THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

Docket No. 03-E-0106

In The Matter Of The Liquidation Of
The Home Insurance Company

RESPONSE AND OBJECTION OF BENJAMIN MOORE & CO. TO LIQUIDATOR'S MOTION FOR APPROVAL OF AGREEMENT AND COMPROMISE WITH AFIA CEDENTS

Policyholder claimant Benjamin Moore & Co. ("Benjamin Moore"), through its counsel Downs Rachlin Martin PLLC, respectfully submits this Response and Objection to the Liquidator's Motion For Approval of Agreement and Compromise With AFIA Cedents, dated February 11, 2004 (the "Motion"). In support of this Response and Objection, Benjamin Moore states as follows:

BACKGROUND

1. Benjamin Moore is a policyholder claimant in these liquidation proceedings, having filed a Proof of Claim under numerous policies of excess liability insurance issued by The Home Insurance Company ("Home") to Benjamin Moore from 1969 through 1990 (the "Policies"). Benjamin Moore has numerous open liability claims against it, as to which it has given notice to Home under the Policies.

2. As a policyholder claimant, Benjamin Moore is entitled to Class II priority with respect to its claims. RSA 404-C:44, II.

3. Despite being a known policyholder of Home, Benjamin Moore received no notice of the Motion from the Liquidator. On information and belief, the Liquidator gave notice of the motion to only a very limited number of parties, and did not provide notice to all policyholder claimants whose interests may be affected by the relief requested in the Motion.

4. In his Motion, the Liquidator asks the Court to approve an agreement that will bind the liquidation estate to treat what would otherwise be classified as Class V residual claims as super-priority Class I administrative claims. The agreement the Liquidator asks the Court to approve will bind the estate to pay to certain foreign reinsureds of Home ("AFIA Cedents"),[1] whose claims the Liquidator agrees would otherwise be Class V claims, approximately 50% of certain reinsurance recoveries made by the Liquidator–funds that would ordinarily have to be distributed according to the statutory distribution scheme set forth in RSA 404-C-44. This preference in payment proposed by the Liquidator elevates the claims of AFIA Cedents from Class V priority to Class I priority. This preference to AFIA Cedents also gives to them a special priority within Class I, by giving them a direct claim to specific assets that would ordinarily be distributable by the Liquidator only as allowed by the Court under RSA 402-C:46.

5. The Liquidator's Motion provides very little in the way of hard data on the sums at issue, but does state that the amount that will be paid to the AFIA Cedents on a special priority basis is expected to exceed $50 million. Motion, ¶ 14. The Liquidator asserts that this $50 million is "a cost of obtaining and collecting an asset of the Home estate . . . ." Motion, ¶ 21. Thus, the Liquidator is essentially asking for Court approval to treat the claims of the AFIA Cedents as Class I "actual and necessary costs of . . . recovering the assets of the insurer," RSA 402-C:44, I.

6. The Liquidator also states in his Motion that the liquidation estate is expected to recover a roughly equivalent amount from reinsurers for distribution to policyholders and other creditors of Home, on a pro rata basis. Thus, these other creditors of Home will get their pro rata share of the estate's share of the reinsurance recovery, while the AFIA Cedents will be treated as

[1] The Motion does not identify all of the AFIA Cedents with claims against Home UK Branch under the AFIA Treaties. There are eight signatories to the agreement appended to the Motion, but the motion also indicates

a special class entitled to split up their share of the recovery amongst themselves, in accordance with arrangements made by them with the Joint Provisional Liquidators of the Home UK Branch.

7. The Liquidator asserts three principal justifications for the special priority to be granted to the AFIA Cedents: this settlement (1) resolves disputes that may potentially have to be litigated over the right of the AFIA Cedents to collect directly from the ACE Group or other reinsurers, (2) avoids the potential that the AFIA Cedents will not file their claims in this liquidation proceeding, precluding the Liquidator from making reinsurance recoveries on account of those claims, and (3) facilitates a global liquidation that might not otherwise occur if the AFIA Cedents assert the right to "wall off" the assets of the Home UK Branch located in the United Kingdom, for distribution solely to UK creditors of the Home UK Branch.

8. The Liquidator offers a number of conclusory statements in support of these justifications for settlement, and an Affidavit from the Special Deputy Liquidator that repeats these conclusory statements, but no meaningful information that permits any interested party to evaluate the merits of these asserted justifications for the settlement. For example, the Liquidator does not identify any existing litigation that will be settled and resolved by the subject agreement, but only identifies certain potential disputes. Nor does the Liquidator provide any meaningful information concerning the relative strength of the Liquidator's positions in these potential disputes, the likelihood of prevailing in any potential litigation, or the projected cost to the estate of litigating its positions, as opposed to settling. Instead, the Liquidator merely asserts generally that approval of this agreement will "avoid costly, uncertain, and protracted multi-jurisdictional litigation." Motion, p. 1. The Liquidator also states that the AFIA Cedents "have so far declined to file substantial claims in Home's liquidation," Motion ¶ 7, but provides no

that there are other AFIA Cedents that have not joined in the agreement. Motion, ¶ 8,9.

other information as to any claims that have been filed, or other useful information as to these claimants' incentives to file claims before the bar date of June 13, 2004.

STANDARD FOR APPROVAL OF CLAIMS SETTLEMENTS

9. The language of the New Hampshire liquidation statute strictly limits the liquidator's authority regarding settlement of claims. RSA Section 402-C:45 states that a liquidator "may compound, compromise or in any other manner negotiate the amount for which claims will be recommended to the court." (emphasis added). The court must then approve allowance of any claim so compromised, in any amount over $500. Under the statute, the liquidator's negotiating authority is limited to the issue of the amount of a claim; no authority is granted to the liquidator to agree to alter the priority of any claims. Moreover, the statute specifically forbids the liquidator from making agreements that create subclasses within any class of claims, as he has done here. Section 402-C:44 states that "No subclasses shall be established within any class."

10. The Court must be guided by these statutory restrictions on the liquidator's ability to make agreements such as that before the Court. The Court can also take guidance from decisions from other jurisdictions on the standards for review of such agreements. There is a substantial body of case law developed by the U.S. bankruptcy courts that provides some well-established standards, as do the less common state court decisions made in the context of insurer insolvencies.

11. The touchstone is that a settlement in a liquidation proceeding must be shown by the proponent, who carries the burden of persuasion, to be in the best interest of the estate, and to be fair and equitable. In re American Reserve Corp., 841 F.2d 159, 161-62 (7th Cir. 1987); In re C.P. del Caribe, Inc., 140 B.R. 320, 326 (Bankr. D.P.R. 1992)("[t]he proponents of a

compromise and settlement have the burden of persuading the court"). The Court, after being informed of all the relevant facts and information, must make its own independent determination as to whether the settlement meets the standards for approval. American Reserve, 841 F.2d at 162. The Court may not simply accept the recommendation of the trustee or liquidator that a compromise is reasonable, without conducting its own informed analysis, and it is never enough for a liquidator to justify a settlement with cursory statements such as "the alternative to settlement is extensive litigation at heavy expense." In re Dow Corning Corp., 192 B.R. 415, 422 (Bankr. E.D. Mich. 1996); see also In re American Reserve, 841 F.2d at 162 (the court may not simply accept the trustee's word that the settlement is reasonable, nor may the court merely "rubber stamp" the trustee's proposal).[2] The court must consider any creditors' objections to the settlement, although the creditors' views are not controlling. In re American Reserve, 841 F.2d at 161-62.

12. As to the "fair and equitable" requirement, the courts have defined this to mean that senior interests are entitled to full priority over junior interests. In re AWECO, Inc., 725 F.2d 293, 298 (5th Cir. 1984); In re American Reserve, 841 F.2d at 162. As stated in American Reserve, "[i]n a settlement context, 'fair and equitable' means that the settlement reasonably accords with the competing interests' relative priorities." Id. This standard ensures faithfulness

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[2] In bankruptcy decisions, the courts have identified the following non-exclusive list of factors to consider in determining if a settlement is in the best interest of the estate:

a. the balance between the likelihood of the trustee's success in litigation compared to the present and future benefits offered by the settlement;
b. the prospect of complex, costly and protracted litigation if settlement is not approved;
c. the difficulties, if any, in collecting any judgment that may be obtained in litigation; and
d. the interests of other creditors.

In re Parkview Hospital, 211 B.R. 603, 608 (Bankr. N.D. Ohio 1996).

to the fundamental rule in insolvency proceedings, codified in RSA 402-C-44, that all claims in each class must be paid in full before the members of the next class receive any payment.

13. The Liquidator acts as a trustee for all the creditors of the liquidation, and as such, his fiduciary duty restrains him from favoring one beneficiary over another. In re Executive Life Ins. Co., 38 Cal. Rptr. 2d 453, 471 (Cal. App. 1995); In re Liquidation of Integrity Ins. Co., 555 A.2d 50, 52 (N.J. Super. 1988). Thus, the Court must also assess whether the proposed agreement is consistent with the Liquidator's fiduciary duty to all creditors of the estate.

14. As explained below, the Liquidator's proposed settlement, on its face, fails to meet these standards, as it places certain select lower priority claimants ahead of higher priority claimants.

THE LIQUIDATOR'S FAILURE TO PROVIDE ADEQUATE INFORMATION FOR THE COURT TO DETERMINE IF THE APPLICABLE STANDARDS ARE MET

15. As to his first justification for the proposed special treatment of the AFIA Cedents, the Liquidator states that the proposed agreement will resolve a potential dispute over rights that "certain of the AFIA Cedents" have asserted to collect reinsurance proceeds directly from the ACE Group. Motion, ¶s 7, 13. According to the Motion, the Liquidator has threatened legal action to prevent this from occurring, but there is no pending litigation. The Motion does not identify how many or which AFIA Cedents have asserted these rights. Nor does the Liquidator offer any information as to the strength of Home's position on this issue, or the potential costs to the estate of protecting its rights through litigation. Based on the scant information provided by the Liquidator, it is impossible to make any reasonably informed judgment as to the extent of the threat to the estate's interests, or the potential costs associated with protecting those interests through available means, including but not limited to litigation.

16. In support of his second asserted justification for the proposed agreement, the Liquidator states that he does not think that the AFIA Cedents will file Class V claims absent this agreement. He bases this on his preliminary guesstimate, made before the bar date for claims expires, and before all assets of the Home estate are known, that "it appears unlikely that there will be sufficient assets for Home to make a significant distribution to [Class V]." Motion, ¶ 6. Apparently, however, some claims have been filed by some AFIA claimants, as the motion also states that "AFIA Cedents have so far declined to file substantial claims in Home's liquidation." Id. But we do not know which of the AFIA Cedents have filed claims, or the amounts of any such claims, or anything about the potential for the filing of additional claims as the bar date approaches. Nor is there any way to determine independently whether any of the AFIA Cedents have filed claims, as the Liquidator's office refuses to make a claims registry available to the public, claiming that it is proprietary information.[3] In short, the Liquidator appears to be assuming that the AFIA Cedents will not file claims, and yet there is little or no information contained in the Motion that would permit the Court or any party to evaluate with any certainty whether that assumption is at all valid.

17. In fact, some AFIA Cedents may have significant incentive to file claims to the extent they are also reinsurers of Home, with the right to offset their liability under reinsurance contracts on a dollar for dollar basis with claims made under reinsurance contracts under which they ceded risk to Home. RSA 402-C:34. On information and belief, a number of the AFIA Cedents are also in the business of reinsuring risks, and may well be reinsurers of risk ceded by Home. This is but one reason that the Liquidator's assumption concerning the filing of claims by

[3] A paralegal with the undersigned's law firm contacted the Home's claims department in New York on March 11,2004, to request a copy of the claims register or similar document listing the claims filed to date. Ron Barta of the claims department advised that the list of claims is proprietary, is not available now, and may only become available to the public after the claims bar date has passed.

AFIA Cedents may not be valid. Another obvious reason is that there is only limited information available as to the assets and liabilities of the estate. The Liquidator has not explained why the AFIA Cedents would not simply file their proofs of claim in order to protect their rights against Home, given the uncertainty as to assets available for distribution and allowable claims. Indeed, they would appear to have significant incentive to do so, given the consequences of failing to file under RSA 402-C:37.

18. Moreover, the Liquidator offers no explanation as to why he chose not to offer similar "incentives" to submit claims to policyholders of the Home, like Benjamin Moore. Any claim against Home insurance policies for which reinsurance is available (just like the claims of the AFIA Cedents) triggers Home's right to seek recovery of reinsurance proceeds that become generally available to creditors of the estate. But the Liquidator, for reasons not explained in his Motion, chose to advance the interests of certain of the estate's preferred (but lower priority) creditors over those of Benjamin Moore and other policyholders that are entitled to higher priority, and then compounded the effect of that decision by not giving those policyholders notice of their disenfranchisement.

19. As to his third asserted justification for the proposed agreement, the Liquidator informs the Court that this agreement will avoid "costly and time-consuming litigation over whether there will be separate US and UK liquidations or a global New Hampshire proceeding." Motion, ¶ 7. At the same time, however, the Liquidator states that both he and the Joint Provisional Liquidators "do not believe that there is any legal merit to the suggestion" that the UK assets[4] could be "walled-off" from the New Hampshire proceedings for exclusive distribution to UK creditors of the Home UK Branch. Id. If the Liquidator is correct, any

litigation over this issue is likely to be the opposite of time-consuming and costly, so the risk of such litigation would not appear to justify any significant compromise of the estate's rights. Based upon the information supplied by the Liquidator, there is so little risk to the estate associated with this issue that it could not possibly justify giving the AFIA Cedents the equivalent of an approximately $50 million special priority administrative claim.

20. Apart from these significant questions as to the validity of the assumptions made by the Liquidator, and the facts underlying the cost-benefit analysis proffered by the Liquidator in support of his proposed compromise with the AFIA Cedents, the Liquidator has failed to address the serious issue whether the proposed compromise contravenes the statutory priority scheme.

THE LIQUIDATOR HAS NOT ESTABLISHED THAT THE AGREEMENT IS AUTHORIZED BY THE INSURER LIQUIDATION STATUTE

21. The priority provisions of the New Hampshire liquidation statute create a strict, comprehensive, and exclusive scheme for the distribution of estate assets to various classes of claimants. Before enumerating ten (10) separate classes of claimants in order of priority, the statute provides:

> **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.

RSA 402-C:44 (emphasis added). This provision establishes three clear principles.

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[4] Nowhere in the Motion does the Liquidator identify what the "UK assets" consist of. It is not clear if they are limited to reinsurance recoveries that can be sought on account of the claims of the AFIA Cedents, or whether there are any other significant assets of the Home UK Branch.

22. First, distribution of estate assets "shall" be in accordance with the priorities established by RSA 402-C:44 I through X. Accordingly, the statute permits no discretionary or equitable deviation from the statutory scheme. See In re: Liquidation of Coronet Insurance Company, 698 N.E.2d 598, 603 (Ill. App. 1st Dist. 5th Div. 1998)(court lacked the power to deviate from the statutory priority scheme); State v. Interstate Casualty Insurance Company, 464 S.E.2d 73, 77 (N.C. App. 1995)(in light of comprehensive statutory scheme for the determination of claim priority, court could not invoke equitable doctrines to deviate from order of distribution); Couch On Insurance § 6:8 (3d ed.)("Statutory priorities are generally regarded as exclusive and should not be disturbed by the creation of equitable priorities").

23. Second, the statute codifies a rule of "absolute priority," by commanding that "every claim in each class shall be paid in full . . . before the members of the next class receive any payment." See In Re: The Liquidation of Security Casualty Company, 537 N.E.2d 775, 780 (Ill. 1989)(recognizing the statutory rule of "absolute priority" prohibiting succeeding class claimants from receiving any share in the distribution of assets before the claims of all senior interests have been paid in full, and overruling trial court order that allowed junior class claimants to receive funds ahead of all other claimants). Thus, Class V claimants, such as the AFIA Cedents here, cannot receive any portion of estate assets until all claims in classes I through IV have been paid in full.

24. Third, "[n]o subclasses shall be established within any class."

25. The Liquidator's proposed agreement offends each of these statutory mandates.

26. The clear effect of the agreement the Liquidator asks the Court to approve is (1) to create a subclass of claimants (the AFIA Cedents) within Class V, and (2) to elevate the interests of the members of this subclass above the interests of all other claimants. Not only

would the proposed agreement impermissibly provide for payment to a subclass of Class V claimants before other claimants are paid, the agreement would unlawfully create a "super priority," because the Liquidator proposes to pay these claimants directly from the proceeds of specific reinsurance claims before even Class I claimants are paid from general estate assets. See In the matter of Conservation Alpine Insurance Company, 741 N.E.2d 663, 668 (Ill. App. 1st Dist. 4th Div. 2000)(rejecting rehabilitation plan that impermissibly created a sub-class of claimants in violation of the priority statute); In Re: The Liquidation of Security Casualty Company, 537 N.E.2d at 780 (vacating trial court's recognition of a constructive trust in favor of junior class claimants because the effect would be to impermissibly "boost the [junior claimants] over those in the statutory ladder, granting the [junior claimants] a super-priority ahead of all other claimants in the liquidation proceedings"). For each of these reasons, the proposed agreement clearly violates RSA 402-C:44.

27. The Liquidator argues that the proposed payments to the AFIA Cedents are proper and fair because they are, in essence, "costs" of the administration of the estate. The Liquidator's position is invalid and must be rejected. Settlement of a claim is not a "cost" of administration. Oxedine v. Commissioner of Insurance, 494 S.E.2d 545, 548 (Ga. App. 1997)(payments under settlement agreements made during rehabilitation were not "costs" or "expenses" of administration under liquidation scheme, because the settlement payments would be for claims asserted against the estate, not costs or expenses incurred). Moreover, the Liquidator proposes to distribute "net proceeds" of the reinsurance claims directly to the AFIA Cedents; these payments would thus be made independently of the general distribution of assets, and they would be made before general Class I claimants are paid. Thus, the AFIA Cedents

would be in a better position than even general Class I claimants. This "super priority" violates the statute.

28. The Liquidator has cited no legal authority for his entering into the agreement. Nothing in the statutory scheme nor the Liquidation Order authorizes the Liquidator to enter the agreement at issue. Although the statute and the Liquidation Order confer many powers on the Liquidator, neither the statute nor the Liquidation Order permit the Liquidator to enter an agreement under which certain preferred Class V claimants would receive funds ahead of all other claimants. To the contrary, as explained above, the statutory order of distribution directly prohibits such an agreement.

29. Based upon the Liquidator's presentation, the Court cannot approve the agreement. Although the New Hampshire Supreme Court has not yet had the opportunity to interpret the priority provisions of the liquidation statute, courts in jurisdictions with similar statutes have uniformly recognized that a court lacks the power to deviate from the statutory order of distribution. Oxedine v. Commissioner of Insurance, 494 S.E.2d 545, 548 (Ga. App. 1997) ("the trial court was not authorized to create a new class of claims with greater priority than those stated in [the liquidation statute]."); In re: Liquidation of Coronet Insurance Company, 698 N.E.2d 598, 603 (Ill. App. 1st Dist. 5th Div. 1998)("In a liquidation action, a circuit court is vested with only as much authority as is provided by the Insurance Code", and "orders, which, together, served to elevate [a junior class claimant] to a first-priority claimant, are in opposition to [the purpose of the liquidation statute], and therefore improper").

CONCLUSION

30. The Liquidator asks the Court to approve an agreement that is in direct violation of the statutory priority scheme based upon the notion that the benefits to the estate flowing from the agreement will outweigh the risks presented by the alternatives available to the estate. Yet the Liquidator provides the Court and other parties with little or no meaningful information with which to assess the reasonableness of the Liquidator's assumptions or his cost-benefit analysis. Based upon the record before the Court, the proposed agreement cannot be approved.

Respectfully submitted,

March 18, 2004

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CERTIFICATE OF SERVICE

I hereby certify that on this day 18 of March, 2004, a Response and Objection of Benjamin Moore & Co. to Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents was served by first class mail, postage prepaid to the following:

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