

THE STATE OF NEW HAMPSHIRE
2004 APP - 2 P 3:19

MERRIMACK COUNTY
MERRIMACK COUNTY

MERRIMACK, SS

SUPERIOR COURT

Docket No 03 - E - 0106

In the matter of the Liquidation of The Home Insurance Company

AFFIDAVIT OF
GARETH HOWARD HUGHES

I, GARETH HOWARD HUGHES, of 1 More London Place, London SE1 2AF, United Kingdom, MAKE OATH AND SAYS AS FOLLOWS:

1. I am a licensed insolvency practitioner and a partner in the firm of accountants Ernst & Young LLP of the above address. I am also one of the Joint Provisional Liquidators of The Home Insurance Company, having been appointed to such office by the High Court in England and Wales on 8 May 2003. My partner Margaret Elizabeth Mills is the other Joint Provisional Liquidator who was appointed on the same date. I make this affidavit on the basis of my own knowledge, alternatively on the basis of information and documents supplied to me. To the extent that the matters to which I depose herein derive from my own personal knowledge, they are true, and to the extent that they derive from information and documents supplied to me, they are true to the best of my knowledge and belief. There is now produced to me marked "GHH1" and exhibited hereto a bundle of copy documents to which I shall refer to herein.
2. I have substantial experience in insurance insolvency matters, having been appointed by the English and/or Bermudian courts as insolvency officeholder to a member of insolvent insurers including The Bermuda Fire & Marine Insurance Company; Scan Re; Pine Top Insurance; Ocean Marine Mutual Association; Taisei Fire & Marine Insurance Company of Japan; Carolina Re and New Cap Reinsurance Company.

- qh*
- OKT*
3. I have seen copies of certain papers filed in the New Hampshire court by Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company and ACE American Reinsurance Company, in which those companies object to the motion of Mr Roger Sevigny, Liquidator of The Home Insurance Company, seeking approval of an agreement and compromise with AFIA Cedents. I make this affidavit in order to respond to certain of the factual assertions made by those objecting parties in their filed papers. For the sake of convenience, I shall adopt in this affidavit, save where the context otherwise requires, the same defined terms used by those parties in their Objections and Response dated 19 March 2004.
 4. As Joint Provisional Liquidators of Home, Ms Mills and I were charged by the English High Court with the responsibility for safeguarding and protecting the assets of Home located in England and Wales. Since our appointment I have been working closely with the Liquidator and his staff on issues confronting the Home estate as a result of its participating in the AFIA pool. In particular, I was closely involved in negotiating the Agreement with the members of the Informal Creditors Committee which was established pursuant to the English High Court's order of appointment.
 5. Since the date of our appointment we have liaised regularly with the Financial Services Authority ("FSA"), the responsible UK regulator of the financial services industry, to keep them informed of progress on the provisional liquidation. In particular, we have kept the FSA informed of the evolving proposal for dealing with the AFIA cedents' claims as envisaged in the Agreement and in the proposed scheme. Mr Sevigny and certain of his staff, as well as his advisers, have also participated in certain of these discussions with the FSA. A copy of the FSA's letter dated 26 March 2004 indicating its "non-objection" to the proposal appears at page 1 of GHH1.
 6. I refer to paragraph 10 of the Objections and Response of the ACE Companies, as well as to their Memorandum in support, in which they assert that Home makes the 'false proposition that the proceeds from recoveries against Century pursuant to the Assumption Agreement constitute 'UK Assets''. They make the point that these are the only alleged 'UK Assets' alluded to in the Liquidator's Motion and they go on to assert that these could not comprise UK Assets in any event.
 7. I understand that the question of 'situs' of particular assets gives rise to complex issues of fact and law. However, it is important to correct the misconception that the Liquidator cannot identify potential 'UK Assets' beyond the proceeds of the Assumption Agreement. This is not accurate. Prior to the execution of the Assumption Agreement in 1984, Home's liabilities under its AFIA policies were protected by a substantial reinsurance contract provided by BAFCO Reinsurance Company of Bermuda Limited ('BAFCO'), a Bermudian company. This reinsurance contact was first executed on 23 December 1982 and was expanded by agreements dated 23 December 1982 and February 1985 ('the BAFCO Reinsurances'). Under the BAFCO Reinsurances, as amended, BAFCO reinsured Home for its entire

inwards treaty reinsurance account for all underwriting years up to and including 1982. The cover written was for 'net losses' exceeding \$95 million in aggregate. Following various name changes and mergers, BAFCO's liabilities under the BAFCO Reinsurances were apparently assumed by another Bermudian company, Century International Reinsurance Company Limited ('CIRC'). CIRC is wholly-owned by the ACE Group.

8. The ACE Group (as run-off managers of the AFIA business) estimated that, as at 31 December 2002, the gross ultimate liabilities of Home on the AFIA business stood at US\$231 million. Home has calculated that, based upon these figures, Home's reinsurance claim against CIRC under the BAFCO Reinsurances would, after set-off, amount to approximately US\$211 million.
9. There is a substantial 'UK nexus' between Home and CIRC; firstly, the BAFCO Reinsurances are expressed to be subject to English law and disputes are to be resolved pursuant to arbitration in England. Secondly, whilst the BAFCO Reinsurances and the indemnity provided to Home by Century under the Assumption Agreement appear to overlap to a significant extent, it is clear that historically it is the BAFCO Reinsurances which have been utilised by INA and then by ACE Group (as the new owners of INA and its successor entities) to make payments to AFIA cedents on Home's behalf.
10. By way of illustration, I attach at pages 2-3 a copy of a memorandum prepared for my staff by two individuals at ACE in England dated 5 June 2003. These individuals are called Peter Bamforth and Avtar Kalsi and they work in the Accounts department of ACE at Maidstone in Kent, England. They had been asked by my staff to prepare this memorandum as part of the cash reconciliation exercise which my staff were carrying out in conjunction with the ACE personnel in order that the Joint Provisional Liquidators could better understand how the Home's UK branch had funded its operations in the period of its stewardship by the ACE Group. It was clear from this exercise that the funds made available for funding claims payments by Home to its creditors were drawn from CIRC, were paid into England and were credited against recoveries falling due from that company under the BAFCO Reinsurances. I would draw this court's attention, in particular, to paragraph 3 (a) of that memorandum. I also attach (at page 4 of GHH1) a copy of a sheet used by ACE Accounts personnel in Maidstone to reconcile the CIRC outstanding balances under the BAFCO Reinsurances to the AFIA ledger maintained by ACE on Home's and St Paul's behalf. This shows cash received from CIRC of \$1 million in January, February and May 2003, as well as pounds sterling 300,000 in January 2003. These payments were received in England.

I understand that the cash balances were not split out as between Home and St Paul at this level but both companies issued policies on the AFIA pool and both were protected by the BAFCO Reinsurances as well as by the indemnity under the Assumption Agreement.

11. ACE Group has previously asserted that Home is no longer the beneficial owner of the BAFCO Reinsurances, on the ground that they were allegedly assigned to INA in 1984 as part and parcel of the AFIA business transfer arrangements. Neither the Liquidator nor the Joint Provisional Liquidators accept this analysis, not least because Home was a signatory of the February 1985 agreement referred to in paragraph 6 above, pursuant to which the BAFCO Reinsurances were amended - i.e. after the date of their alleged "assignment" to INA. I attach at pages 5-7 of GHH1 a copy of a letter (provided to me by Jonathan Rosen, Chief Operating Officer of Home, from Home's records in New York) sent by AFIA Worldwide Insurance to the UK Department of Trade and Industry dated 28 October 1985 (this was sent at a time when the CIGNA group had assumed responsibility for running off the Home's AFIA business under the Assumption Agreement but prior to ACE's acquisition of that part of the CIGNA group). The UK Department of Trade and Industry was at that time the responsible regulator for the insurance industry in the UK. It is noteworthy that in this letter Mr White, on behalf of the CIGNA group entities then running off the Home business, makes express reference to the BAFCO Reinsurances and observes (bottom of page 1) that '*all losses of the UK Treaty Departments of Home and St Paul and certain uncollectable reinsurance is recoverable from BAFCO.*' Further, at the bottom of page 2 of that letter, Mr White goes on to observe: '*In conclusion I would suggest that the reinsurance now afforded by BAFCO under the [BAFCO Reinsurances] ... provide high quality protection for the United Kingdom Treaty Department of Home and St Paul.*'
12. I now allude to paragraphs 12 and 13 of the ACE Companies' Objection and Response and to their assertions that, first, AFIA cedents would be likely to file proofs of claim in the Home liquidation in any event and, second, the Liquidator has not substantiated his assertion that, but for the proposed scheme of arrangement contemplated by the Agreement, AFIA cedents would seek to 'wall off' the UK assets or seek to negotiate side agreements with the ACE group.
13. With respect to the first assertion, I fundamentally disagree with the ACE Companies. Several members of the Informal Creditors Committee (including Excess Insurance, Unionamerica, Equitas, Agrippina and Continental Insurance Company) have made it clear to me on a number of occasions that they would be most unlikely to prosecute proofs of claim in the New Hampshire liquidation proceeding in the absence of the Agreement (save, possibly, to the extent necessary to preserve any set-off rights which they might have), for the simple reason that they would not wish to incur the time and expense of prosecuting those claims in circumstances where they would not receive payment for their claims.
14. With respect to the second assertion, I can certainly provide substantiation. In a number of discussions which I and/or my staff have had with certain Informal Creditors Committee members (Equitas, Agrippina, Excess), those members have made it clear that they have been considering what methods may be available to them to enable them to 'cut-through' to the reinsurances provided to Home by the ACE Group or otherwise to negotiate a direct agreement with the ACE Group. In

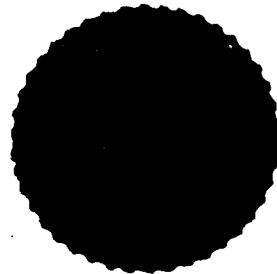
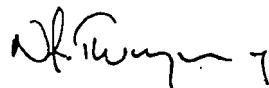
particular, they have suggested that they might try to negotiate direct arrangements with the ACE Group whereunder the ACE Group would make payments to AFIA cedents, by-passing the Home estate in the process. Both the Liquidator and the Joint Provisional Liquidators have made it clear that we would not regard any such arrangements as legally permissible but I am nevertheless very concerned that the threat has been made. In my experience, it is very difficult in practice for insolvent insurers to pre-empt and deal with such arrangements and I understand that, certainly as a matter of English law, the legal basis for challenging this type of 'cut-through' arrangement is very far from straightforward.

15. With respect to the "walled off" liquidation issue, the Informal Creditors Committee members as a body indicated to us that they wished to investigate the question of whether there should be a separate "ring-fenced" English liquidation procedure whereunder the assets of the UK branch of Home would be ear-marked for distribution to the UK branch creditors. The legal advisers to Excess and Continental Insurance have since indicated to us that, if the scheme of arrangement envisaged by the Agreement does not proceed, they will certainly revisit this issue.

Sworn this 31st day of March 2004)
gmlhthy6

Before me NICHOLAS ANDREW THOMPSON)

Notary Public



Notary Public London England (Nicholas A. Thompson)

My Commission Expires at Death

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THE STATE OF NEW HAMPSHIRE

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Docket No 03 - E - 0109

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