THE STATE OF NEW HAMPSHIRE
SUPREME COURT

Docket No. 2004-0319

In the Matter of the Liquidation of
The Home Insurance Company

APPEAL FROM THE FINAL DECISION OF THE
MERRIMACK COUNTY SUPERIOR COURT

BRIEF FOR RESPONDENTS-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 Merrimack County Superior Court err as a matter of law when it ruled that the liquidator of an insolvent insurer had the authority under the New Hampshire Insurers Rehabilitation and Liquidation Act, RSA 402-C:1, *et seq.* (the "Act") to enter into an agreement with a subclass of Class V creditors under RSA 402-C:44 of the Act whereby those creditors would receive a distribution of assets from the estate of an insolvent insurer before claimants in prior classes have been paid in full, and in an amount different than the rest of the Class V creditors? (Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents ("Motion"), Jt. App. at 45-48, ¶¶ 9, 12-15; Objections and Response of the ACE Companies to the Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents ("ACE Companies' Objections"), Jt. App. at 68-72, ¶¶ 3-5, 7-15.)

2. Did the Merrimack County Superior Court engage in an unsustainable exercise of discretion in refusing to require adequate notice or to allow discovery or an evidentiary hearing on the factual issues raised by the motion to approve the aforementioned agreement? (ACE Companies' Objections, Jt. App. at 70-71, 73, ¶¶ 7-10, 17.)

STATUTES INVOLVED

The statutes at issue in this appeal are RSA 402-C:1, RSA 402-C:25 and RSA 402-C:44. (Jt. App. at 1-7.)

STATEMENT OF THE CASE

Respondents-Appellants Century Indemnity Company ("Century"), ACE Property and Casualty Insurance Company ("ACE P&C"), Pacific Employers Insurance Company ("PEIC"), and ACE American Reinsurance Company ("AARe") (collectively, the "ACE Companies") appeal from an Order of the Merrimack County Superior Court (McGuire, J.), dated April 29,

2004 (the "Order"), on the Liquidator's Motion for Approval and Compromise with AFIA Cedents (the "Motion") in *In the Matter of the Liquidation of the Home Insurance Company*, Superior Court No. 03-E-0106. In the Order, the Superior Court approved an agreement (the "Proposed Agreement") that Roger A. Sevigny, Insurance Commissioner of the State of New Hampshire, as Liquidator (the "Liquidator") of Home Insurance Company ("Home"), had entered into with representatives of certain insurers who had ceded insurance risk to Home's U.K. branch office as participating members of the American Foreign Insurance Association ("AFIA") reinsurance pool.[1] (Order, Jt. App. at 283-85.) The Superior Court also implicitly denied the ACE Companies' objection to the Proposed Agreement on the grounds of inadequate notice and their request for limited discovery and an evidentiary hearing on the matters raised by the Proposed Agreement. (*Id.*)

On February 11, 2004, the Liquidator filed his Motion for approval of the Proposed Agreement, whereby an English law "scheme of arrangement" would be established for Home.[2] Under the scheme, the AFIA Cedents would be paid an "incentive" to file their claims against Home amounting to ***half*** of the net proceeds recovered from reinsurers (principally ACE Group companies) based on those claims. (Motion, Jt. App. at 47-68, ¶¶ 13-15.) The Liquidator sought to justify the Proposed Agreement by alleging that the AFIA Cedents had no reason to file proofs of claim in Home's New Hampshire liquidation (beyond those necessary to offset any obligations the AFIA Cedents owed to Home) because such claims would be Class V claims under RSA 402-C:44 and as such would be unlikely to be paid, in whole or in part (as typically assets are

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[1] In this brief, the insurers that participated in the AFIA reinsurance pool will be referred to as the "AFIA Cedents." The background of the AFIA pool is described more fully below in the Statement of Facts.

[2] The details of the "scheme of arrangement" are described more fully below in the Statement of Facts.

insufficient to cover even higher priority claims). (*Id.*, at 41-44, ¶¶ 6-7.) If the AFIA Cedents did not file claims against Home, the Liquidator argued, he would be unable to recover from Home's reinsurers for those claims. (*Id.*, at 47, ¶ 13.)

Moreover, according to the Liquidator, certain AFIA Cedents were threatening to seek to satisfy their claims against Home through separate proceedings in England or otherwise outside the New Hampshire liquidation. (*Id.*, at 42-44, ¶ 7.) Although the Liquidator acknowledged that such attempts would be without legal basis and could be defeated, he sought to justify the Proposed Agreement as a "compromise" or "settlement" of the AFIA Cedents' threats. (*Id.*, at 42-44, ¶ 7.) Despite the unprecedented nature of the relief sought, only ***five*** creditors of Home's thousands of creditors were provided with notice of the Motion. (Notice of Motion, Jt. App. at 8-9.) On February 11, 2004, the ACE Companies were served with a copy of the Motion. (*Id.*, at 8-9.)

The ACE Companies, which like the AFIA Cedents are Class V creditors of Home, and certain of which also are reinsurers of Home's AFIA liabilities,[3] filed objections to the Liquidator's Motion on March 19, 2004. (ACE Companies' Objections, Jt. App. at 67-75.) The ACE Companies alleged that the Proposed Agreement violated the mandatory order of distribution provisions in RSA 402-C:44 which provides, in 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.

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[3] The ACE Companies' relationships with Home are described more fully below in the Statement of Facts.

> 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 . . . .
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> . . . .
>
> V. Residual Classification. All other claims . . . not falling within other classes under this section. . . .

RSA 402-C:44 (emphasis added); (ACE Companies' Objections, Jt. App at 68-69, ¶ 4.) The ACE Companies argued that the Proposed Agreement was unlawful because it provided for the payment of a distribution to a small subclass of Class V creditors (the AFIA Cedents) before higher classes of creditors were paid in full, and before similarly situated Class V creditors were paid in a like amount, in direct contravention of RSA 402-C:44. (*Id.*)

The ACE Companies also argued that the Liquidator lacks the authority under the Act to circumvent the order of distribution established by the New Hampshire Legislature (the "Legislature") in RSA 402-C:44 via an alleged "compromise." (*Id.*, at 70, ¶ 7.) The ACE Companies further objected to the Motion on the grounds of inadequate notice (*id.*, at 72, ¶ 16), sought limited document discovery and depositions of the witnesses who submitted affidavits in support of the Motion, and asked the Superior Court to conduct an evidentiary hearing on the facts relating to the Motion (*id.*, at 73, ¶ 17). On March 26, 2004, the ACE Companies filed their Assented To Petition to Intervene in Home's liquidation proceedings. (Petition to Intervene, Jt. App. at 24-26.)

On April 2, 2004, the Liquidator filed his reply brief, together with six additional affidavits in further support of the Motion. (Rosen Affidavit, Jt. App. at 117-130; Hughes Affidavit, Jt. App. at 131-144; Warmuth Affidavit, Jt. App. at 145-159; Williams Affidavit, Jt. App. at 160-164; Averill Affidavit, Jt. App. at 165-178; Knowles Affidavit, Jt. App. at 179-182.)

He also objected to the ACE Companies' request for discovery and an evidentiary hearing. (April 9, 2004 Transcript, Jt. App. at 187:7-13, 189:13-20.) The ACE Companies had no opportunity to respond to those affidavits because at a status conference on April 9, 2004, the Superior Court announced that it first would decide the issue of whether the Liquidator has the authority, as a matter of law, to enter into the Proposed Agreement. (*Id.*, at 191:21-192:9, 194:22-23.) The Superior Court further indicated that, if it found that the Liquidator had such authority, it then would consider the issues of discovery and the presentation of evidence. (*Id.*, at 191:17-192:9.) Notably, at the April 9, 2004 status conference, counsel for the Liquidator agreed that the ACE Companies have standing to participate in this case. (*Id.*, at 108:16-19.)

The Superior Court heard argument on the question of the Liquidator's authority on April 23, 2004. (April 23, 2004 Transcript, Jt. App. at 212-282.) Once again, counsel for the Liquidator did not dispute the ACE Companies' standing to pursue their objections. (*Id.*, at 216:11-14.) On April 29, 2004, the Superior Court issued the Order, holding that "the agreement proposed by the Liquidator 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-C:1, IV." (April 29 Order, Jt. App. at 284.) The Order granted the Motion in its entirety, thus implicitly denying the ACE Companies' due process objection and their request for discovery and an evidentiary hearing. (*Id.*, at 284-285.) The alleged factual bases underlying the Proposed Agreement thus have yet to be tested.

On May 6, 2004, the ACE Companies filed a Motion to Transfer Question of Law for Interlocutory Appeal. (*See* Motion for Stay of Order Pending Mandatory Appeal Pursuant to Rule 7, June 9, 2004, at ¶ 5.) On May 7, 2004, Benjamin Moore & Co. ("Benjamin Moore") filed a Notice of Mandatory Appeal directly with this Court. Pursuant to Rule 7(4) of the Rules

of the Supreme Court of the State of New Hampshire, the ACE Companies are a party to this appeal by virtue of the Notice of Mandatory Appeal. Also on May 7, 2004, the Liquidator filed an Opposition to Motion to Transfer Question of Law for Interlocutory Appeal on the basis that the Order was final and appealable as of right. (*See* Exhibit B to Motion for Stay of Order Pending Mandatory Appeal Pursuant to Rule 7.)

On May 11, 2004, the ACE Companies filed with this Court a motion to stay the Order pending appeal and a motion to waive the requirement, in Supreme Court Rule 7-A, that motions for a stay be filed with the Superior Court in the first instance. That same day, this Supreme Court denied the motion to waive filing and remanded the case to the Superior Court for the limited purpose of ruling on any motion to stay filed by the ACE Companies. The ACE Companies filed such a motion on May 12, 2004.

By Order dated June 1, 2004, the Superior Court denied the ACE Companies' motion for a stay, noting the case had been "remanded for the limited purpose of ruling upon any motion to stay filed by the ACE Companies." (*See* Exhibit C to Motion for Stay Pending Mandatory Appeal pursuant to Rule 7.) Despite the limited scope of the remand, the Superior Court also purported to issue an "Addendum" to the Order of April 29 stating that "a further evidentiary hearing into whether the Liquidator has reasonably exercised his authority in endorsing the agreement would not be helpful." (June 1, 2004 Addendum Order, Jt. App. at 287.) Thereafter, the ACE Companies filed another motion to stay with this Court.

On June 1, 2004, the Liquidator filed a Motion to Dismiss Appeal, alleging that the ACE Companies lacked standing to appeal the Order. The ACE Companies filed a Response to the Liquidator's Motion on June 11, 2004. By Order dated June 11, 2004, the Court denied the ACE

Companies' Motion to Stay, deferred ruling on the Liquidator's Motion to Dismiss Appeal and established an expedited briefing schedule and hearing for this Appeal.

STATEMENT OF FACTS

I. The ACE Companies' Interests as Creditors of Home

Century, ACE P&C, PEIC, and AARe are members of the ACE Group. (Durkin Aff., Jt. App. at 77, ¶ 4.) All of the ACE Companies are incorporated in Pennsylvania with their principal place of business in Philadelphia. (*Id.*)

Prior to its insolvency, Home was a reinsurer of the ACE Companies pursuant to various separate and independent reinsurance agreements. (*Id.*, at 77, ¶ 5.) As creditors of Home, the ACE Companies stand to suffer financial damage as a result of Home's inability to fulfill its contractual obligations due to its insolvency. (*Id.*) The ACE Companies have filed proofs of claim against Home in the amount of $153,423,300.74.[4] (Proofs of Claims, Jt. App. at 300-349.) The ACE Companies understand that their claims will be treated as Class V claims pursuant to RSA 402-C:44.

II. Century's Interest as a Reinsurer of Home's AFIA Obligations

A. Background of AFIA

The Proposed Agreement at issue in this appeal concerns obligations assumed by Home as part of its participation in an insurance "pool" previously known as the American Foreign Insurance Association and later as AFIA. (Durkin Aff., Jt. App. at 77-78, ¶ 6; Motion, Jt. App. at 40, ¶ 2.) AFIA was an unincorporated entity formed in 1918 through which its members --

[4] Each of the ACE Companies has filed proofs of claim against Home, in the following amounts: Century -- $139,291,554.56; ACE P&C -- $13,992,050.79; AARe -- $121,799; and PEIC -- $17,896.39. (Proofs of Claim, Jt. App. at 300-349.)

U.S. insurance companies -- carried on business outside of the U.S. (Durkin Aff., Jt. App. at 77-78, ¶ 6.) The structure of the pool was that various AFIA member companies obtained licenses or authorizations to operate branches in foreign countries and carry on the business of insurance through such branches in their own names. (*Id.*) Regardless of which company issued a policy or contract of reinsurance, through a series of reinsurance agreements, every risk ultimately was shared by each member of AFIA in a fixed percentage equal to its number of "units of participation" in AFIA. (*Id.*) The AFIA members also arranged for common reinsurance that protected all members in excess of certain claim levels. (*Id.*)

In connection with its participation in AFIA, Home opened a branch office in London, England through which it issued policies of insurance and reinsurance. (*Id.*, at 78, ¶ 7; Motion, Jt. App. at 40, ¶ 2.) Home's London office was not a separate English company or subsidiary; the results of the London office's activities were included in Home's accounts. (Durkin Aff., Jt. App. at 78, ¶ 7.) Notably, Home issued reinsurance agreements to AFIA Cedents that were not located solely in the U.K. (*Id.*, at 80, ¶ 14.) To the contrary, numerous AFIA Cedents were domiciled in the U.S., Canada, Bermuda, and indeed throughout the world.[5] (*Id.*)

B. Century's Assumption of Home's AFIA Liabilities

The merger between Insurance Company of North America ("INA") and Connecticut General Insurance Company that created the CIGNA Corporation in 1982 set in motion a series of transactions that resulted in the sale of the rights and interests in the AFIA business to CIGNA

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[5] A list of the domiciles of various AFIA Cedents is attached as Exhibit B to the Durkin Aff., Jt. App. at 93.

in 1984.[6] (Durkin Affidavit, Jt. App. at 78, ¶ 8.) As part of the transfer of the AFIA business to CIGNA, Home (and other AFIA companies) entered into an Insurance and Reinsurance Assumption Agreement (the "Assumption Agreement")[7] with INA (a CIGNA company) dated January 31, 1984, pursuant to which INA reinsured 100% of Home's liabilities under the insurance and reinsurance contracts Home had issued.[8] (*Id.*, at 78-79, ¶ 9.) Century became the successor to INA with respect to the Assumption Agreement by virtue of a corporate restructuring under Pennsylvania law. (*Id.*, at 79, ¶ 10.) Century thereafter was acquired by the ACE Group when ACE purchased the CIGNA Property and Casualty Companies in 1999. (*Id.*) Thus, Century is now Home's counterparty with respect to the Assumption Agreement. (*Id.*)

The Assumption Agreement contains the following terms that are relevant to the matters raised in the Motion:

- Century assumed all obligations of Home (*id.*, at 82, ¶ 2);
- Century assumed the obligation to administer the business, including the investigation and settlement of claims, and was given full power of attorney to act on Home's behalf for that purpose (*id.*, at 82-83, ¶ 3);
- in the event of Home's insolvency, Century's reinsurance obligations are payable to Home or its liquidator; in turn, Century has the right to receive

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[6] That merger resulted in the situation in which CIGNA owned one member of AFIA (Aetna Insurance Company) while also competing with AFIA through CIGNA's existing affiliates. (Durkin Aff., Jt. App. at 78, ¶ 8.) This situation was contrary to the governing principles of AFIA, and led to negotiations that resulted in CIGNA's purchase of all AFIA interests. (*Id.*) No new business was written through AFIA after it was acquired by CIGNA (with the exception of business written by a CIGNA affiliate until approximately 1987 in accordance with the sale documents). (*Id.*)

[7] A true and correct copy of the Assumption Agreement is attached as Exhibit A to the Durkin Aff., Jt. App. at 81-92.

[8] With regard to Home's direct insurance obligations, there was a statutory transfer in the U.K. whereby CIGNA companies were substituted for Home and the other AFIA companies. (Durkin Aff., Jt. App. at 78-79, ¶ 9, n.3.) Such a transfer (or novation) did not take place with regard to the assumed treaty reinsurance operations of Home. (*Id.*)

notice of any claim, and investigate and interpose defenses to such claims in the liquidation proceedings (*id.*, at 84-86, ¶ 6); and

- the Assumption Agreement is governed by New York law (*id.*, at 90, ¶ 10), with disputes to be resolved in arbitration to take place in New York (*id.*, at 86-87, ¶ 7).[9]

Since 1984, Century (and its predecessor and affiliates) have complied fully with the financial and administrative obligations under the Assumption Agreement to handle and adjust claims by Home's AFIA cedents. (*Id.*, at 90, ¶ 11.) In so doing, Century has handled claims without any day-to-day involvement of Home, even after Home became financially troubled in the mid-1990s and was placed into rehabilitation proceedings.[10] (*Id.*, at 90-91, ¶ 12; Motion, Jt. App. at 40-41, ¶ 4.)

III. Events Leading Up to the Motion and Proposed Agreement

Without the knowledge of Century or any of the other ACE Companies, the Commissioner, as Home's Rehabilitator, began negotiations with certain U.K.-based AFIA Cedents at some point during the spring of 2003 that ultimately led to the Proposed Agreement. (April 23, 2004 Transcript, Jt. App. at 219:16-19, 222:13-15.) On May 8, 2003, the Commissioner filed a petition with the Superior Court to liquidate Home on grounds of insolvency. (Motion, Jt. App. at 41, ¶ 5.) That same day, Home was placed into provisional liquidation by the High Court of Justice in London, England, and Joint Provisional Liquidators

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[9] In the Motion, the Liquidator referred to the "repatriation" of "U.K. Assets" of Home. (Motion, Jt. App. at 39-40, 42-44, 46, ¶¶ 1, 7, 11.) Although the Liquidator did not define those U.K. assets, the only assets alluded to in the Motion are reinsurance recoveries against Century pursuant to the Assumption Agreement. (*Id.*, at 47, ¶ 13.) Given that those recoveries would be from a Pennsylvania company pursuant to a contract governed by New York law with New York arbitration provisions, Century's obligations under the Assumption Agreement cannot be characterized as "U.K. Assets" of Home.

[10] Since the Superior Court placed Home into Liquidation, Century has continued to investigate and administer the claims of Home's AFIA cedents pursuant to the Assumption Agreement, in close cooperation with Home's Liquidator, but Century has not made any binding determinations. (Durkin Aff., Jt. App. at 79, ¶ 12.) The Liquidator has taken the position that Century's obligation to investigate and adjust the claims by cedents of Home's U.K. branch continues despite the insolvency of Home. (*Id.*)

were appointed for it.[11] (*Id.*) On June 13, 2003, the Superior Court declared Home insolvent and appointed the Commissioner as Home's Liquidator. (*Id.*)

Thereafter, the Joint Provisional Liquidators, supported by the Liquidator (but again without the knowledge of any of the ACE Companies), continued to negotiate with those U.K.-based AFIA Cedents to develop an English law "scheme of arrangement" for Home.[12] (April 23, 2004 Transcript, Jt. App. at 219:16-19, 222:13-15, 226:5-8.) The purpose of the scheme was to enable the Liquidator to collect reinsurance, principally from "the ACE Group," by paying a portion of the proceeds recovered directly to the AFIA Cedents. (Proposed Agreement, Jt. App. at 53-55, 57, ¶¶ 1, 1.3, 1.3.4, 1.3.5, 1.4, 1.5.1, 1.9.3, 1.9.4, 1.9.5, 1.9.7.) Ultimately, the negotiating parties reached the Proposed Agreement, which contained the following relevant terms:

- the Liquidator would seek the Superior Court's approval for the implementation of a scheme of arrangement between Home and the AFIA Cedents (Proposed Agreement, Jt. App. at 53, ¶ 1.1.2.);
- once the Superior Court's approval was obtained, the Joint Provisional Liquidators would seek the High Court's approval for the scheme of arrangement, as well as the approval of the requisite majority of creditors (*id.*, at 54, ¶ 1.1.3.);
- the AFIA Cedents would file claims against Home, thus enabling Home to seek reimbursement for those claims from "the ACE Group or any 'Third Party Reinsurer'" as defined therein (*id.*, at 54, ¶ 1.3.); and
- 50% of the "proceeds received by Home from the ACE Group or any Third Party Reinsurer" as a result of the AFIA Cedents' claims, less certain deductions specified in the Proposed Agreement, would be distributed *pari passu* to the

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[11] As set forth in the Affidavit of Richard Hacker, Q.C., a provisional liquidation often is commenced solely for the purpose of effecting the statutory automatic stay of proceedings against an insolvent debtor. (Hacker Aff., Jt. App. at 99, ¶¶ 15-16.)

[12] As noted in the Hacker Affidavit, a scheme of arrangement is a creation of English statute that enables a debtor – solvent or insolvent – to enter into an arrangement with his creditors (either as a whole or with one or more classes of creditor) relating to the claims existing between them. (Hacker Aff., Jt. App. at 100, ¶¶ 17-18.) A non-assenting creditor may be bound by the terms of the scheme against his wishes if a specified majority of the class of which the creditor is a member (a simple majority in value representing not less than 75% in value of those voting on the scheme proposal) has approved the scheme. (*Id.*)

AFIA Cedents according to the value of their claims (*id.*, at 54, 56-57, ¶¶ 1.3, 1.9.1.).[13]

Notwithstanding Century's contractual entitlement to adjust and administer claims by Home's AFIA Cedents, the Liquidator did not inform, involve or consult with Century or any other ACE Company about the Proposed Agreement. (Durkin Aff., Jt. App. at 79, ¶ 13.) Indeed, the ACE Companies knew nothing of the Proposed Agreement until it had already been executed.[14] (*Id.*)

SUMMARY OF THE ARGUMENT

The Superior Court erred as a matter of law when it approved the Proposed Agreement. The Liquidator has no authority to make distributions to creditors that directly contravene the express mandates of the order of distribution statute, RSA 402-C:44, regardless of whether the agreement pursuant to which such payments are made allegedly benefits the Home estate. The general purpose of the Act and the general powers afforded to the Liquidator cannot trump the specific statutory priorities created by the Legislature. Similarly, the Liquidator cannot offer unlawful "incentives" to a subclass of creditors in the guise of a "compromise," nor can he pass

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13 Thus, the larger the value of the claims that the AFIA Cedents file, the greater the amount of the payments they will receive.

14 Beyond their lack of knowledge of the Liquidator's negotiations with certain AFIA Cedents about the Proposed Agreement, the ACE Companies were disturbed to learn that the Proposed Agreement actually restricts the AFIA Cedents from communicating with Century regarding settlements of claims that Century has the right to investigate and adjust. (Proposed Agreement, Jt. App. at 55, ¶¶ 1.4, 1.5.1.) Century believes that the Liquidator's conduct in negotiating such provisions directly breaches Home's duty of utmost good faith to Century under the Assumption Agreement. Whether the Liquidator's conduct and the Proposed Agreement have violated Home's duties to Century under the Assumption Agreement is not before the Court. Century reserves the right to address separately issues such as Century's obligations for claims, and its rights and duties under the Assumption Agreement generally. Because the Assumption Agreement is governed by an arbitration clause, arbitration is the necessary and appropriate forum for those issues. Century also reserves its right to seek reimbursement of expenses under the Assumption Agreement, including those incurred in relation to this dispute.

off those unlawful "incentives" as an "administrative expense" of the estate. The order of distribution mandated by the Legislature must be enforced, and thus the Superior Court's Order must be reversed.

Alternatively, even if the Act permitted some deviation from the order of distribution in RSA 402-C:44 (which it clearly does not), the Superior Court engaged in an unsustainable exercise of discretion in refusing to require adequate notice to all affected parties and to allow limited discovery and a hearing on the merits of the Liquidator's alleged compromise. Basic due process requires that each creditor of Home that could be adversely affected by the Liquidator's unprecedented scheme must be given a right to be heard on it. Moreover, the limited evidence adduced below demonstrated that the factual bases for the Proposed Agreement are highly questionable at best. Certainly no record has been created upon which this Court may determine whether any discretion that might exist has been exercised appropriately. In such circumstances, the Superior Court's Order approving the Proposed Agreement must be reversed.

ARGUMENT

I. THIS COURT'S STANDARDS OF REVIEW

In its Order, the Superior Court considered whether the Liquidator had authority to enter into the Proposed Agreement despite the mandatory order of distribution set forth in RSA 402-C:44 of the Act. This Court reviews such questions of statutory interpretation *de novo*. *Blackthorne Group v. Pines of Newmarket*, 848 A.2d 725, 728 (N.H. 2004).

In approving the Proposed Agreement without requiring adequate notice, discovery or an evidentiary hearing, the Superior Court implicitly held that the Liquidator's exercise of his alleged discretion was reasonable as a matter of law and under the facts presented by the Liquidator. In so doing, the trial court engaged in an unsustainable exercise of discretion that

was unreasonable and to the prejudice of the ACE Companies' case. *State v. Gaffney*, 147 N.H. 550, 556 (2002) (citations omitted).

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

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

RSA 402-C:44 establishes multiple classes of claimants in an insurance company liquidation, and compulsory rules for the eventual distribution of assets to those claimants:

> Order of Distribution. 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.***
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> 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.
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> 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 . . . .
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> . . . .
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> V. Residual Classification. -- All other claims ... not falling within other classes under this section . . . .

RSA 402-C:44 (emphasis added).

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 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 millions of dollars in distributions before those 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 "equitable," 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, RSA 402-C:44 does not allow for *any* variation or exercise of discretion by a liquidator. By approving the Proposed Agreement, the Superior Court failed to enforce the statute as written.

Well-established precedent and rules of statutory construction require that the Legislature's unambiguous mandates be enforced. This Court has stressed that the Legislature's choice of the word "shall" in RSA 402-C:44 cannot be ignored. "Pursuant to general rules of statutory construction, the word 'shall' is a command, which requires mandatory enforcement." *Fastrack Crushing Servs. v. Abatement Int'l/Advatex Assocs, Inc.*, 149 N.H. 661, 664-65 (2003) (citation omitted). Moreover, "[w]hen examining the words in a statute, [courts] ascribe to them their plain and ordinary meanings." *Sanborn Reg'l Sch. Dist. v. Budget Comm.*, 150 N.H. 241, 242 (2003) (citation omitted). Further, "[w]hen the language of a statute is plain and unambiguous, [courts] do not look beyond it for further indications of legislative intent." *Id.*; *accord Hutchins v. Peabody*, 849 A.2d 136 (N.H. 2004); *Remington Investments v. Howard*, 843 A.2d 334, 336 (N.H. 2004); *Estate of Ireland v. Worcester Ins. Co.*, 149 N.H. 656, 661 (2003); *Marceau v. Concord Heritage Life Ins. Co.*, 149 N.H. 216, 218 (2003). "The legislature is presumed to choose the words of a statute advisedly." *Appeal of Public Serv. Co.*, 141 N.H. 13,

17 (1996) (citation omitted). "Courts can neither ignore the plain language of the legislation nor add words which the lawmakers did not see fit to include." *Id.* "The legislative intent is to be found not in what the legislature might have said, but rather in the meaning of what it did say." *Id., see also, Appeal of Ann Miles Builder* 150 N.H. 315, 318 (2003) ("We will not consider what the legislature might have said or add words that the legislature did not include.") (citations omitted).

A recent decision illustrates that the Court will strictly interpret a statute's plain mandate. In *Blackthorne Group v. Pines of Newmarket*, 824 A.2d 725 (N.H. 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 728. The Court held that a real estate broker's failure to obtain a license precluded it from suing for services provided. *Id.* at 729. "We cannot ignore the statute's plain language to permit the plaintiff to bring claims the statute expressly prohibits." *Id.* at 730. 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.* at 731. 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."[15] *Id.* (internal citation omitted). By approving the Proposed Agreement, the

[15] In this case, the Liquidator has argued that the ACE Companies would receive a "windfall" if the Proposed Agreement was rejected; the Superior Court likewise referred to a "windfall" of $231 million. (April 23, 2004 Transcript, Jt. App. at 227:10-12, 267:2-5.) As noted in *Blackthorne*, the existence of any purported "windfall" is irrelevant; the Court must focus on the language of the statute rather than any alleged effect caused by a strict application of its terms. 824 A.2d at 730-31. Moreover, the purported "windfall" is illusory. The agreement proposed by the Liquidator unlawfully pays the AFIA Cedents to file claims that allegedly they would not bother to submit in a liquidation that complied with New Hampshire law. As noted herein in Section II (B), the fact that the statutory scheme may affect certain creditors' incentives to participate in the liquidation is something that the Legislature plainly contemplated when it placed those creditors lower in the statutory priority scheme. In any event, the figures reported by the Liquidator are from 2002, and thus are obsolete. The current estimate of the claims that could be filed by the AFIA Cedents is believed to be lower.

Superior Court allowed the Liquidator to substitute his own judgment for that of the Legislature. The Order therefore must be reversed.

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

New Hampshire's order of distribution statute is not new, nor is it novel. The mandatory order of distribution provision set forth at RSA 402-C:44 dates back to 1969 and is virtually identical to analogous provisions in all states.[16] The elevated status afforded to policyholders gives them a priority on an insolvent insurer's assets. Policyholders thus have an increased incentive to file their claims, as they are more likely to be paid than lower priority creditors are.

When legislatures in New Hampshire and throughout the United States made a conscious policy decision to elevate the claims of policyholders above those of other creditors, they necessarily understood that lowering the priority of other creditors might affect their incentives to file claims with insolvent insurers. By relegating general creditors, including reinsured creditors, virtually to the bottom of the priority list, legislators certainly appreciated that such creditors might have a diminished motivation to assert claims against the insolvent insurer where its assets are insufficient to cover claims of policyholder creditors. One consequence of a reinsured creditor's failure to file claims might be that reinsurance potentially covering such

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[16] Such priority schemes date back to the late 1960s. Prior to then, most states had adopted insurance receivership schemes that were modeled on the New York statute, N.Y. Ins. Law ch. 30, §§ 400-28 (Consol. 1932), and the Uniform Insurers Liquidation Act, 13 U.L.A. 321 *et seq.* (1939). *Cf.* 1935 Cal. Stat. ch. 291, § 1010 *et seq.*; Ill. Rev. Stat. ch. 73, ¶¶ 799-833 (1935); Tex. Rev. Civ. Stat. Ann. tit. 78, art. 5068c (1939); *see also* 1936 National Ass'n of Ins. Comm'rs Proc. 30-32 ("An act relating to the rehabilitation, reorganization or liquidation of insurers doing business in more than one state"). The New York statute contained a priority scheme consistent with settled common law principles: administration expenses were paid first, followed by wage claims, and then all other claims according to priorities the receivership court directed. N.Y. Ins. Law ch. 30 G§§ 419, 426. Equity interest claims were paid last. In 1967, beginning with a new statute in Wisconsin, states began re-ordering the priority of claims against insolvent insurers to elevate policyholders' claims over those of general creditors and the government. Wis. Stat. Ann. § 645.68 (West 1980). Whereas the equal treatment of unsecured creditors is the rule in federal bankruptcies, all states have elevated the claims of policyholders in their priority of distribution schemes.

claims could not be accessed. Despite this fact, the Legislature nonetheless chose to make the order of distribution provisions, with their self-evident incentives, mandatory and absolute.

Consistent with these mandates, there has been no reported instance of variation from 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, similar issues have been addressed by courts in other states. For example, in *Washburn v. Dyson, (In re Liquidation of Security Casualty Co.)*, 537 N.E.2d 775 (Ill. 1989), the Illinois Supreme Court considered whether defrauded shareholders of an insurance company in liquidation should be able to impose a constructive trust on the proceeds of a stock offering that were in the possession of the insolvent insurer. The constructive trust effectively would have satisfied the shareholders' claims outside of the priority statute.[17] The court determined that "the liquidation provisions of the Insurance Code provide the exclusive scheme for determining priorities in distribution" of an insolvent insurer's assets. *Id.* at 782. It therefore ruled that "equitable relief, such as a constructive trust, is precluded [and that the trial court] could not avoid the effect of the statutory scheme by imposing a constructive trust on [the insurer's] assets."[18] *Id.*

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[17] Like New Hampshire, Illinois has a comprehensive statutory scheme for the liquidation of insolvent insurance companies, including a provision regarding the priority of distribution of assets that mirrors New Hampshire's in all material respects. *See, e.g.*, 215 ILCS 5-205.

[18] The legislative history of the National Association of Insurance Commissioners Insurers Rehabilitation and Liquidation Model Act (which contains a similar order of distribution section) reveals that the various state insurance commissioners agreed with the court in *Security Casualty* that "to allow a lower class creditor to receive a preference over a higher class creditor based on equitable remedies is inconsistent with the priority scheme." *See* Legislative History of NAIC Insurers Rehabilitation and Liquidation Model Act, § 47 (Priority of Distribution) at 555-94.

Similarly, in *Illinois ex rel. Boozell v. Coronet Insurance Co. (In re Liquidation of Coronet Insurance. Co.)*, 698 N.E.2d 598 (Ill. App. 1998), the Illinois Appellate Court found that the trial court had erred in holding that an attorney's claim under a retaining lien should be considered a Class I administrative expense of the estate. The appellate court noted that the trial court was "vested with only as much authority as is provided by the Insurance Code; equitable remedies in contradiction to those plainly set forth within the Insurance Code are therefore precluded." *Id.* at 603; *accord Northwestern Nat'l Ins. Co. v. Kezer (In re Aspen Indem. Corp.)*, 812 P.2d 688, 690 (Colo. 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").

Indeed, so absolute are statutory distribution priorities that plans to rehabilitate a financially troubled insurer have been rejected where they violate those priorities, even though rehabilitators generally have greater discretion than liquidators to manage an insolvent insurer's affairs.[19] *See, e.g., Illinois ex rel. Shapo v. Alpine Ins. Co. (In re Conservation of Alpine Ins. Co.)*, 741 N.E.2d 663, 667-68 (Ill. App. 2000) (rejecting proposed rehabilitation plan that differentiated among members of the same priority class); *Commercial Nat'l Bank v. Superior Ct., (In re Rehabilitation of Executive Life Ins. Co.)*, 14 Cal. App. 4th 393, 408-11 (Cal. App. 1993) (same). New Hampshire's order of distribution statute is equally comprehensive and thus

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[19] *See, e.g., Grode v. Mutual Fire, Marine & Inland Ins. Co.*, 572 A.2d. 798, 804 (Pa. Commw. Ct. 1990) (holding that "the Insurance Commissioner, as Rehabilitator, is given broader discretion to structure a rehabilitation plan than is given to her as statutory liquidator"). Similarly, courts uniformly have rejected efforts by reinsured creditors to recast themselves as "policyholders" or "insureds" of the insolvent insurer to achieve a payment that would be higher than if they were classified as general creditors (as would be the effect of the Proposed Agreement). *See e.g., American Re-Ins. v. Washburn (In re Liquidation of Reserve Ins. Co.)*, 524 N.E.2d 538, 539, 542 (Ill. 1988) (holding that claims of reinsured creditors were "claims of general creditors," and not claims of "policyholders, beneficiaries [or] insureds"). *Accord Covington v. Ohio Gen'l Ins. Co.*, 789 N.E.2d 213, 217 (Ohio 2003); *Neff v. Cherokee Ins. Co.*, 714 S.W.2d 1, 4-7 (Tenn. 1986); *Foremost Life Ins. Co. v. Department of Ins.*, 409 N.E.2d 1092, 1097 (Ind. 1980); *In re Liquidation of Sussex Mut. Ins. Co.*, 694 A.2d 312, 315 (N.J. Super. App. Div. 1997); *State ex rel. Long v. Beacon Ins. Co.*, 359 N.E.2d 508, 511-12 (N.C. App. 1987).

equally exclusive. RSA 402-C:44. Thus, the Proposed Agreement is contrary not only to the plain language of the Act but also to the decisions of ***every court*** that has considered similar issues. The Order approving the Proposed Agreement therefore should be reversed.

III. THE SUPERIOR COURT'S REASONS FOR APPROVING THE PROPOSED AGREEMENT WERE WRONG AS A MATTER OF LAW

A. The Liquidator's "Broad Array Of Powers" Cannot Override The Mandatory Provisions Of RSA 402-C:44.

Even though the Superior Court acknowledged that the Proposed Agreement would allow the AFIA Cedents to "receive payments which, as Class V claimants, they would not otherwise receive," the Superior Court found that it "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 29, 2004 Order, Jt. App. at 284.) The Superior Court also found that the payments to the AFIA Cedents could be allowed on the theory that they benefited class II creditors and did not harm other class V creditors. (*Id.*, at 284-85.) Each of these justifications was wrong as a matter of law.

B. The Powers Enumerated In RSA 402-C:25 Do Not Allow The Liquidator To Act Contrary To Statutory Mandates

With regard to the first of the Superior Court's reasons, the Superior Court effectively has rewritten RSA 402-C:44 to make all of its mandatory provisions subservient to a 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 act contrary to 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 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 liquidator's 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.[20] Had that been the Legislature's intent, it would not have inserted the word "shall" multiple times in RSA 402-C:44 without ***any*** qualification.

C. 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.

In authorizing the Proposed Agreement, the Superior Court also found that it "was consistent with the goals and purposes" of the Act as expressed in RSA 402-C:1, which states that "[t]he purpose of this chapter is the protection of the interests of insureds, creditors, and the public generally." RSA 402-C:1, IV. In so ruling, the Superior Court stated that the Proposed Agreement would further those interests because it would allow for the marshaling of assets that otherwise would be unavailable to the estate absent the Liquidator's incentive plan. The Superior Court's reliance on the general purpose expressed in RSA 402-C:1 to trump the specific mandates of RSA 402-C:44 is misplaced.

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[20] The Liquidator also relied on a specific provision, RSA 402-C:25, VI, in support of the Motion. This provision allows the Liquidator to "[c]ollect all debts and moneys due and claims belonging to the insurer" and to "do such other acts as are necessary or expedient to collect, conserve or protect [the insurer's] assets or property." RSA 402-C:25, VI. Of course, RSA 402-C:25, VI only addresses the collection of assets and it does not permit a liquidator, having brought money into the estate, to distribute the funds as it sees fit and without regard to the priorities established in RSA 402-C:44.

1. Specific Provisions Of A Statute Must Override General Preamble Language.

It is a well-established maxim of statutory construction that general language expressing 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."); *Eller Media Co. v. Community Redevelopment Agency,* 133 Cal. Rptr. 2d 324, 333 (Cal. App. 2003) ("The enumeration of specific items or factors will be controlling over general statements placed before or after the list of specific items or factors.").

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, specifying 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) In such circumstances, the Superior Court erred in allowing the Liquidator to ignore the non-discretionary mandates of RSA 402-C:44.

2. Other Courts Have Rejected The Superior Court's Reasoning In Similar Circumstances

The Superior Court's ruling regarding the "general purposes" of the Act 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 Insurance Co. v. Kemper Reinsurance Co. (In re Liquidation of Midland Insurance 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.)

The California Supreme Court came to the same conclusion in *Prudential Reinsurance Co. v. Superior Court (In re Liquidation of Mission Insurance Cos.)*, 842 P.2d 48, 63 (Cal. 1992). In that case, the liquidator brought suit against various reinsurers on behalf of a group of insolvent insurers to compel payment into the liquidation estate of all reinsurance proceeds owed, without any offset credit. The court rejected policy arguments based on priority of payment to policyholders, asserting that "the Legislature has created an exception to the general rules of priority in situations in which the claimant and the insolvent have mutual debts; that exception is codified . . . . We cannot ignore its broad mandate." *Id.* at 62. In so ruling, the court emphasized that its decision did not take into account alleged equitable considerations that would hold reinsurers to a different standard than policyholders. *Id.* at 63. Rather, the court deferred to the "construction of a comprehensive broadly phrased statute," and left the policy

considerations to the legislature.[21] *Id.* The Superior Court in this case was wrong to ignore RSA 402-C:44 in favor of alleged policy considerations. The Order therefore should be reversed.

D. The Superior Court's Disregard Of The Clear Requirements Of RSA 402-C:44 Allows The Liquidator To Act Contrary To The Legislature's Clear Policy Judgment

At bottom, the Liquidator's argument, as adopted by the Superior Court, is that the Liquidator may provide "incentives" to certain creditors if, in his judgment, it benefits the estate by bringing in more assets -- even if to do so violates RSA 402-C:44.[22] As discussed above in section II, the Legislature clearly understood when it enacted RSA 402-C:44 that it was creating certain incentives among the creditor classes. The Liquidator now seeks to justify the Proposed Agreement because, in his view, it is necessary to ***change*** the incentives for Class V creditors created by the Legislature. The Liquidator should not be allowed to create his own set of incentives by paying off creditors to file claims against Home when those incentives are not sanctioned by the Act. If the Liquidator does not like the impact of the incentives put in place by

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[21] 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. App. 1995), is inapposite. *Executive Life* involved the approval of a ***rehabilitation*** plan for a financially-troubled life insurer. As noted above, it is well-settled that rehabilitators have greater discretion than liquidators in managing the insolvent insurer's affairs. 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).

[22] Reinsurers are particularly vulnerable to such ad hoc "incentives." In most property-casualty insurance company insolvencies, reinsurance constitutes the primary (if not virtually the sole) asset of the estate. As the Liquidator repeatedly has emphasized in his efforts to win approval of the Proposed Agreement, an insurer only becomes entitled to claim against its reinsurers when it becomes liable for claims under insured polices, as reinsurance is a contract of indemnity. Whereas a solvent insurance company is required to pay its policyholders before it may make a claim against a reinsurer (as reinsurance contracts are contracts of indemnity), virtually all reinsurance agreements in the U.S. contain an "insolvency clause" that, in statutorily-mandated language, requires the reinsurer to indemnify the insolvent insurer on the basis of its liability and without regard to whether the insolvent company actually pays a claim. (*See, e.g.*, RSA 402-C:36.) The Assumption Agreement contains such an insolvency clause. (Durkin Aff., Jt. App. at 85.) However, whereas solvent insurance companies have an interest in minimizing claims against them and in disputing questionable claims, liquidators of insolvent companies actually possess an incentive to allow claims regardless of their merit, or to solicit the filing of claims that would not otherwise be made, ostensibly in order to maximize the assets available to the estate.

the Legislature, he can seek to persuade the Legislature that his ideas are better and that the Act should be amended. It is not for the Liquidator, however, to vary the Legislature's express provisions based on his view of what individual circumstances warrant.

Indeed, if the principles underlying the Order are allowed to stand, myriad wholesale violations of RSA 402-C:44 could be justified. For example, if the Liquidator 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. Any creditor (whether in class V or class II) whose claim is reinsured arguably has a more valuable claim to the estate than a creditor is not reinsured. If the Superior Court's reasoning is correct, then the Liquidator could pay "incentives" to such claimants (or even additional "incentives" to creditors with very large claims) in order to ensure that their claims were filed in their maximum value. Creditors thus 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. RSA 402-C:44 obviously was designed to prevent such uncertain, inequitable results.

RSA 402-C:44 likewise cannot be ignored in order to prevent an alleged "windfall" to the ACE Companies if the AFIA Cedents do not pursue their claims against Home. It always will be the case in insurance company liquidations that parties with little prospect of recovering funds might decide that it is not worthwhile to pursue those claims. When the New Hampshire legislature relegated certain classes of claimants to the bottom of the priority list, it clearly understood that those claimants might not possess a strong incentive to file. That is the statutory scheme, and the Liquidator must live with the incentives put in place by the legislature. The agreement proposed by the Liquidator unlawfully pays the AFIA Cedents to file claims they

allegedly would not, in the ordinary course of business, submit in a liquidation of Home that complies with New Hampshire law. The Liquidator cannot create his own set of "incentives" by paying creditors to file claims when those "incentives" are not sanctioned by the Act.[23]

If the Legislature wishes the Liquidator to have the authority to negotiate distributions from the estate on a case-by-case basis, it can amend RSA 402-C:44 to make the statutory order of distribution permissive rather than mandatory. To date the Legislature has not chosen to do so. The Superior Court's Order authorizing such discretion therefore should be reversed.

IV. THE ALTERNATIVE JUSTIFICATIONS ARGUED BY THE LIQUIDATOR IN THE COURT BELOW ARE EQUALLY BASELESS

A. The Liquidator Cannot Justify Its Violation Of RSA 402-C:44 Based On Equitable Doctrines.

None of the Liquidator's other justifications for the Proposed Agreement before the Superior Court support this Court affirming the Order on appeal. For example, the Liquidator contended that the Proposed Agreement is permitted under "equitable doctrines" that allow for payments out of the ordinary course when doing so would be in the "best interest" of the estate. (April 23, 2004 Transcript, Jt. App. at 216:6-10, 228:22-229:2, 244:17-245:8.) As demonstrated above, courts consistently have rejected arguments relying on equity when construing order of distribution statutes like RSA 402-C:44. (*See* § II, above.) Those courts refused to use their

[23] Moreover, regardless of the statutory incentives, it is not typical for reinsured creditors of an insolvent insurer simply to abandon their claims. To the contrary, most creditors -- even those afforded priority below policyholders -- file claims as a matter of routine practice, particularly where the claim is sizeable. The Liquidator provided no credible explanation why one particular group of Class V creditors (the AFIA Cedents) requires an incentive to file, when other Class V creditors (like the ACE Companies) do not.

equitable powers to add to the types of preferred claims or to establish different priorities because the priority of distribution statute, by its plain terms, did not so authorize.[24]

The courts' unwillingness to depart from statutory mandates is not surprising. The reasoning expressed by the Seventh Circuit Court of Appeals in *In re Kmart Corp.* on one of the equitable doctrines espoused by the Liquidator -- the "doctrine of necessity" -- is persuasive:

> The fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be.
>
> A 'doctrine of necessity' is just a fancy name for a power to depart from the Code. Although courts in the days before bankruptcy law was codified wielded power to reorder priorities and pay particular creditors in the name of 'necessity,' today it is the Code . . . that must prevail . . . . Answers to contemporary issues must be found within the Code (or legislative halls). Older doctrines may survive as glosses on ambiguous language . . . but not as freestanding entitlements to trump the text.

359 F.3d 866, 871 (7th Cir. 2004) (citations omitted) (holding in a Chapter 11 reorganization proceeding that § 105(a) of the Bankruptcy Code allowing a bankruptcy court to take steps "necessary or appropriate to carry out [Code] provisions" did not "create discretion to set aside the Code's rules about priority and distribution").[25]

The New Hampshire Legislature has enacted a clear and comprehensive statutory scheme for the distribution of an insolvent insurer's assets. No equitable "gloss" is necessary to interpret

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[24] The Liquidator has tried to distinguish these cases on the grounds that the proposed remedies would have harmed creditors by preventing the distribution of assets to them. Contrary to the Liquidator's assertion, the courts based their holdings on the fact that the relief requested violated the statutory order of distribution. Nothing in the cases suggests that a deviation from statutory priorities in an insurance company liquidation is lawful so long as it arguably benefits the estate.

[25] Moreover, unlike the debtor in *Kmart*, Home is in liquidation, not rehabilitation. The Liquidator is not seeking to make unusual payments in an attempt to preserve ongoing business operations or to obtain additional financing. Likewise, no "critical vendor" or "new value" (other equitable doctrines relied on by the Liquidator in the Superior Court) is involved here.

RSA 402-C:44. Therefore, this Court should reject any attempt to override the specific requirements of RSA 402-C:44 by relying on general equitable doctrines.

B. The Improper Distributions Contemplated By The Proposed Agreement Cannot Be Passed Off As An Administrative Cost Of The Estate

The Liquidator's attempt to recast payments to the AFIA Cedents as "administrative costs" likewise does not withstand scrutiny.[26] Although the Liquidator claims that the tens of millions of dollars he is proposing to pay the AFIA Cedents can be justified as "a cost of obtaining and collecting an asset of the Home estate," (Motion, Jt. App. at 51-51, ¶ 21), this suggestion is so far from the ordinary and common sense interpretation of "administrative costs" that it is difficult to take it seriously. Indeed, a past attempt to transform settlement proceeds into an "administrative expense" in an insurance company liquidation was squarely rejected. In *Oxendine v. Commissioner* (*In re Coastal States Life Ins. Co.*), 494 S.E.2d 545 (Ga. App. 1997), the Georgia Court of Appeals considered whether settlements that had been entered into with general creditors of an insurer during rehabilitation should be paid as an administrative expense once the insurer was placed into liquidation. The court rejected the general creditors' argument that the settlements should be treated as administrative expenses because they "preserved the assets of the estate." *Id.* at 548. In so ruling, the court noted that "[n]o reasonable definition of 'costs' or 'expenses' can include the [settlement] claims . . . . These claims are for money which

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[26] The Liquidator's eleventh-hour denial that such payments constitute "distributions" from Home's estate similarly defies common sense. He conceded multiple times in the Motion that the payments would constitute "distributions." (Motion, Jt. App. at 46-47, 49, ¶¶ 12, 13, 18.) Indeed, the payments contemplated are based solely on the AFIA Cedents' claims against Home as determined in Home's New Hampshire liquidation proceedings, and on Home's recovery from reinsurers based on those claims. (Proposed Agreement, Jt. App. at 54,56, ¶¶ 1.9.1, 1.2, 1.3.) The Motion plainly stated that the Proposed Agreement "will provide for the distribution of a portion of the proceeds to the AFIA Cedents." (Motion, Jt. App. at 47, ¶ 13.) The Proposed Agreement likewise specifies that "the distributions to AFIA Cedents under the Scheme will be taken into account in determining appropriate New Hampshire distributions." (Proposed Agreement, Jt. App. at 55, ¶ 1.5.2.) Thus, it cannot seriously be disputed that the recoveries under the Proposed Agreement are distributions of Home's assets directly related to the AFIA's Cedents' claims against Home.

appellees claim from the [insurer's] estate and not administrative costs or expenses incurred." *Id.*

As in *Oxendine*, placing a judicial imprimatur upon the payment of tens of millions of dollars to unsecured creditors as an "administrative expense" defies "common sense and sound reasoning." *Id.* Indeed, if these payments can be characterized as an administrative expense, ***anything*** can be so characterized, thus rendering the entire statutory scheme meaningless.[27] The Court should not sanction such an absurd result.

C. The Proposed Agreement Cannot Be Justified As A Compromise Of A Dispute With The AFIA Cedents

The Order also cannot be affirmed on the basis that the Proposed Agreement is necessary to compromise a legitimate "dispute" over the proceeds of the Assumption Agreement, The Liquidator's original justification for the Proposed Agreement was that, absent the alleged "compromise," the AFIA Cedents might attempt to use an English insolvency proceeding to "wall off" the proceeds of the Assumption Agreement for distribution exclusively to the AFIA Cedents (and not to Home's other creditors). (Motion, Jt. App. at 42-44, ¶ 7.) Even assuming that such "disputes" existed, the Liquidator has no authority to "compromise" them in a manner that violates the Act, as set forth in § III, above.

Even if a violation of RSA 402-C:44 could be justified on the basis of a necessary "compromise" (which, as demonstrated above, it cannot), the Liquidator did not demonstrate before the Superior Court that such a good faith "compromise" existed. At best, the evidence

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[27] Bankruptcy cases on the payment of administrative expenses are instructive. Administrative expenses in federal bankruptcy proceedings include "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). A claim will not qualify as an administrative expense 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." *In re Hemingway Transport*, 954 F.2d 1, 5 (1st Cir. 1992). In this case, it cannot be disputed that the AFIA Cedents' claims arise from contracts that were entered into before Home's liquidation. Therefore, payments for such claims should not be characterized as "administrative expenses."

presented via affidavit as to the bona fides of the alleged "dispute" to be compromised was conflicting, and all of it was untested.[28] No evidence demonstrating the bases or reasonableness of the alleged "compromise" was adduced. If indeed a wholesale deviation from RSA 402-C:44 may be justified on the basis of a "compromise," at a minimum the Court should reverse the Order and remand for appropriate factual findings as to whether such a basis exists, and whether the "compromise" reached is in the best interest of the Home estate.

V. THE ORDER CANNOT BE SUSTAINED WHERE INSUFFICIENT DUE PROCESS WAS AFFORDED BELOW

If implemented, the Proposed Agreement will affect the economic interests of each of Home's numerous policyholders and creditors. Moreover, Century and every other reinsurer of Home potentially is affected by the Liquidator's "end run" around RSA 402-C:44. Despite the unprecedented scope and value of the relief sought in the Motion, however, the Liquidator deigned to provide notice only to ***five*** parties or groups of parties. (Notice of Motion, Jt. App. at 8.) Such paltry notice violates well settled constitutional norms:

> Notice by mail or other means as certain to ensure actual notice is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of ***any*** party, whether unlettered or well versed in commercial practice, if its name and address are reasonably ascertainable.

Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 800 (1983) (emphasis in original). New Hampshire law is fully in accord:

> For more than a century, the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified. The notice must be of

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[28] Indeed, the Liquidator did not really challenge the ACE Companies' evidence that there was no credible threat that the AFIA Cedents could (or would seek to) "wall off" the alleged "U.K. Assets" in an English insolvency proceeding, or that such an attempt would not result in "complex, protracted and costly litigation," as he had alleged in the Motion. (Motion, Jt. App. at 42-45, ¶¶ 7-8; April 23 Transcript, Jt. App. at 221:2-17, 223:11-17.) Indeed, as set forth in the Affidavit of Richard Hacker, Q.C., any effort by creditors that did business with Home via its U.K. Branch to "wall off" Home's alleged "U.K. Assets" for their exclusive benefit would be summarily dismissed with an award of costs to the Liquidator. (Hacker Aff., Jt. App. at 103-04, ¶ 30.)

> such nature as reasonably to convey the required information and must be more than a mere gesture.

Berube v. Belhumeur, 139 N.H. 562, 567 (1995) (citations omitted); *see also State v. Hess*, 118 N.H. 491, 492 (1978) (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 318 (1950)) ("When the name and address of a party is known, due process requires at least that notification be attempted by mail addressed personally to the party."). The timing of a hearing is also of crucial importance:

> The fundamental requisite of due process is the opportunity to be heard, and that opportunity is useless unless one is informed of the matter pending and the hearing is granted at a meaningful time and in a meaningful manner.

Royer v. New Hampshire Dep't of Employment Sec., 118 N.H. 673, 679, (1978) (citing *Armstrong v. Manzo*, 380 U.S. 545, 550 (1965)).

The Superior Court should not have approved the Proposed Agreement where virtually no notice was provided to affected persons. Each creditor of Home is potentially affected by the Motion and had a right to be heard with regard to it:

> It is not necessary for a proceeding to directly adjudicate the merits of a claim in order to 'adversely affect' that interest. In *Mennonite* itself, the tax sale proceedings did not address the merits of the mortgagee's claim. Indeed, the tax sale did not even completely extinguish that claim, it merely 'diminished the value' of the interest. Yet the Court held that due process required that the mortgagee be given actual notice of the tax sale.

Tulsa Prof'l Collection Serv. v. Pope, 485 U.S. 478, 488 (1988) (citations omitted). It was wrong for the Court to rule on the Liquidator's Motion when even the most minimal due process requirements were ignored. The Order therefore should be reversed on this ground alone.

Moreover, the Motion rested on factual assertions about matters that the ACE Companies either contest or have no knowledge of. For this reason, the ACE Companies sought to obtain limited written discovery and to depose the Liquidator's affiants with knowledge of the facts and

circumstances described in the Motion. At a hearing on April 9, 2004, the Superior Court announced that it first would decide the issue of whether the Liquidator has the authority, as a matter of law, to enter into the Proposed Agreement. The Superior Court further stated that, assuming the Liquidator had such authority, it then would consider the issue of discovery on whether the Liquidator's discretion had been exercised reasonably.

Despite establishing this two-stage procedure, the Superior Court granted the Motion in its entirety, thus approving the Proposed Agreement without any discovery having been made or an evidentiary hearing held on the complex factual issues involved.[29] The ACE Companies thus were deprived of their fundamental due process right to take discovery and participate in an evidentiary hearing on the myriad factual issues relating to the Motion.[30] Indeed, on the current record, it is impossible for this Court to determine whether any discretion that may exist has been exercised appropriately. Thus, even in the event this Court affirms the Order as to the Liquidator's authority, this matter should be remanded for proper discovery and factual findings as to whether such authority was exercised reasonably.

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29 The ACE Companies respectfully submit that the Superior Court lacked any jurisdiction to issue the "Addendum" to the Order on June 1, 2004. The filing of an appeal divested the Superior Court of general jurisdiction and, indeed, this Court noted the limits of the Superior Court's jurisdiction when it remanded the case solely for a decision on the ACE Companies' Motion to Stay. (*See* Exhibit 5.) In the June 1 Order, the Superior Court recognized that "the case was remanded for the limited purpose of ruling upon any motion to stay filed by ACE Companies." (June 1 Addendum Order, Jt. App. at 286.) Moreover, no party had asked the Superior Court to clarify, amend or supplement the Order prior to the filing of the appeal. The "Addendum" therefore is a nullity.

30 Indeed, the ACE Companies have had no opportunity even to address the six affidavits the Liquidator submitted with his ***reply*** brief, as the Superior Court had indicated it was only considering the threshold issue of the Liquidator's authority at that time. (April 9 Transcript, Jt. App. at 191:21-192:9, 194:22-23.)

VI. THE ISSUE OF STANDING WAS RESOLVED BELOW AND, IN ANY EVENT, THE ACE COMPANIES ARE "PERSONS AGGRIEVED" BY THE ORDER

The ACE Companies incorporate by reference the arguments contained in their Objection and Response to the Liquidator's Motion to Dismiss filed June 11, 2004. (*See* Exhibit 10.) As set forth in that Response, it cannot seriously be contended that the ACE Companies' lack standing where they are members of the same creditor class as the AFIA Cedents (Class V) and are the targets of the Proposed Agreement (and indeed are mentioned in that Agreement ***by name*** numerous times). (Proposed Agreement, Jt. App. at 53-55, 57, ¶¶ 1, 1.3, 1.3.4, 1.3.5, 1.4, 1.5.1, 1.9.3, 1.9.4, 1.9.5, 1.9.7.) The Liquidator's Motion to Dismiss therefore should be denied.

CONCLUSION

For the foregoing reasons, the ACE Companies respectfully request that the Court reverse the Order and grant such other and further relief as this Court deems just and proper.

The ACE Companies request oral argument and understand that the Court has allotted 30 minutes for oral argument, with 15 minutes allocated to the ACE Companies and Benjamin Moore & Co., and 15 minutes allocated to the Liquidator. The ACE Companies' argument will be presented by Gail M. Goering.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that I served two copies of the foregoing on the following counsel via First Class mail on June 24, 2004.

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