side deals," *i.e.*, impermissible secret arrangements between the AFIA Cedents and ACE which would provide an incentive for the AFIA Cedents not to file claims in the estate.

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[7] At the July 2005 hearing, Jonathan Rosen of Home testified that he was concerned about the potential for cut-through litigation in light of the decisions in *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 150 F.3d 545 (6th Cir. 1988), and *Koken v. Legion Ins. Co.*, 831 A.2d 1196 (Pa. Commw. Ct. 2003). Neither case, however, supports the threat of cut-through litigation here. In *Nationwide*, the Sixth Circuit held the provisions of the very same Assumption Agreement at issue in this proceeding ***preclude*** a direct suit against the reinsurer. (Mr. Rosen attempted to argue that Home's insolvency could affect the result in *Nationwide*, but, as noted above, the insolvency clause in the Assumption Agreement makes it even more difficult to prevail on a cut-through theory.) *Legion* is similarly unavailing because, as the Superior Court found and Mr. Rosen admitted at the hearing, that case is materially different from this one. (*See* Proposed Findings of Fact and Ruling of Law, Jt. App. at 596, ¶ 120; September 2005 Order, Jt. App. at 58-59 (granting ¶ 120).)

(*See* September 2005 Order, Jt. App. at 43-46, 51, 54.) The evidence from the July 2005 hearing shows that no such threat existed.

The ACE Companies presented detailed and uncontroverted findings to the Superior Court demonstrating that the three AFIA Cedents identified by Home as potential parties to a side deal — Unionamerica, Equitas and Agrippina — had no plans to enter into such an arrangement and never informed Home or ACE that they would do so. (*See* Jt. App. at 599-605, ¶¶ 131-156.)[8] In addition, several other critical facts (most of which the Superior Court accepted in the September 2005 Order) establish that there was no realistic possibility of a side deal between ACE and any of the AFIA Cedents.

First, ACE gave a commitment to Home in October 2003 that (a) it would not have discussions with the AFIA Cedents while the commutation (*i.e.*, settlement) discussions between ACE and Home were ongoing; and (b) even if the ACE-Home commutations talks ceased, ACE would not enter into any side deals with the AFIA Cedents without providing notice to Home. As the Superior Court found, notice of a side deal between ACE and any of the AFIA Cedents would have given Home the opportunity to ask a U.S. court to set aside or enjoin the arrangement. (*See* Jt. App. at 597-598, ¶¶ 123-24.)[9]

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8 The Superior Court granted the proposed findings of fact in paragraphs 133, 139, 140 (as to the assertions that Mr. Williams had not given the Liquidator's representatives any specifics regarding an alleged side deal with ACE), 141, 145, 148, 150, 153 and 155; denied paragraphs 131-132, 134-136, 138, 140 (except for the portion noted above), 142-144, 147, 152 and 156; and neither granted nor denied paragraphs 137, 146, 149, 151 and 154. (*See* Jt. App. at 58-59.)

9 With one qualification, the Superior Court granted the proposed findings of fact in paragraphs 123 and 124. (*See* Jt. App. at 58-59.) The exception is that the Superior Court held there were no commutation discussions between Home and ACE at the time of ACE's commitments. (*See id.* (granting ¶ 123 except to the extent it implies "that negotiations had begun").) The evidence, however, clearly shows that both parties believed they were in settlement negotiations during this period. At the September 30, 2003 meeting, the Liquidator presented a proposal to ACE for a "comprehensive business resolution," including a commutation with Home. (*See* Proposed Findings of Fact and Rulings of Law, Jt. App. at 583, ¶¶ 66.) Messrs. Bengelsdorf, Rosen and Hughes admitted at the July 2005 hearing that those discussions related to a commutation. (*Id.* at 583, ¶ 65.) Even more significantly, the ACE representatives — who gave the commitment not to discuss side deals with the AFIA Cedents while the settlement talks were ongoing —

Second, ACE was not involved any side deal discussions with the AFIA Cedents, had no intent to enter into such side deals and was "very concerned" that any side deal would expose it to double liability (in the event that a court would require Century to pay under the Assumption Agreement despite a side arrangement). Home's representatives had pointed out this potential for double liability, and aggressively took the position that any attempt by an AFIA Cedent to enforce a side deal would be deemed a claim against the estate (thereby triggering Century's reinsurance obligation). (*See* Proposed Findings of Fact and Rulings of Law, Jt. App. at 598, ¶¶ 125-26; September 2005 Order, Jt. App. at 58-59 (granting ¶¶ 125-26).) Indeed, a leading commentator on reinsurance issues recently stated that because of the potential for double liability "ACE would have been foolhardy to negotiate a side deal with the AFIA Cedents." Robert M. Hall, "When Can A Receiver Ignore Priority Of Distribution Statutes?", MEALEY'S LITIG. REP.: INS. INSOLVENCY, Vol. 17, Issue 8 (Dec. 2005) at 23.

Third, there were other significant impediments to side arrangements, including the fact that (a) New Hampshire law and the Order of Liquidation in this proceeding bar payments to any party other than Home or the Liquidator; (b) the insolvency clause in the Assumption Agreement requires payment to Home or the Liquidator and prohibits payment to the AFIA Cedents directly; (c) there is no privity of contract under the Assumption Agreement between ACE and the AFIA Cedents; and (d) a side deal would result in a loss of the AFIA Cedents' setoff rights (potentially worth tens of millions of dollars). (Proposed Findings of Fact and Rulings of Law. Jt. App. at 598-599, ¶ 127.) The Superior Court accepted the proposed findings of fact on these issues. (*See* September 2005 Order, Jt. App. at 58-59.)

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thought they were involved in commutation discussions with Home at the time. (Wamser Test., Vol. 5-B, 170:8-176:21.)

Under the circumstances, there was no reasonable basis for the Liquidator to conclude that side deals between the AFIA Cedents and ACE posed any realistic threat, let alone a threat justifying the payment of tens of millions of dollars to the AFIA Cedents.

IV. Proposed Findings of Fact/Rulings of Law And September 2005 Order

After the July 2005 hearing, the ACE Companies presented detailed proposed findings of fact and rulings of law demonstrating that the Proposed Agreement is not fair and reasonable and that the proposed payments to AFIA Cedents are not necessary as an incentive for the filing and prosecution of claims. (*See* Jt. App. at 570-618.) Nevertheless, the Superior Court issued the September 2005 Order in which it granted the Motion. The ACE Companies and Benjamin Moore filed timely Notices of Appeal. (*See* Jt. App. at 804-859; 860-918.)

SUMMARY OF THE ARGUMENT

The Superior Court's errors in interpreting the Act – which this Court reviews *de* novo – mandate reversal. The Superior Court improperly ordered that the Liquidator may deviate from RSA 402-C:44's mandatory order of priority, relying on sections of the Act which grant general powers to the Liquidator. It is well settled that such general provisions cannot preempt the specific and mandatory provisions in RSA 402-C:44. In addition, the Liquidator has admitted that the Proposed Agreement is a settlement of the AFIA Cedents' claims and that the proposed payments would be "distributions." RSA 402-C:44 expressly forbids claims distributions to Class V creditors until the higher priority classes have been paid. It also bars the Liquidator from favoring one subset of Class V creditors over others. There is no precedent for the Proposed Agreement and, to the contrary, the courts have rejected similar efforts to alter the priority of payment. This Court should reverse the Orders and enforce the plain language of RSA 402-C:44, which states that distributions ***shall*** be made in accordance with the order of priority.

The Superior Court also erred in holding that the proposed payments to the AFIA Cedents would qualify as "administration costs" under RSA 402-C:44, I. The payment of tens of millions of dollars to pre-liquidation claimants — relating to the same claims for which they have filed proofs of claim — cannot be dressed up as "administration costs." The Court did not cite any authority supporting this interpretation of RSA 402-C:44, I, and the case law directly on point prohibits the recasting of claims settlements as administrative expenses.

The Superior Court's holding on the necessity, reasonableness and fairness of the Proposed Agreement suffers from similar infirmities. Rather than following the mandate of the Court in the September 2004 Order and the controlling cases this Court cited, the Superior Court came up with its own standards for evaluating the Proposed Agreement. The Superior Court further erred in applying the facts to the law because its conclusions are not supported by the record and, in many instances, are contradicted by other findings of fact that it made.

Therefore, this Court should reverse the Orders and enter an order holding that (a) the Proposed Agreement violates New Hampshire law; and (b) the Proposed Agreement is neither necessary, fair nor reasonable under the circumstances.

ARGUMENT

I. THIS COURT'S STANDARD OF REVIEW

A trial court's interpretation of a statute is reviewed *de novo*. *E.g., Blackthorne Group v. Pines of Newmarket*, 150 N.H. 804, 806 (2004). Therefore, this Court should review *de novo* the Superior Court's interpretation of RSA 402-C:44, RSA 402-C:25 and other provisions in the Act, as discussed below in Sections II, III, IV and VI.

In the September 2005 Order, the Superior Court also considered whether the Proposed Agreement was fair, reasonable and necessary as a matter of law. This Court independently reviews such determinations of the applicable law and an application of that law to the facts of the case

under a "plain error" standard. *E.g., Fleet Bank-N.H. v. Chain Constr. Corp.*, 138 N.H. 136, 139 (1993). That is, the Court will determine "whether the [trial] court's decision is consonant with applicable law." *Id.* The Superior Court's findings of fact are reviewed under a "clearly erroneous" standard, and cannot be upheld if they are not supported by the evidence presented at trial. *Bielagus v. Emre of N.H. Corp.*, 149 N.H. 635, 639 (2003).

II. THE PROPOSED AGREEMENT UNLAWFULLY VIOLATES THE MANDATORY ORDER OF DISTRIBUTION UNDER THE ACT

A. The Proposed Agreement Violates The Unambiguous Mandate of the New Hampshire Legislature

As discussed above, RSA 402-C:44 establishes multiple classes of claimants in an insurance company liquidation, and compulsory rules for the distribution of assets to those claimants. The Proposed Agreement violates the unambiguous language of RSA 402-C:44 in two ways. First, it creates impermissible subclasses by splitting Class V in two, with one group consisting of the AFIA Cedents and the other group consisting of other Class V creditors (including some of the ACE Companies). Second, the 50% "incentive" that the Liquidator proposes to pay to the AFIA Cedent subclass violates the statutory order of distribution by allowing the AFIA Cedent subclass to leap ahead of Classes II, III and IV and to receive tens of millions of dollars in distributions before the higher classes' claims have been paid in full, as required by the statute.

RSA 402-C:44 is comprehensive, clear and unqualified. It does not provide that the order of distribution and prohibition against subclasses "may" be changed where it is "necessary and expedient," or where to do so would protect "the interests of the insureds, creditors and the public generally." It does not say "unless ordered otherwise by the court." Unlike other sections of the Act, which state that the provisions are mandatory unless "good cause" is shown, *see, e.g.*, RSA 402-C:37, there is nothing in RSA 402-C:44 that allows for ***any*** variation of the order of priority or the exercise of discretion by a liquidator.

During the July 2004 oral argument on the initial appeal, this Court expressly recognized the mandatory nature of RSA 402-C:44. One Justice noted that the statute "appears pretty mandatory on its face and with respect to Class 5 creditors it says 'thou shall not create subclasses.'" (Jt. App. at 386; *see also id.* at 394 ("The statute doesn't say you can have subclasses where it doesn't really matter. It says you can't have subclasses 'period.'").) Because the Proposed Agreement would create such subclasses and elevate the AFIA Cedents above other Class V creditors, it cannot be squared with the mandatory provisions of RSA 402-C:44.

A recent decision by this Court illustrates the strict interpretation that unambiguous statutes must be given. In *Blackthorne Group, Inc. v. Pines of Newmarket*, 150 N.H 804 (2004), the Court construed a statute providing that a real estate broker may not initiate a lawsuit for compensation from a client if, at the time the services were rendered, it was not licensed in New Hampshire. *Id.* at 806. The Court held that a real estate broker's failure to obtain a license precluded it from suing for services provided. *Id.* at 807. "We cannot ignore the statute's plain language to permit the plaintiff to bring claims the statute expressly prohibits." *Id.* at 809. The plaintiff argued that permitting it to recover at least a partial fee would be equitable and would prevent the defendant "from obtaining a windfall." *Id.* While acknowledging that "prohibiting the plaintiff from recovering even a portion of its fee may be a harsh result," the Court maintained that "[t]he wisdom and reasonableness of the legislative scheme are for the legislature, not the courts, to determine." *Id.* at 810 (internal citation omitted).

In this case, as in *Blackthorne*, the Liquidator has argued that the ACE Companies would receive a "windfall" if the Proposed Agreement were rejected. (April 23 Hearing Tr., Jt. App. at 262:10-12.) The Superior Court similarly referred to an alleged windfall in the Orders. (*See* Jt. App. at 15, 55.) In *Blackthorne*, however, this Court stressed that the existence of any purported

"windfall" is irrelevant; instead, the focus is on the language of the statute rather than any alleged effect caused by a strict application of its terms. 150 N.H. at 809-10.[10]

B. Every Court That Has Construed Similar Provisions In Other States Has Enforced The Mandatory Order Of Distribution

The provisions in the Act setting forth the order of priority are virtually identical to analogous provisions adopted in all states. In passing such statutes, the Legislature and legislatures throughout the United States made a conscious decision to move away from a *pari passu* treatment of creditors' claim in favor of a mandatory order of priority.

Consistent with these mandates, there has been no reported instance of variation from an order of distribution statute, such as RSA 402-C:44, in an insurance company liquidation. Although no New Hampshire court has ruled on whether a Liquidator may allow (let alone affirmatively encourage) one group of creditors to circumvent the statutory priority scheme, courts in other states have rejected similar efforts to alter the priority of distribution. *See Washburn v. Dyson (In re Liquidation of Security Casualty Co.)*, 537 N.E.2d 775, 782 (Ill. 1989) (holding that defrauded shareholders could not impose constructive trust on proceeds of stock offering held by insolvent insurer because it would satisfy those claims outside of exclusive and mandatory priority statute); *Illinois ex rel. Boozell v. Coronet Insurance Co. (In re Liquidation of Coronet Insurance. Co.)*, 698 N.E.2d 598, 603 (Ill. App. Ct. 1998) (holding that trial court erred in allowing attorney's claim under retaining lien as a Class I administrative expenses and stating that "equitable remedies in contradiction to those plainly set forth within the Insurance Code are therefore precluded");

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[10] In any event, the purported "windfall" is illusory. The facts here do not support the Liquidator's premise that the AFIA Cedents would not have filed and prosecuted claims in the absence of the Proposed Agreement. Also, the fact that the statutory scheme might affect certain creditors is something that the Legislature plainly contemplated in devising the order of priority. The Act is patterned after the Wisconsin statute, Wis. Stat. Ann. § 645.68 (West 1980), and the legislative history for that statute notes that the order of priority was intentionally based on the "relative social and economic importance of the claims likely to be asserted against an insurer." (Jt. App. at 943.) As such, the Wisconsin statute (and the Act) stand in contrast to the *pari passu* system they replaced, under which unsecured creditors had equal ranking.

Northwestern Nat'l Ins. Co. v. Kezer (In re Aspen Indem. Corp.), 812 P.2d 688, 690 (Colo. Ct. App. 1990) (holding that state insurance priority of distribution statute is "both specific and comprehensive" and "leaves no room for the judiciary to add to the type of claims to be preferred or to establish a method of preference not created by the statute"). Thus, there is no authority for the Liquidator's attempt to give preference to the AFIA Cedents in exchange for the filing and prosecuting of their claims against the estate.

III. THE SUPERIOR COURT'S HOLDING THAT THE LIQUIDATOR HAS THE AUTHORITY TO ENTER INTO THE PROPOSED AGREEMENT UNDER THE GENERAL PROVISIONS OF THE ACT WAS WRONG AS A MATTER OF LAW

The Superior Court found that the Proposed Agreement "is authorized under the broad array of powers granted the Liquidator under RSA 402-C:25" and "is consistent with the goals and purposes of the statute to protect the interests of the insureds and creditors," as set forth in RSA 402-C:1, IV. (April 2004 Order, Jt. App. at 319.) These justifications were wrong as a matter of law. As Justice Dalianis remarked during the July 2004 oral argument on the prior appeal, "the fact that everybody likes [the Proposed Agreement] doesn't necessarily mean that it is legal." (Jt. App. at 384.)

A. The Liquidator's "Broad Array Of Powers" Cannot Be Exercised In A Manner That Is Inconsistent With Specific Provisions In The Act

The Superior Court effectively rewrote RSA 402-C:44 by making all of its mandatory provisions subservient to the Liquidator's "broad array of powers." Although RSA 402-C:25 enumerates numerous discretionary powers that a liquidator possesses, that section cannot be construed to allow a liquidator to disregard mandatory provisions in the Act. To the contrary, RSA 402-C:25 states that a liquidator may exercise its discretionary powers, but only insofar as they are "not inconsistent" with the Act. RSA 402-C:25, XXI. Indeed, with regard to one enumerated power, the statute makes it plain that a liquidator cannot vary RSA 402-C:44. That section provides that a liquidator may "use assets of the estate to transfer policy obligations to a solvent assuming

insurer," but ***only*** "if the transfer can be arranged without prejudice to applicable priorities under RSA 402-C:44." RSA 402-C:25, VIII. Given this expressed concern for maintaining the priorities in RSA 402-C:44, the Legislature cannot have intended, in listing the general powers in RSA 402-C:25, to give liquidators the authority to ignore or contravene the mandatory order of distribution set forth in RSA 402-C:44. As one of the Justices noted during the July 2004 argument on the earlier appeal, "[y]ou can't give the liquidator broad powers that will allow the Liquidator, for instance, to create subclasses." (Jt. App. at 382.)

B. The Proposed Agreement Cannot Be Justified As "Consistent With The Goals And Purposes" Of The Act When It Violates An Express Provision Of The Act

Equally misplaced is the Superior Court's reliance on the general purpose of the Act, as expressed in RSA 402-C:1, IV, to trump the specific mandates of RSA 402-C:44.

First, it is a well-established maxim of statutory construction that general language regarding the intent of a statute cannot override specific provisions in the same statute. *See, e.g., Bissette v. Colonial Mortgage Corp.*, 477 F.2d 1245, 1246 n.2 (D.C. Cir. 1973) (noting that a general section of the statute setting forth its purpose cannot prevail over the statute's specific provisions); *People v. Woodhead,* 239 Cal. Rptr. 656, 660-661 (Cal. 1987) ("The preamble to [the statutory proposition] provides no persuasive evidence of the intended meaning of the specific language of [a specific] section."). If the Liquidator's interpretation of the Act were correct, he could justify ***any*** action simply by claiming that he was acting in "the interests of insureds, creditors, and the public generally." Nothing in the Act or elsewhere reveals that the Legislature intended to grant liquidators such unfettered discretion. Indeed, RSA 402-C:1, IV(c) provides the opposite, stating that the Act's liquidation provisions were designed to provide "enhanced efficiency and economy of liquidation, ***through clarification and specification of the law***, to minimize legal uncertainty and litigation." (emphasis added) RSA 402-C:44 is exactly the type of "clarification and specification" referred to in RSA 402-C:1, IV(c).

Second, the Superior Court's ruling effectively holds that the "ends justifies the means," *i.e.*, any violation of the Act may be permitted so long as it arguably benefits creditors by bringing more money into the estate. In analogous circumstances, however, courts in other states uniformly have refused to vary from statutory mandates, even where to do so would increase estate assets. For example, in *Midland Ins. Co. v. Kemper Reinsurance Co. (In re Liquidation of Midland Ins. Co.)*, 590 N.E.2d 1186 (N.Y. 1992), the New York Court of Appeals rejected a liquidator's argument that reinsurers' statutory set-off rights should be limited to amounts owing under a single contract, even though this would have allowed the liquidator to realize very substantial reinsurance recoveries that could have been distributed to policyholders. In so ruling, the court noted that the New York legislature had enacted the set-off statute over any such competing public policy concerns. *Id.* at 1191. *See also Prudential Reinsurance Co. v. Superior Court (In re Liquidation of Mission Ins. Cos.)*, 842 P.2d 48, 63 (Cal. 1992) (refusing to create exception to mandatory priority provision).[11]

C. Allowing A Deviation From The Clear Requirements Of RSA 402-C:44 Would Open The Door To Similar Deals With Other Creditors Or Attempts By Creditors To Enhance Their Priority

The Orders, if affirmed, would set a precedent for wholesale violations of RSA 402-C:44. If the Liquidator here can justify paying a massive incentive to a subclass of Class V creditors merely on the grounds that to do so ultimately will benefit the estate, then there is nothing to stop other individual or groups of creditors from negotiating their own incentive packages. Creditors thus

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[11] The sole case offered by the Liquidator in the Superior Court for the proposition that he has a general power to enter into the Proposed Agreement, *In re Executive Life Ins. Co.*, 38 Cal. Rptr. 2d 453 (Cal. Ct. App. 1995), is inapposite. *Executive Life* involved the approval of a ***rehabilitation*** plan for a financially troubled life insurer. It is well settled that rehabilitators have greater discretion than liquidators in managing the insolvent insurer's affairs. *See, e.g., Grode v. Mutual Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990). Moreover, the issue considered in *Executive Life* was materially different than the issue here, where the Proposed Agreement would result in a subclass of creditors receiving payment before claimants with higher priorities had been paid in full and before other class members had received similar payment. The *Executive Life* court only considered whether holders of guaranteed investment contracts should be classified as either policyholders (class 5) *or* general creditors (class 6). There was no suggestion that the class 6 creditors (or a sub-class of the class 6 creditors) would receive a distribution before the class 5 creditors (as would be the case here).

would be free to negotiate individual percentage distributions depending on the value of their claim to the liquidation, so long as the distribution arguably would result in a net benefit to the estate. *See* Hall, "When Can A Receiver Ignore Priority of Distribution Statutes?", INS. INSOLVENCY, Vol. 17, Issue 8 at 23-24 (discussing the problems caused by an "ends justifies the means" approach to priority statutes). Even if liquidators were to refuse to enter into deals with other creditors, those creditors could tie up the estate in litigation and attempt to gain leverage by relying upon the rule established in the Orders. RSA 402-C:44 obviously was designed to prevent such treatment of creditors and potential harm to the estate.

IV. THE PROPOSED PAYMENTS TO THE AFIA CEDENTS CANNOT BE CLASSIFIED AS "ADMINISTRATION COSTS" UNDER RSA 402-C:44, I

After finding that the Liquidator had the authority to enter into the Proposed Agreement, the Superior Court concluded that the proposed payments to the AFIA Cedents could be classified as "costs and expenses of administration" because they would be "actual and necessary costs of preserving or recovering the assets of the insurer." (Order on Remand, Jt. App. at 20; September 2005 Order, Jt. App. at 58 (granting conclusion of law ¶ 3).) As an initial matter, the fact that the Superior Court felt compelled to reclassify the distributions to the AFIA Cedents as administration costs demonstrates that those payments would otherwise violate the mandatory order of distribution under RSA 402-C:44.[12] In any event, the Superior Court's ruling on this issue is contrary to the language and clear intent of RSA 402-C:44, I, the undisputed evidence and the Superior Court's own findings of fact, the applicable case law, and the Legislature's rejection, in February 2005, of the exact same reading of RSA 402-C:44.

[12] The Superior Court specifically ruled, as a matter of law, that the proposed payments would not conflict with the order of priority or impermissibly create subclasses of Class V creditors ***because*** they would be administration costs. (Jt. App. at 58 (granting conclusion of law ¶ 6).)

A. Payments Arising From Pre-Liquidation Claims Are Not Administration Costs

RSA 402-C:44 gives Class I priority to "[t]he costs and expenses of administration." RSA 402-C:44, I. The "administration" referred to in the statute is the administration of the insurer's estate ***after*** the order of liquidation has been entered. Thus, by its terms, RSA 402-C:44, I is limited to only those "costs" and "expenses" that arise post-liquidation.[13]

As discussed above, RSA 402-C:44 has its genesis in the Wisconsin liquidation statute. The administrative expense provision in that statute is in turn derived from federal bankruptcy law. (*See* Jt. App. at 943.) Cases construing the analogous administrative expense provision in the Bankruptcy Code, 11 U.S.C. § 503(b)(1)(A), provide further support for the argument that the proposed payments to the AFIA Cedents cannot be classified as "administration costs." It is well settled that a claim will not qualify as an administrative expense under the Bankruptcy Code unless, among other things, "the right to payment arose from a post-petition transaction with the debtor estate, rather than from a prepetition transaction with the debtor." *Woburn Assocs. v. Kahn (In re Hemingway Transport, Inc.)*, 954 F.2d 1, 5 (1st Cir. 1992). In applying this rule, bankruptcy courts have uniformly concluded that claims arising out of post-petition settlements triggered by pre-petition events do not receive priority status. For example, in *In re Food Barn Stores, Inc.*, 175 B.R. 723 (Bankr. W.D. Mo. 1994), the court refused to recognize an indemnification claim as an administrative expense because the events triggering the claim occurred pre-petition. *See id.* at 727, 730. *See also Mass. Div. of Empl. and Training v. Boston Reg'l Med. Ctr. (In re Boston Reg'l Med. Ctr.)*, 291 F.3d 111, 125 (1st Cir. 2002) (denying administrative expense priority to state's claims for reimbursement of post-petition payment of severance pay to debtor's employees arising out of

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[13] The reference in RSA 402-C:44, I to "services rendered in the liquidation" buttresses the conclusion that administration costs are limited to post-liquidation costs. The ACE Companies also presented evidence at the July 2005 evidentiary hearing from their expert, Robert Craig, that administration expenses typically include post-liquidation costs incurred by a liquidator, such as legal fees, accounting fees and the like. The Superior Court accepted Mr. Craig's testimony on this point, and granted the ACE Companies' proposed finding of fact to the same effect. (*See* Jt. App. at 58-59 (granting finding of fact ¶ 169).)

their pre-petition employment). Here, too, there is a clear nexus between the post-liquidation proposed settlement and the pre-liquidation claims from which it derives.[14]

B. There Is No Dispute That The Proposed Payments To The AFIA Cedents Arise From Pre-Liquidation Claims

There is overwhelming and undisputed evidence that the proposed payments to AFIA Cedents arise from their pre-liquidation claims, and as such they cannot be "administration costs." The Liquidator conceded in the Motion that the Proposed Agreement is a "settlement" or "compromise" of the AFIA Cedents' pre-liquidation claims and the proposed payments to the AFIA Cedents would constitute "distributions." (*See* Jt. App. at 65-68, 70-72, ¶¶ 8, 10-13, 18 and 21.) Indeed, the payments would be based solely on the AFIA Cedents' pre-liquidation claims against Home in the liquidation and on Home's recovery from reinsurers based on those claims. (*See* Proposed Agreement, Jt. App. at 76-78, ¶¶ 1.2, 1.3, 1.5.2, 1.9.1.) The Motion expressly states that the Proposed Agreement "will provide for the distribution of a portion of the proceeds to the AFIA Cedents." (Jt. App. at 68, ¶ 13.) The Proposed Agreement refers to distributions to AFIA Cedents under the Scheme that will be taken into account in determining the New Hampshire distributions and states that the payments "will be distributed *pari passu* (as far as reasonably practicable) to all AFIA Cedents according to the value of their claims." (Jt. App. at 77-78, ¶ 1.5.2, 1.9.1.)

The evidence adduced at the July 2005 hearing reinforced the Liquidator's concessions. The Liquidator's representatives testified that the proposed payments are on account of, and directly

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[14] The Liquidator cannot portray the proposed payments to the AFIA Cedents as akin to finders' fees in bankruptcy cases. First, the AFIA Cedents are not "finders," which is defined to include those who "… locate[ ] a particular type of executive or professional for a corporation; or … who locate[ ] a particular type of business acquisition for a corporation." *Shinberg v. Bruk*, 875 F.2d 973, 977 (1st. Cir. 1989). Second, the law requires that the finder be employed in the "ordinary course of business," which compels the debtor to demonstrate that "other [similar] businesses … would engage in the conduct in question as a normal part of their business operations," and its "creditor[s] would expect the debtor to engage in the particular course of conduct." *In re Foundation Group Sys., Inc.*, 141 B.R. 196, 199 (Bankr. E.D. Cal. 1992). The payment of tens of millions of dollars as an incentive to one group of creditors ahead of others cannot be described as an ordinary part of Home's business operations or conduct that the other creditors would expect in the normal course of business.

relate to, the AFIA Cedents' pre-liquidation claims. (*See* Ellis Test., Vol. 2-B, at 135:10-136:18; Williams Test., Vol. 4-B, at 138:10-23.) The Liquidator also introduced at the hearing a presentation that his representatives made in November 2003 in which they expressly distinguished between the proposed payments to the AFIA Cedents (described in the presentation as a "dividend") and the true administrative costs of the Proposed Agreement. (Liquidator's Trial Ex. 32, Jt. App. at 788-791; Bengelsdorf Test., Vol. 3-B, at 193:2-194:12.)

Given the undisputed evidence that the proposed payments arise from the AFIA Cedents' pre-liquidation claims, they cannot be Class I claims under the "administration costs" provision. During the July 2004 oral argument, one of the Justices emphasized this point, noting that under the Proposed Agreement the Liquidator would be "paying and distributing an asset to a claimant that doesn't look and sound like an expense of collecting assets." (Jt. App. at 388.)

C. The Applicable Case Law Demonstrates That The Superior Court's Ruling On The "Administration Costs" Issue Was In Error

The ACE Companies are not aware of any cases that support the Superior Court's ruling that the proposed payments to the AFIA Cedents would be "administration costs." To the contrary, in *Oxendine v. Commissioner of Ins. of N.C. (In re Coastal States Life Ins. Co.)*, 494 S.E.2d 545 (Ga. Ct. App. 1997), the Georgia Court of Appeals squarely rejected a similar attempt to recast a settlement of pre-liquidation claims as an administrative expense. *Oxendine* involved the interpretation of an administrative expense provision in the Georgia code that tracks the language of RSA 402-C:44, I. Creditors who had settled claims against the estate prior to the company's rehabilitation argued, when the insurer was later liquidated, that the settlements should be considered post-liquidation administrative expenses because they "preserved the assets of the estate." *Id.* at 548. The *Oxendine* court stated, in language that applies with equal force here, that:

> No reasonable definition of 'costs' or 'expenses' can include the [settlement] claims which appellees assert. These claims are for money which appellees claim from [the] estate and not administrative costs or expenses incurred.

Id. The court also found that the effect of allowing pre-liquidation claims to be classified as administrative expenses "would be to render meaningless the priority of claims established [by the Georgia statute]." *Id.* Affirming the administration costs ruling in the Orders would likewise render RSA 402-C:44 meaningless and would give liquidators the broad discretion to deviate from the order of distribution whenever they deem it advisable to do so.

The Liquidator has tried to distinguish *Oxendine* by arguing that the settlement in that case was pre-liquidation and had nothing to do with the post-liquidation collection of assets for the benefit of the estate. However, the creditors in *Oxendine* ***did*** contend the settlements "preserved the assets of the estate," which is the same as the Liquidator arguing in this case that the Proposed Agreement would help to marshal estate assets. Thus, *Oxendine* is directly on point and should have been followed by the Superior Court. The Superior Court, however, completely ignored the *Oxendine* case in the Orders.

D. The Legislature Rejected The Liquidator's Effort To Amend The Act To Allow For The Reclassification Of Claims Payments As Administration Costs

The final nail in the coffin is the Legislature's refusal to accept the Liquidator's proposed amendment to RSA 402-C:44, which contained the same interpretation of RSA 402-C:44 that the Liquidator has put forth in this proceeding.

In January 2005 — after the Court expressed reservations at the July 2004 hearing regarding the elevation of the payments under the Proposed Agreement to Class I priority — the Liquidator introduced an amendment to RSA 402-C:44 in Senate Bill 74. It stated that: "This section [*i.e.*, RSA 402-C:44] shall not be construed to prohibit any payments, as administrative costs, made to claimants in lower priority classes where those payments assist or result in the collection or recovery of assets or property . . . ." (Jt. App. at 414.) In his statement before the Senate committee considering S.B. 74, the Liquidator requested that the Legislature pass the amendment in order to clarify the intent of RSA 402-C:44: "The amendment is appropriate at this time because the issue is

one of legislative intent that may be further contested before the New Hampshire Supreme Court. The Legislature could resolve the question of its intent through the clarifying amendment." (Jt. App. at 434.)

At the initial hearing on S.B. 74, several committee members indicated that they were reluctant to include the proposed amendment and the committee scheduled a further hearing. Before that hearing took place, the Liquidator withdrew his amendment — an act which speaks for itself. The Legislature's refusal to accept the Liquidator's interpretation of the statute, as set forth in the proposed amendment, demonstrates that it was ***not*** the Legislature's intent to allow the reclassification of claims payments as "administration costs" under RSA 402-C:44, I.

V. THE SUPERIOR COURT PLAINLY ERRED IN CONCLUDING THAT THE PROPOSED AGREEMENT IS FAIR AND REASONABLE

A. The Superior Court Failed To Apply The Controlling Multi-Factored Standard For Fairness And Reasonableness

In discussing the Superior Court's consideration of the fairness issue on remand, this Court cited *In re Boston & Providence R.R. Corp.*, 673 F.2d 11 (1st Cir. 1982), and *In re Estate of Indian Motorcycle Mfg., Inc.*, 299 B.R. 8 (D. Mass. 2003). (*See* September 2004 Order, Jt. App. at 335-336.) Thus, the Court made it clear that those cases (and related authority) govern the issue of whether the Proposed Agreement is fair and reasonable.

The *Indian Motorcycle* court, relying on First Circuit precedent, listed the following factors to be considered in assessing the fairness of a settlement agreement:

> (i) the probability of success in the litigation being compromised; (ii) the difficulties, if any, to be encountered in the matter of collection; (iii) the complexities of the litigation involved, and the expense, inconvenience, and delay attending it; and (iv) the paramount interest of the creditors and a proper deference to their reasonable views … .

299 B.R. at 20. In *Boston & Providence,* the First Circuit similarly held that in assessing a settlement agreement, the supervising court "had the obligation to form an independent judgment of

the complexity, expense, and likely duration of litigation, as well as any other factors relevant to a full and fair assessment of the wisdom of the compromise." 673 F.2d at 12.

The *Boston & Providence* court also provided guidance on the supervising court's duties, stating that it "must play a quasi-inquisitorial role" and not give undue deference to the proponent of the agreement. *Id.* The supervising court has "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." *Id.* Finally, the court's analysis must be "in sufficient detail that a reviewing court could distinguish it from 'mere boilerplate approval'" of the proponent's justification for the agreement. *Id.* (*quoting Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 434 (1968)).[15]

As noted above, the Liquidator identified several "threats" that allegedly motivated him to enter into the Proposed Agreement. In order to assist the Superior Court in evaluating the Proposed Agreement (as a compromise of the alleged threatened litigation by the AFIA Cedents), the ACE Companies summarized the relevant factors from the cases as follows:

> In determining whether the Agreement is fair and reasonable, the Court must look to the following factors:
>
> (i) As a threshold matter, whether a reasonable liquidator would have believed that the threatened litigations would take place.
>
> (ii) Whether a reasonable liquidator would have believed that the threatened litigations would be complex.
>
> (iii) The costs and expenses that a reasonable liquidator would have believed the estate would incur.
>
> (iv) The likelihood that Home would prevail in such litigations, as perceived by a reasonable liquidator.

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[15] The ACE Companies included the legal standard from *Indian Motorcycle*, *Boston & Providence* and other cases in its proposed rulings of law. (*See* Jt. App. at 610-611, ¶¶ D-F.) With one notable exception discussed below, the Superior Court granted these rulings of law. (*See* Jt. App. at 59.)

(Jt. App. at 610, ¶ E.)[16] Without any explanation, the Superior Court denied the above proposed ruling of law, even though it granted every other one of the ACE Companies' proposed rulings of law on the legal standard for fairness and reasonableness. (*See* Jt. App. at 59.)

The Superior Court, moreover, failed to apply the multi-factored test from *Indian Motorcycle* and *Boston & Providence* in determining whether the Proposed Agreement is fair and reasonable. The Superior Court focused on only ***one*** factor, stating that it was reviewing the Proposed Agreement "'with the paramount interest of creditors' in mind." (*Id.* at 55.) This was plain error, and it led the Superior Court to ignore or downplay such crucial factors as the likelihood that the threatened litigations would take place, the cost and complexity of such litigations, and the likelihood that Home would prevail. The Superior Court was not free to ignore the cases that this Court, in the September 2004 Order, directed it to apply in determining the fairness and reasonableness issue. Therefore, the Superior Court erred because it did not follow the clearly applicable law, as set forth in the September 2004 Order.[17]

The Superior Court also erred by failing to fulfill its "quasi-inquisitorial role" in assessing the Proposed Agreement's fairness and reasonableness. In its rulings of law, the Superior Court acknowledged this role and held that it may not give undue deference to the Liquidator's judgment. (*See* Jt. App. at 59 (granting ruling of law ¶ D).) At the same time, however, the Superior Court held that it would defer to the Liquidator's "business judgment" regarding the Proposed Agreement.

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[16] The ACE Companies did not include the final factor cited in *Indian Motorcycle*, which relates to the interest of the creditors, because RSA 402-C:1 already states that the Liquidator should take the interests of creditors into account in discharging his duties.

[17] The Superior Court misunderstood the ACE Companies' position on the issue of fairness and reasonableness, even though they had articulated it at the July 2005 hearing and included the multi-factor test in their proposed rulings of law. According to the Superior Court, the "crux" of the ACE Companies' argument is that the Liquidator did not negotiate a commercial resolution in good faith. (*See* September 2005 Order, Jt. App. at 55.) While it is certainly the case that the Liquidator treated the ACE Companies unfairly during the negotiation process, the main thrust of the ACE Companies' argument is (and was at the hearing) that the Proposed Agreement cannot be considered fair and reasonable under the multi-factor standard established by this Court in the September 2004 Order.

(Jt. App. at 51.) Although *Indian Motorcycle* states that compromises are "generally approved if they meet the business judgment of the trustee," 299 B.R. at 21, this statement of the general rule does not mean that the Superior Court could abdicate its "quasi-inquisitorial role." Indeed, after taking note of the tendency to accept a trustee's business judgment, the *Indian Motorcycle* court applied the multi-factored test to the settlement at issue and only then found that it passed scrutiny. *See id.* at 20-23. By contrast, the Superior Court relied on the Liquidator's business judgment and accepted, at face value, his assertion that the Proposed Agreement was a response to certain "threats" (even though the evidence clearly shows that the alleged threats were illusory).

B. A Proper Application Of The Multi-Factored Test Demonstrates That The Proposed Agreement Is Neither Fair Nor Reasonable As A Matter Of Law

There was no realistic possibility that the AFIA Cedents would attempt to bypass Home's estate through novation, cut-through litigation, a side deal with ACE or a "walling off" of U.K. assets. *See* Statement of Facts, III.B, *supra*. The legal theories underlying the AFIA Cedents' "threats" are demonstrably meritless. Indeed, by the time of the July 2005 hearing, the Liquidator abandoned each of the other purported justifications and focused almost exclusively on the alleged threat of a side deal. However, given all the impediments to side deals (which the Superior Court acknowledged), it is highly unlikely that the AFIA Cedents and ACE would have or even could have pursued such arrangements. The evidence showed that the AFIA Cedents and ACE never discussed side deals. If ACE had entered into any side deal, Home would have almost certainly prevailed in any litigation without incurring significant costs. Indeed, those costs would pale in comparison to the extremely high cost of the Proposed Agreement.

VI. THE SUPERIOR COURT PLAINLY ERRED IN HOLDING THAT IT WAS "REASONABLE" FOR THE LIQUIDATOR TO CONCLUDE THAT THE PROPOSED AGREEMENT IS "NECESSARY" UNDER RSA 402-C:25

In the September 2005 Order, the Superior Court determined that the Proposed Agreement is "necessary" under RSA 402-C:25, which states that a liquidator may take steps to collect, conserve

or protect the assets of the estate. RSA 402-C:25, VI. In discussing necessity under RSA 402-C:25, the Superior Court essentially revived the equitable doctrine of necessity that it had already rejected in the Order on Remand. (*See* Order on Remand, Jt. App. at 20-21.)[18] Necessity under RSA 402-C:25 — like the equitable doctrine of necessity — cannot be used to circumvent the order of priority dictated by RSA 402-C:44.

Even if RSA 402-C:25 is relevant here, the Superior Court applied the wrong standard in determining the necessity issue. Without citing any authority, the Superior Court stated that the standard is "whether it was ***reasonable*** for [the Liquidator] to conclude that an agreement with the AFIA Cedents was necessary to marshal and maximize the assets of the estate." (Jt. App. at 53; emphasis added.) The Superior Court concluded that "the Liquidator has met his burden of proving that a reasonable liquidator under the circumstances would have concluded that the agreement was necessary to preserve access to and marshal the AFIA reinsurances." (*Id.* at 54.)

The Superior Court's focus on the reasonableness of the Liquidator's actions under RSA 402-C:25 has no support in the statute or the case law. RSA 402-C:25 does not refer to reasonableness, and the ACE Companies are not aware of any case holding that necessity turns on whether the Liquidator acted reasonably. Instead, the ACE Companies pointed out to the Superior Court that the word "necessary" in this context is the same as "essential." *See, e.g., United Savings Ass'n v. Timbers of Inwood Forest*, 484 U.S. 365, 375-76 (1988) (the phrase "necessary to an effective reorganization" in Section 362(d)(2) of the Bankruptcy Code means "essential for an effective reorganization"). Therefore, in their proposed rulings of law, the ACE Companies stated that the proper standard is "whether the AFIA Cedents, in the absence of the Agreement, would have filed and prosecuted their claims." (Jt. App. at 615, ¶ EE.) This standard is a "but for" test,

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[18] The Liquidator's brief on the prior appeal directly drew an analogy between the equitable doctrine of necessity and RSA 402-C:25. (*See* Liquidator's Br. at 25.) At the July 2004 oral argument, one of the Justices questioned how such equitable principles could be applied in a manner directly contrary to the statute. (Jt. App. at 385-386.)

under which the Liquidator must prove that the AFIA Cedents would not have filed and prosecuted their claims unless they were given an incentive to do so.

The Superior Court ***accepted*** the "but for" test by granting the ACE Companies' ruling of law (*see* Jt. App. at 59), but then erroneously used the reasonableness standard in deciding whether the Proposed Agreement is necessary. This error was critical. The reasonableness standard waters down the purely objective, "but for" test, and it caused the Superior Court to rely on the Liquidator's subjective beliefs rather than objectively examining whether the AFIA Cedents would have filed and prosecuted their claims.

An objective examination of the evidence reveals that the AFIA Cedents would have filed and prosecuted claims even in the absence of the Proposed Agreement. As noted above (*see* Statement of Facts at III.A, *supra*), there are several incentives for the filing and prosecution of reinsurance claims, including the preservation of set off, tax concerns and the possibility of a better than expected return for the estate. *See generally* Hall, "When Can A Receiver Ignore Priority of Distribution Statutes?", INS. INSOLVENCY, Vol. 17, Issue 8 at 22 (noting that companies routinely file claims in insolvencies and that many have entire departments handling such matters). Furthermore, the AFIA Cedents' prosecution of their pre-liquidation claims would not cease once the level of setoff is reached (if setoff were ever known), nor would it be difficult or costly to prosecute the claims. The Liquidator also has the ability to obtain claims information through his powers of compulsion. *See* Statement of Facts at III.A, *supra*. Thus, it was error for the Superior Court to conclude that the Proposed Agreement is necessary.

The Superior Court further erred because it attempted to support the necessity ruling by briefly discussing some of the alleged threats cited by the Liquidator. (*See* Jt. App. at 53-54.) This cursory discussion, under the Superior Court's newly created standard of "reasonable necessity," is not a substitute for a quasi-inquisitorial application of the factors listed in *Indian Motorcycle* and

Boston & Providence. Moreover, the Superior Court's findings with regard to the purported threats are contradicted by the evidence in this case.

The Superior Court found, for example, that there was "significant legal uncertainty about whether the [AFIA] Cedents or ACE could successfully litigate various theories, or negotiate side deals to gain economic advantage." (*Id.* at 54.) The Superior Court specifically mentioned the *Nationwide* case, the decision in *National Employers' Mut. Gen'l Ins. Ass'n Ltd. v. AGF Holdings (UK) Ltd.*, [1997] 2 BCLC 191 ("*NEMGIA*"), and the possibility of legal action based on a theory of constructive novation. (Jt. App. at 54.) As shown above, the *Nationwide* case actually held that a cut through, under the very same Assumption Agreement at issue here, is ***not*** permissible.[19] The constructive novation argument is equally weak and was never considered by the relevant AFIA Cedents post-liquidation. Lastly, the *NEMGIA* case cannot be the basis of any "legal uncertainty" on the issue of cut-through litigation. That case was decided under U.K. law, but it is undisputed that New York law governs the Assumption Agreement. Thus, there was no realistic "legal uncertainty" regarding the AFIA Cedents' threats, and certainly no basis for the Liquidator to conclude that he should pay the AFIA Cedents tens of millions of dollars for prosecuting their pre-liquidation claims.

CONCLUSION

The Superior Court's holdings in the Orders are contrary to RSA 402-C:44, the applicable case law, this Court's directives in the September 2004 Order and evidentiary record that was developed at the July 2005 hearing. Therefore, the ACE Companies respectfully request that the Court (a) reverse the Orders; (b) enter an order holding that the Proposed Agreement violates New

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[19] The Superior Court stated that *Nationwide* "left unanswered the question of whether a cut through would be permissible in the case of an insolvency." (*Id.*) However, in the event of an insolvency, the ability to cut through is diminished even further because of the insolvency clause in the Assumption Agreement. The Superior Court recognized that the insolvency clause in the Assumption Agreement forbids a cut through. (*See* Jt. App. at 58-59 (granting ¶ 113).)

Hampshire RSA 402-C:44 and is not necessary, fair and reasonable under the circumstances; and (c) grant such other and further relief as it deems just and proper.

REQUEST FOR ORAL ARGUMENT

The ACE Companies request fifteen minutes for oral argument, which will be presented by Gary S. Lee.

Respectfully submitted,

Dated: December 27, 2005

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CERTIFICATE OF SERVICE

I, Lisa Snow Wade, hereby certify that two copies of the foregoing brief have been forwarded to counsel of record via overnight mail on December 27, 2005.

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Lisa Snow Wade