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

**MEMORANDUM OF LAW OF
CENTURY INDEMNITY COMPANY SUPPORTING
MOTION TO LIFT STAY AND TO COMPEL ARBITRATION**

Century Indemnity Company ("CIC"), by its attorneys, Morrison & Foerster LLP and Orr & Reno P.A., respectfully submits this Memorandum of Law Supporting Motion to Lift Stay and to Compel Arbitration. The stay entered by this Court in its June 13, 2003 Liquidation Order (the "Stay Order") should be lifted to allow CIC to assert defensive claims in an arbitration proceeding against Home Insurance Company ("Home"). This arbitration is required because Home breached the Insurance and Reinsurance Assumption Agreement dated January 31, 1984 (the "Insurance and Reinsurance Agreement") between Home and CIC.

I. PRELIMINARY STATEMENT

Under the Insurance and Reinsurance Agreement, CIC agreed to reinsure and service Home's AFIA business. The Insurance and Reinsurance Agreement sets forth CIC's and Home's rights and obligations in connection with the AFIA business and contains a broadly worded agreement to arbitrate any dispute between the parties.[1]

As is true with all reinsurance relationships, the rights and obligations of Home and CIC under the Insurance and Reinsurance Agreement are underpinned by a mutual duty of utmost good faith. Courts have characterized the duty of utmost good faith as "the core duty

[1] The Insurance and Reinsurance Agreement states that "*any* dispute" between the parties regarding the "interpretation [of the agreement] or their rights under it... *shall be submitted to arbitration.*" Insurance and Reinsurance Agreement (attached as Exhibit A) at ¶ 7 (emphasis added).

accompanying reinsurance contracts." *Mich. Nat'l Bank-Oakland v. Am. Centennial Ins. Co.*, 674 N.E.2d 313, 319 (1996). Utmost good faith is not only a legal rule, "but also a tradition honored by ceding insurers and reinsurers in their ongoing commercial relationships." *Uniguard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049, 1054 (2d Cir. 1993). This duty is not affected by Home's insolvency.

Since 1984, CIC has fully performed all of its obligations under the Insurance and Reinsurance Agreement. CIC (or its predecessor, Insurance Company of North America ("INA")) has administered, serviced and, where appropriate, paid claims submitted by certain cedents of Home (the "AFIA cedents") and, since August 2004, pursuant to both the Insurance and Reinsurance Agreement and a claims protocol (the "Protocol").

CIC, pursuant to the Protocol and New Hampshire statutory authority, has claimed setoff for amounts due CIC from Home against amounts Home is claiming against CIC under the Insurance and Reinsurance Agreement. Until March 30, 2008, CIC was a net creditor of Home, that is, CIC's setoff was more than the amounts Home claimed were due under the Insurance and Reinsurance Agreement.

While CIC has acted in good faith toward Home in connection with the Insurance and Reinsurance Agreement, the converse is true for Home. In January 2004, Home entered into an agreement (the "AFIA Agreement") with the AFIA cedents, pursuant to which Home agreed to pay the AFIA cedents half the net approved value of the claims they submitted and prosecuted in the Home Liquidation. The payments were an incentive for the AFIA cedents to file and prosecute those claims – claims the AFIA cedents would not have filed – so that Home could, in turn, collect the value of those claims from its reinsurer, CIC. In March 2004, Home sought this Court's approval of the AFIA Agreement; CIC objected on the grounds that the Liquidator

exceeded his statutory authority. The AFIA Agreement was approved by the New Hampshire Supreme Court on December 5, 2006. The Supreme Court evaluated the AFIA Agreement solely on statutory grounds, that is, the decision rested on whether the Liquidator exceeded his statutory authority or had otherwise violated the provisions of the Insurers Rehabilitation Act, RSA ch. 402-C. The effect of the AFIA Agreement on Home's separate contractual and good faith duties to CIC under the Insurance and Reinsurance Agreement were not litigated, considered or decided in these earlier proceedings.

While CIC has fully performed its obligations under the Insurance and Reinsurance Agreement and the Protocol, its performance has been under a full reservation of rights, including the right to assert that CIC has no contractual obligation to reinsure Home for any AFIA Liabilities that were submitted pursuant to the AFIA Agreement.[2] CIC now contends that, by entering into an agreement for the sole purpose of increasing the amount its reinsurer pays, Home breached not only the Insurance and Reinsurance Agreement, but also its duty of utmost good faith. As described above, these contract-based defenses have not previously been raised by CIC.

At the end of March 2008, CIC became a net debtor of Home, in that the value of the court-approved AFIA claims now exceeds the value of CIC's setoff. By wire transfers on March 28 and 31, 2008, CIC paid Home more than $1 million, representing the net balance due after CIC's setoff was deducted from the approved claims. CIC intends to continue fulfilling all its contractual duties under the Insurance and Reinsurance Agreement, including paying the court-

[2] Even before the AFIA Agreement was signed, the AFIA cedents intended to file claims against Home's estate to the extent that they owed money to Home, that is, to the extent that their reinsurance claims would offset amounts that they would otherwise owe Home. CIC is thus not disputing its obligation to reinsure the claims that arise out of these offsets.

approved claims balance if, as and when it becomes due, in order to avoid any possible prejudice to Home's estate while Home's breach is arbitrated.

CIC's recent payment, however, puts squarely into play the issue of whether CIC may validly refuse to make such payments because the Liquidator breached the Insurance and Reinsurance Agreement when he entered into the AFIA Agreement. The stakes are high: Home is seeking to collect millions of dollars in reinsurance for claims that were filed only because Home paid its cedents to do so. The AFIA cedents testified to this precise effect – as did Home – in connection with CIC's challenge to the legality of the AFIA Agreement under RSA 402-C; in its September 22, 2005 order, the Court accepted that fact as true.

Home's breach of the Insurance and Reinsurance Agreement and the duty of utmost good faith, however, could go unexamined and uncorrected because CIC intends to pay the approved claims as they become due. Home will thus never have to bring a claim against CIC for non-performance, and CIC will never have the opportunity, unless the Stay Order is lifted, to raise available defenses to payment. As a result, CIC is in a Catch-22 situation: unless it precipitates a lawsuit by Home by refusing to pay the amounts Home claims are due under the Insurance and Reinsurance Agreement, the Stay Order prevents CIC from asserting that Home's breach of the Insurance and Reinsurance Agreement and the duty of utmost good faith is a defense to CIC's payment obligations. The result would be that the Stay Order – which is designed to provide for the orderly management of Home's estate – would require the disruption of payments to Home before CIC is able to adjudicate its defenses. This is unfair to CIC and is certainly not in the interest of Home's estate.

Here, CIC seeks to defend against the Liquidator's demands for payment on the ground that its liability arises out of a breach of contract. CIC's claim, therefore, is no different from the

defensive claims which liquidation courts have regularly permitted to proceed to arbitration. Accordingly, CIC requests that this Court lift the Stay Order and compel Home to participate in an arbitration – the forum in which CIC and Home agreed their rights and obligations under the Insurance and Reinsurance Agreement would be determined – where CIC can defend itself against Home's demand for payment of the AFIA claims.

II. BACKGROUND

A. AFIA

Prior to 1984, Home, through its branch operation in the United Kingdom, was a member of the American Foreign Insurance Association ("AFIA"), an unincorporated association of American insurers. Home wrote insurance and reinsurance in the United Kingdom through certain reinsurance treaty arrangements (the "AFIA treaties"), and then reinsured that business with AFIA.

B. The Insurance And Reinsurance Agreement

INA and Connecticut General Insurance Company merged in 1982, creating CIGNA Corporation. This merger set in motion a series of transactions that resulted in the sale of the AFIA business to CIGNA in 1984. As part of the transfer, Home (and the other AFIA companies) entered into the Insurance and Reinsurance Agreement with INA, pursuant to which INA reinsured 100 percent of Home's liabilities under the AFIA treaties (the "AFIA Liabilities").[3] By virtue of a corporate restructuring, CIC became the successor to INA, including INA's rights and obligations under the Insurance and Reinsurance Agreement.

The Insurance and Reinsurance Agreement contains the following relevant terms:

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[3] The Affidavit of Michael Durkin, dated March 19, 2004, which was filed in this Court as an attachment to the Objections and Response of the ACE Companies to the Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents, describes the factual background of the Insurance and Reinsurance Agreement and is attached for the Court's convenience as Exhibit B.

- CIC assumed Home's AFIA Liabilities and agreed to pay them as they became due.
- CIC agreed to administer and service the AFIA Liabilities, which include investigating, settling and defending claims, and was given full power of attorney to act on Home's behalf for that purpose.
- Home agreed to cooperate with CIC in its administration of the AFIA Liabilities.
- In the event of Home's insolvency, CIC has the right to receive notice of any claim, and to investigate and interpose defenses to claims in the liquidation proceedings.

Exhibit A, ¶¶ 2, 3, 5, 6. Significantly, the Insurance and Reinsurance Agreement also contains a broad arbitration provision:

> [I]f any dispute shall arise between any of the parties to this Agreement with reference to its interpretation or their rights under it, such dispute *shall be submitted to arbitration* upon the written request of any party to the disputes.

Id. at ¶ 7; emphasis added.

C. The AFIA Agreement

On May 8, 2003, the Insurance Commissioner for the State of New Hampshire, as Rehabilitator of Home, filed a petition to liquidate Home on the grounds of insolvency. Rather than abide by Home's obligation to minimize claims that might become the responsibility of CIC, its reinsurer (an obligation that is rooted in the centuries-old duty of utmost good faith), the Commissioner undertook negotiations with certain AFIA cedents to incentivize them to file claims against Home. These negotiations culminated in the AFIA Agreement (attached as Exhibit C), an unprecedented scheme pursuant to which Home agreed to pay up to $78 million to the AFIA cedents in exchange for their filing proofs of claim in this Liquidation and prosecuting their pre-liquidation reinsurance claims against Home. These incentive payments are distributions tied directly to the AFIA cedents' claims against Home. Home thus turned its duty of utmost good faith to CIC on its head by paying the AFIA cedents to file claims against it –

claims that those cedents admitted under oath they would never otherwise have filed and prosecuted and that will ultimately be borne by CIC.

D. The Approval Of The AFIA Agreement

Home sought approval of the AFIA Agreement in March 2004 and CIC, with ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company and ACE American Reinsurance Company (collectively, the "ACE Companies"), objected on the grounds that the AFIA Agreement violated RSA 402-C. On April 29, 2004, this Court approved the AFIA Agreement, and the ACE Companies appealed to the New Hampshire Supreme Court. In an order dated September 13, 2004, the Supreme Court reversed and remanded the case, directing on remand that this Court decide issues related to the legality of the AFIA Agreement under RSA 402-C based on a more fully-developed record.

The Order on Remand dated October 8, 2004 addressed some of the issues identified by the Supreme Court; this Court held an evidentiary hearing in July 2005 on the remaining issues. In a September 22, 2005 order (the "September 22 Order"), this Court concluded that the AFIA Agreement did not violate the relevant provisions of RSA 402-C. The ACE Companies again appealed and, on December 5, 2006, the New Hampshire Supreme Court affirmed the September 22 Order.

E. The Claims Protocol

During the pendency of the above proceedings, on August 6, 2004, Home and CIC signed the Protocol, an agreement "for the ongoing handling by Century Indemnity Company ('CIC') of claims in respect of AFIA Liabilities . . . ." (A copy of the Protocol is attached as Exhibit D.) The Protocol was "intended to describe the process for the continued performance by CIC of its obligations" under the Insurance and Reinsurance Agreement. Among other things, the Protocol provided:

> Nothing in this letter shall be construed so as to prejudice, negate or otherwise interfere with the rights of CIC...as against HICIL whether under the Agreements or otherwise including the right to assert that...CIC...has any contractual obligation to indemnify HICIL with respect to AFIA Liabilities or AFIA Licence [sic] Business.

Exhibit D, ¶ 7.2.

F. CIC's Right To Arbitration

The exclusive issue before the New Hampshire courts in the proceedings relating to the approval of the AFIA Agreement was its legality under RSA 402-C.[4] The Supreme Court thus addressed (1) whether the Liquidator had the authority to enter into the AFIA Agreement; (2) whether the payments contemplated by the AFIA Agreement could be properly made as "administrative expenses"; and (3) whether the AFIA Agreement was fair and reasonable to the creditors of Home's estate. CIC expressly and consistently reserved the distinct issue of whether the Liquidator's conduct also constituted a breach of the Insurance and Reinsurance Agreement.[5] The Supreme Court neither addressed nor resolved this issue.

Because payment of the court-approved AFIA claims under the Insurance and Reinsurance Agreement was recently required and CIC has paid the net amount Home claims is owed, the issue of whether CIC may validly refuse to make such payments on account of the Liquidator's contractual breach is now ripe for determination. Since the Insurance and Reinsurance Agreement requires that disputes of this nature be arbitrated, CIC now seeks to lift

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[4] Specifically, both the ACE Companies and co-appellant Benjamin Moore & Company filed objections pointing out that the distributions under the proposed AFIA Agreement would violate the mandatory order of distribution provisions in RSA 402-C:44. The ACE Companies further argued that the Liquidator lacked the authority to circumvent, through a compromise with the AFIA cedents, the mandatory order of distribution established by this provision.

[5] *See, e.g.*, Memorandum of the ACE Companies in Support of Their Objections and Response to Liquidator's Motion for Approval of Agreement and Compromise with AFIA Cedents filed March 23, 2004, at 7, n.6; Brief for Respondents-Appellants Century Indemnity Company, ACE Property and Casualty Insurance Company, Pacific Employers Insurance Company, and ACE American Reinsurance Company (N.H. Supreme Court, Docket No. 2004-0319) filed June 24, 2004, at 12, n.14; Protocol (Ex. D) at ¶ 7.2.

the Stay Order and to defend itself in an arbitration against the required payments on the distinct ground that the Liquidator's actions in negotiating and entering into the AFIA Agreement, while legal under RSA 402-C, nonetheless breached the Insurance and Reinsurance Agreement and the duty of utmost good faith.

CIC has served the attached Demand for Arbitration (Exhibit E) to permit CIC to litigate these defenses. As set forth in the Demand for Arbitration, the Liquidator's actions:

- have improperly modified and expanded CIC's obligations without CIC's written consent, as required by Paragraph 13 of the Insurance and Reinsurance Agreement;
- have interfered with CIC's administration and service of the liabilities arising under the AFIA treaties pursuant to Paragraph 3 of the Insurance and Reinsurance Agreement;
- constitute a breach of the cooperation clause in Paragraph 5 of the Insurance and Reinsurance Agreement;
- have interfered with CIC's right to investigate claims and interpose defenses pursuant to Paragraph 6 of the Insurance and Reinsurance Agreement; and
- constitute a breach of the duty of utmost good faith.

G. <u>The Claim Procedures Order Does Not Apply To This Dispute</u>

The issues that CIC seeks to arbitrate – that is, whether Home breached the Insurance and Reinsurance Agreement and the duty of utmost good faith – are not subject to the Restated and Revised Order Establishing Procedures Regarding Claims Filed With The Home Insurance Company In Liquidation (the "Claims Procedures Order") because CIC is not a "Claimant" within its terms. Paragraph 2.b. of the Claims Procedures Order defines a Claimant as one "whose right to payment is at issue." Here, CIC is not seeking payment from Home. Similarly, this is not the type of claim that falls into the distribution scheme set forth in RSA 402-C:44 because, again, CIC is not seeking any payment from Home. Rather, CIC is proposing

mandatory arbitration to obtain a defensive declaration against Home's claim that CIC is required to pay Home.

Because this issue is now ripe for determination, clearly arbitrable under the Insurance and Reinsurance Agreement, and appropriate despite Home's liquidation, the Court should lift the Stay Order to the extent that CIC be permitted to pursue in arbitration a declaration that the Liquidator's actions breached the Insurance and Reinsurance Agreement. CIC represents and agrees that during the pendency of the arbitration it will continue to administer and service the AFIA Liabilities and make payments as they come due, under a continuing reservation of rights.

III. SUMMARY OF ARGUMENT

Since 1984, CIC (or its predecessor) has performed all its obligations to Home under the Insurance and Reinsurance Agreement. It has acted in good faith in fulfilling its contractual duties to administer, service and, where appropriate, pay the claims of the AFIA cedents. Nothing in the Insurance and Reinsurance Agreement or the New Hampshire liquidation statute permits a party to an agreement to discard its obligation of utmost good faith simply because it is in liquidation. But Home did just that when it offered financial incentives to the AFIA cedents to file claims that CIC, Home's reinsurer, must ultimately pay – claims that those same cedents admitted under oath they would never have filed but for those incentives. *See, e.g.*, September 22 Order at 16, 22-23.

CIC has made its first payment under the Insurance and Reinsurance Agreement since Home breached it by entering into the AFIA Agreement. CIC, however, has valid defenses to payment based upon Home's breach of contract and of the duty of utmost good faith; it is entitled to arbitrate those defenses, just as CIC and Home agreed to do more than 20 years ago. But because CIC has paid the net amount now due – and has agreed to pay all approved AFIA claims as they come due – Home will not have to sue CIC for non-payment. Such a suit would

trigger CIC's right to enforce the Insurance and Reinsurance Agreement's arbitration provision and to raise its defenses in that proceeding, without violating the Stay Order. CIC should not be penalized for its commitment to its contractual obligations, nor should CIC's nominal position as the petitioner in the arbitration determine whether CIC has the right to arbitrate its defenses in the absence of a breach. Such a result would be a victory of form over substance that certainly is not the purpose of the Stay Order.

Thus, lifting the Stay Order to permit arbitration of CIC's defenses to payment of the AFIA Liabilities is appropriate. In the first instance, this Court has discretion to modify its own orders, a discretion that is not limited by the liquidation statute. The New Hampshire legislature has left the decision to enjoin parties from bringing post-liquidation actions against an insolvent insurer to the discretion of the liquidation court; thus, there is no impediment to this Court's exercising its discretion to lift the stay.[6] The purpose of the Stay Order will not be impaired by lifting it, because CIC seeks only to litigate defenses to payment, not to recover any amounts from Home's estate that would upset the statutory priority. CIC's defenses are based upon breach of contract and breach of the duty of utmost good faith and do not require the expertise of the liquidation court. The alleged breaches also arise out of post-liquidation activities of Home, which courts have routinely excepted from litigation stays.

Finally, arbitration of these defenses should be ordered because arbitration is the forum selected by CIC and Home for resolving their disputes. Both the legislature, in enacting the New Hampshire Arbitration Act, and New Hampshire's courts have decreed that arbitration is favored in New Hampshire and agreements to arbitrate should be enforced. The Federal Arbitration Act, which applies here, also requires and encourages arbitration of disputes that are subject to broad

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[6] This discretion is reflected in RSA 402-C:5, which provides that the liquidator "*may* at any time apply for" an order enjoining "[t]he institution...of any actions or proceedings," which "any court of general jurisdiction...*may* grant" (emphasis added).

arbitration provisions like that in the Insurance and Reinsurance Agreement. For all these reasons, the stay should be lifted and the parties directed to arbitration.

Courts confronted with a party seeking to litigate defenses against an insolvent insurer have routinely exercised their discretion to lift litigation stays. The exercise of this discretion here comports with equity and fairness: CIC should not be foreclosed by the Stay Order from defending against Home's demands for performance of the Insurance and Reinsurance Agreement when Home is in breach of that same agreement. Nor should CIC be required to breach the Insurance and Reinsurance Agreement simply to precipitate a lawsuit against it, so that its request for relief from the Stay Order is in the "proper" procedural posture. Rather, when Home insists on performance, CIC should be permitted to demonstrate that Home is in breach and to raise defenses to payment of the AFIA Liabilities in an arbitral forum – the one to which the parties agreed.

IV. ARGUMENT

A. The Stay Should Be Lifted As To CIC

The Stay Order is a discretionary order that can, and should, be modified to permit CIC to arbitrate its defenses to payment of the AFIA Liabilities. Lifting the Stay Order in this limited way will not run afoul of the purpose of the stay, which is to prevent actions against the estate "that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding." RSA 402-C:5 I(k). Nor do the issues involved – the validity of defenses based upon breach of contract and breach of the duty of utmost good faith – implicate the liquidation or its procedures, thus requiring the parties to resolve this dispute only in the liquidation court. Instead, the question of whether Home breached its duty of utmost good faith – "the core duty accompanying reinsurance contracts," *Mich. Nat'l Bank*, 674 N.E.2d at 319 – is properly adjudicated by a panel of reinsurance

professionals, who will assess whether Home violated this "tradition honored by ceding insurers and reinsurers in their ongoing commercial relationships," *Uniguard*, 4 F.3d at 1054. Accordingly, the stay should be lifted and arbitration ordered.

1. The Court Has The Power To Lift The Stay

In enacting RSA 402-C, the New Hampshire legislature did not limit the liquidation court's inherent power to modify its own orders, particularly where, as here, the order in question is discretionary. RSA 402-C:28 contains a mandatory stay, but requires only that a litigation stay be entered in abatement of pending actions; the prospective litigation stay authorized by RSA 402-C:5, on the other hand, is merely permissive. Since the liquidation statute does not restrict the court's power to issue stay orders, the liquidation court retains the ability to lift the prospective litigation stay as equity requires.

This Court, therefore, can and should modify the Stay Order to permit CIC to pursue arbitration to defend against Home's claims under "longstanding principles of equity, which allow courts to...modify decrees for good cause shown." *In re Birmingham*, 154 N.H. 51, 56 (2006). *See also Coburn v. First Equity Assocs., Inc.*, 116 N.H. 522, 523 (1976) ("As a general proposition, courts have power to set aside, vacate, modify, or amend their judgments for good cause shown," citing *Adams v. Adams*, 51 N.H. 388, 396 (1872)); *Bussey v. Bussey*, 94 N.H. 328, 329 (1947); *Lancaster Nat'l Bank v. Whitefield Savs. & Trust Co.*, 92 N.H. 337, 339 (1943).

Nothing in the liquidation statute prevents a modification of the Stay Order because, to the extent that the litigation stay here is prospective, it is not mandatory. RSA 402-C:28 contains the automatic stay provisions and provides:

> Upon issuance of any order appointing the commissioner liquidator of a domestic insurer or of an alien insurer domiciled in this state, all actions and all proceedings against the insurer whether in this state or elsewhere shall be abated . . .

This provision says nothing about prospective stays. Thus, unlike the mandatory abatement of pending actions, the New Hampshire legislature left it to the discretion of the liquidator to seek, and the court to grant, other relief in aid of the liquidation, including, among other things, an injunction against post-liquidation actions against the insolvent insurer:

> Any receiver appointed in a proceeding under this chapter *may* at any time apply for and any court of general jurisdiction in this state *may* grant, such restraining orders, temporary and permanent injunctions, and other orders as are deemed necessary and proper to prevent:
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> * * * * *
>
> (f) The *institution*...of any actions or proceedings...

RSA 402-C:5 (emphasis added).

Just as this Court exercised its discretion to issue a prospective litigation stay, it is within the court's inherent equitable powers to lift or modify the stay. New Hampshire courts have not yet addressed this issue, but case law in California (whose insurance insolvency statute, like New Hampshire's, permits the court to decide if a litigation stay is necessary[7]) is instructive. In *Webster v. Superior Court of Los Angeles County*, 758 P.2d 596 (Cal. 1988), the petitioner sought relief from a litigation stay so that he could bring an action against the insolvent insurer in another court. The *Webster* court lifted the stay, holding that because the litigation stay was optional California's legislature did not intend to restrict the liquidation court's equitable powers:

> [T]he Legislature may under certain circumstances guide or control the exercise of the courts' equitable discretion, but absent a clear and unmistakable indication that the Legislature has chosen to do so, we find that section 1020 does not eliminate the courts' discretion . . . .

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[7] Cal. Ins. Code § 1020 (2007) provides:

> Upon the issuance of an order...under section...1016, or at any time thereafter, the court shall issue such other injunctions or orders as may be deemed necessary to prevent any or all of the following occurrences:
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> * * * *
>
> (c) The institution or prosecution of any actions or proceedings...

Id. at 600. Similarly, in *LaVecchia v. Am. Preferred Provider Plan, Inc.*, Doc. No. C-119-98 (N.J. Super. Ct. Ch. Div., Mercer County, Feb. 4, 2000), the court entered an order granting "limited relief" from the "stay on litigation against American Preferred Provider Plan, Inc.," and, as in *Webster*, permitted an action to proceed in another New Jersey state court. Here, also, the New Hampshire legislature has chosen not to limit the court's discretion in deciding whether to enjoin future actions against the insolvent insurer; this Court's inherent discretion to modify its own orders thus remains intact.

2. Lifting The Stay Order As Against CIC Would Not Undermine The Stay's Purpose

According to RSA 402-C:5 I(k), injunctions issued by the court (including stays against future proceedings) are designed, among other things, to prevent actions "that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding." Here, CIC's claims are defensive only and will not involve any payment by Home to CIC. Therefore, permitting CIC's breach of contract claims to go forward will not undermine the purposes of the Stay Order, as the claims will not "lessen the value of [Home's] assets or prejudice the rights of policyholders, creditors or shareholders."

Nor will arbitrating CIC's breach of contract claim interfere with or impact "the administration of the [liquidation] proceeding." In this very liquidation, the First Circuit rejected the Liquidator's claim that a dispute between Home and Wausau should be remanded to the Liquidation Court because it might interfere with "the state court's policy-oriented discretion." *Sevigny v. Employers Ins. of Wausau*, 411 F.3d 24, 28 (1st Cir. 2005). In reversing the remand below, the court noted that where "the state law issues presented...appear conventional, are not discretionary policy or administrative judgments and could arise in any common-law action," the dispute does not require "deference to a state's administrative processes for the determination of

complex, policy-laden, state-law issues." *Id.* at 28-29. As in *Sevigny v. Wausau*, the defenses CIC seeks to raise involve "conventional" issues that do not implicate "discretionary policy or administrative judgments," and "could arise in any common law action." *Id.* Thus, as in *Sevigny v. Wausau*, CIC's defenses do not implicate the "administration of the proceeding" or undermine the purpose of the Stay Order. This, coupled with the defensive nature of CIC's claims, further demonstrates that the Stay Order can and should be lifted. *See, generally, Fragoso v. Lopez*, 991 F.2d 878, 882 (1st Cir. 1993) ("Puerto Rico's insolvent insurers' liquidation provisions do not bear in the slightest on the substantive outcome of the appeal.").

Other jurisdictions have clearly articulated that a litigation stay in an insurance insolvency proceeding serves to "preserve an insolvent insurer's assets for orderly disposition by the commissioner," *Webster*, 758 P.2d at 599, and to guarantee that the statutorily imposed order of distribution among creditors is not frustrated by the ability of one creditor to jump past other creditors through litigation, *Koken v. Legion Ins. Co.*, 865 A.2d 1, 7 (Pa. Commw. Ct. 2004) (holding that the purpose of the stay is to "freeze the rights of creditors and policyholders and to prevent prejudicial preferences"). *See also TSG, Inc. v. Wang Labs., Inc.*, No. 93-11325-MLW, 1996 U.S. Dist. LEXIS 879, *11 (D. Mass. Jan. 4, 1996) (holding that the purpose of the stay in bankruptcy is to "protect the debtor and preserve[ ] the bankruptcy estate for later distribution").

Here, CIC's claim does not undermine the orderly distribution of Home's estate. Instead, CIC's claim would achieve the opposite effect – it would clarify the size of Home's estate and properly determine the amount available for distribution to the creditors. *Cf., Bennett v. Liberty Nat'l Fire Ins. Co.*, 968 F. 2d 969, 972 (9th Cir. 1992) ("only if a court or arbitrator determines that the funds belong to [the insolvent insurer] does that money become part of the estate that the liquidator will distribute . . . ."). Nor is CIC seeking to arbitrate a claim that would ultimately

place it above other creditors of the Home, since the claim does not involve, nor will it result in, any payments due from Home to CIC. CIC is merely asking for the opportunity to submit to an arbitration panel the question of whether the Liquidator breached the Insurance and Reinsurance Agreement and the duty of utmost good faith by entering into the AFIA Agreement.

The reasoning used by bankruptcy courts in lifting litigation stays (which are both automatic *and* mandatory in bankruptcy) is also instructive. Like the Stay Order here, the purpose of a litigation stay in bankruptcy is intended "to prevent a chaotic and uncontrolled scramble for the debtor's assets" and "to harmonize all of the creditors' interests with one another." *Fid. Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 55 (2d Cir. 1976). And, like the liquidation court here, the bankruptcy court can modify the stay order "according to the particular circumstances of the case...guided by considerations...of what is just to the claimants, the debtor and the estate." *Foust v. Munson S.S. Lines*, 299 U.S. 77 (1936).

Recognizing these purposes and guided by these considerations, the court in *In re Sonnax Indus., Inc. v. Tri Component Prods. Corp.*, 907 F.2d 1280, 1286 (2d Cir. 1990), identified the following twelve factors "to be weighed in deciding whether litigation should be permitted to continue in another forum":

> (1) whether relief would result in a partial or complete resolution of the issues; (2) lack of any connection with or interference with the bankruptcy case; (3)whether the other proceeding involves the debtor as a fiduciary; (4) whether a specialized tribunal with the necessary expertise has been established to hear the cause of action; (5) whether the debtor's insurer has assumed full responsibility for defending it; (6) whether the action primarily involves third parties; (7) whether litigation in another forum would prejudice the interests of other creditors; (8) whether the judgment claim arising from the other action is subject to equitable subordination; (9) whether movant's success in the other proceeding would result in a judicial lien avoidable by the debtor; (10) the interests of judicial economy and the expeditious and economical resolution of litigation; (11) whether the parties are

> ready for trial in the other proceeding; and (12) impact of the stay on the parties and the balance of harms.

Analysis of the factors cited by the Second Circuit is relevant to this Court's consideration of whether it should modify the Stay Order, particularly because New Hampshire courts have not addressed the issue of when a litigation stay should be lifted. Several of the factors considered by the *Sonnax* court militate in favor of lifting the Stay Order and directing CIC and Home to arbitrate CIC's defenses. For example, all of the outstanding contract issues between CIC and Home concerning the AFIA Agreement would be resolved in the arbitration, thus providing guidance to the parties regarding their contractual obligations under the Insurance and Reinsurance Agreement. *See Sonnax* factor (1). Similarly, since CIC's defensive claims arise out of Home's breach of contract and of the duty of utmost good faith, they "lack any connection with or interference with" the issues that should be decided in the liquidation court. *See Sonnax* factor (2). Conversely, the panel of reinsurance professionals before which CIC's and Home's dispute will be arbitrated "is a specialized tribunal with the necessary expertise...to hear the cause of action." *See Sonnax* factor (4).

Nor will "litigation in another forum...prejudice the interests of" other claimants in the liquidation because the defenses do not involve, nor will result in, any payments due from Home to CIC. *See Sonnax* factor (7). The "interests of judicial economy" will also be served in that the arbitration process will be an "expeditious and economical resolution of" the dispute between CIC and Home and will avoid protracted appellate review. *See Sonnax* factor (10).

Finally, "the balance of harms" weighs in CIC's favor, because CIC is defending against Home's demands for millions of dollars in reinsurance payments, obligations that arose solely out of Home's breach of its contractual and good faith duties to CIC. *See Sonnax* factor (12). Indeed, the AFIA cedents and Home each admitted, and this Court found, that but for the

incentive payments, the AFIA cedents would not have filed and prosecuted claims in excess of their setoff. *See, e.g.*, September 22 Order at 30 (noting that "[w]hile there was no dispute that Cedents would file and prosecute claims to take advantage of any offset opportunities, beyond that, there was a very high degree of uncertainty."). These factors militate in favor of lifting the Stay Order and directing CIC and Home to arbitrate CIC's defensive claims. *See also In re Pro Football Weekly, Inc.*, 60 B.R. 824, 826 (N.D. Ill. 1986) (relief from stay appropriate because it would permit "Gannett...to fully defend its position against PFW....").

B. Arbitrating CIC's Defenses Would Not Interfere With The Orderly Liquidation Of Home

The dispute between CIC and Home arises exclusively from the Insurance and Reinsurance Agreement. As such, the resolution of CIC's contract defenses to payment under the Insurance and Reinsurance Agreement does not implicate the liquidation court or its policies or procedures. Under these circumstances, this Court should lift the Stay Order and direct CIC and Home to arbitrate this dispute.

Courts in other jurisdictions have regularly permitted claims of breach of contract like these to go to arbitration. For example, in *Suter v. Munich Reinsurance Co.*, 223 F.3d 150, 161 (3d Cir. 2000), the Third Circuit ordered arbitration of the dispute between Integrity's liquidator and Integrity's reinsurer, holding that the action seeks "to enforce contract rights for an insolvent insurer....Accordingly, we fail to perceive any potential for interference with the Liquidation Act. . . ." Similarly, the court in *Nichols v. Vesta Fire Ins. Corp.*, 56 F. Supp. 2d 778, 780 (E.D. Ky. 1999), ordered the liquidator of Delta American to arbitrate its reinsurance dispute because "[t]he instant action before the Court...is a common law breach of contract action which merely happens to involve an insolvent insurer."

The liquidator of American Integrity Insurance was also directed to arbitrate its dispute with its reinsurer because the suit "[did] not involve the business of insurance." *Koken v. Cologne Reinsurance (Barbados), Ltd.*, 34 F. Supp. 2d 240, 256 (M.D. Pa. 1999). In ordering the parties to arbitrate, the *Cologne Re* court relied on the reasoning of the Third Circuit in *Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 8 F.3d 954, 959 (3d Cir. 1993), as follows:

> Although the regulation of insolvent insurance companies is surely an important state interest, this case does not involve the complex and highly regulated issues of insurance regulation; rather, it is a simple contract action involving an allegedly unpaid debt. The complex regulations relating to insolvent insurance companies have to do with plans of rehabilitation and payment to policy holders. Simple contract and tort actions that happen to involve an insolvent insurance company are not matters of important state regulatory concern or complex state interests.

(Footnote omitted.) And in *Bennett*, the court ordered arbitration "[b]ecause the rights the liquidator seeks to enforce are derived primarily from the insolvent insurer's contracts rather than Montana's insolvency statute . . . ." 968 F. 2d at 970. *See also Quackenbush v. Allstate Ins. Co.*, 121 F.3d 1372, 1381 (9th Cir. 1997) ("The reasoning of *Bennett* applies with equal force here.").

As in these cases, the arbitration sought by CIC involves "a common law breach of contract action that merely happens to involve an insolvent insurer." The arbitration will involve amounts that Home will seek to recover from CIC in the future, amounts that become part of Home's estate only *after* they are paid; resolution of CIC's defenses thus will not affect assets that are presently part of Home's estate. Nor will a judgment on the contract issues adversely impact the priority of claim distribution, since the judgment will not involve payment to CIC, but instead will determine whether CIC is required to pay Home. Since allowing CIC's claims to move forward will not undermine the purposes of the stay or interfere with the liquidation,

Sevigny v. Wausau, 411 F.3d at 28-29 (where "the state law issues presented...could arise in any common-law action," the dispute does not require "deference to a state's administrative processes..."), the Court should modify the Stay Order so that CIC can arbitrate its breach of contract defenses.

1. CIC's Claim Does Not Interfere With Home's Orderly Liquidation Since It Arises From The Post-Liquidation Actions Of The Liquidator

As explained above, CIC's claim is purely defensive and does not implicate the policies behind the Stay Order. In addition, CIC's breach of contract claim against Home arises post-liquidation, and courts have agreed that actions arising out of such post-petition activities inherently do not violate the purposes of the stay.

Where, as here, New Hampshire law is not explicit, federal bankruptcy law is instructive. Section 362 of the Federal Bankruptcy Code mandates the issuance of a litigation stay, but section 362(d) permits the court to lift the stay "for cause"; although the statute does not define "for cause," the legislative history provides some guidance. For example, Congress considered that the automatic stay should not apply to the "post-petition activities of the debtor." S. Rep. No. 989 at 52 (1978). Actions arising from post-petition behavior "bear no relationship to the purpose of the automatic stay, which is the protection of the debtor and his estate from creditors." *Sonnax*, 907 F.2d at 1285-86.

That actions arising from the debtor's post-petition conduct do not further the purpose of the automatic stay is at the core of the decision in *Larami Ltd. v. Yes! Entm't Corp.*, 244 B.R. 56 (D.N.J. 2000). There, Larami commenced an action against Yes!, the Chapter 11 debtor, alleging post-petition patent infringement. Yes! argued that the suit was commenced in violation of the automatic stay as it sought to affect property of the estate. Denying the motion and allowing Larami's suit to continue, the district court noted:

> Section 362(a)(3) was intended to prevent interference with a bankruptcy court's orderly disposition of the property of the estate, it was not intended to preclude post-petition suits to enjoin unlawful conduct. If this section were read to prevent the injunctive relief sought here, bankrupt businesses which operated post-petition could violate patent rights with impunity.

Id. at 60 (internal quotations removed). Similarly, the court in *M. Frenville Co. v. M. Frenville Co.*, 744 F.2d 332, 338 (3d. Cir. 1984), refused to stay a post-petition claim, finding that "there is no compelling reason to stay judicial proceedings predicated on [post-petition] claims." *See also Fed. Aviation Admin. v. Gull Air, Inc.*, 890 F.2d 1255 (1st Cir. 1989) (claims arising from debtor's post-petition actions not stayed).

The *Larami* and *Frenville* decisions confirm that litigation stays like the Stay Order should not be employed as a shield for the protection of improper post-petition conduct. Since CIC's claim derives from the Liquidator's activities post-liquidation, the Liquidator should not be able to avoid responsibility for a breach of contract solely because of an insolvency proceeding. Permitting the Stay Order to foreclose CIC's claim would allow the Liquidator to breach contracts with impunity; such a result cannot be the purpose of the Stay Order. Conversely, allowing CIC to assert defenses against the Liquidator arising from post-liquidation actions does not undermine the purpose of the Stay Order, which is to protect the distribution of the estate – not to grant immunity to the Liquidator.

2. CIC's Claim Does Not Interfere With Home's Orderly Liquidation Because It Is A Defensive Claim

Finally, CIC's claims against the Liquidator are raised solely as a defense to the Liquidator's demand for payment of the AFIA Liabilities, which, CIC alleges, arise out of the Liquidator's breach of the Insurance and Reinsurance Agreement. Courts have consistently permitted defensive claims to be raised against an insolvent insurer, even when a litigation stay is in place. *See Legion Ins. Co.*, 865 A.2d at 7 (allowing the bank to assert available defenses

against the insolvent insurer while denying other claims); *Benjamin v. Credit Gen. Ins. Co.*, No. 04AP-642, 2005 Ohio App. LEXIS 1402, *14-15 (Ohio Ct. App. Mar. 29, 2005) (noting the distinction between defensive and offensive actions in deciding to modify a litigation stay).

Here, CIC's claim is no different: CIC seeks to defend against the Liquidator's demand for payment on the ground that the alleged liability arises out of a breach of contract. *See Sevigny v. Wausau*, 411 F.3d at 26 (noting that Wausau argued "that the primary issue was its issue-preclusion defense that the setoffs were proper . . . ."). That the defense arises because CIC initiates the action rather than refusing to pay Home's billings to precipitate a lawsuit by Home is a distinction without a difference. CIC should not be forced to breach the Insurance and Reinsurance Agreement just so its defenses to payment can be brought before an arbitral panel. Such a result does not further the purpose of the Stay Order, but unfairly requires CIC to choose between adjudicating its defenses and fulfilling its contractual obligations. Under these circumstances, the Stay Order should be modified so that CIC can commence an arbitration to properly assert its defenses.

C. Arbitration Of CIC's Claim Is Mandated

Once the Stay Order is modified so that CIC can assert its defenses to paying the AFIA Liabilities, arbitration – not this Court – is the proper forum for resolving CIC's and Home's dispute. As described above, the Insurance and Reinsurance Agreement contains a broad arbitration clause, and New Hampshire statutes and case law require that such a provision be enforced.

That Home is in liquidation does not require a different result.[8] While New Hampshire courts have not addressed this issue, the majority view is that disputes between an insolvent cedent and its reinsurer that are subject to an arbitration agreement must be arbitrated. *See, e.g.*, *Suter*, 223 F.3d 150 (applying New Jersey insurance law); *Quackenbush*, 121 F.3d at 1381 (California law); *Grode*, 8 F.3d at 953 (applying Pennsylvania law); *Selcke v. New England Ins. Co.*, 995 F.2d 688, 689 (7th Cir. 1993) (applying Illinois insurance law); *Bennett*, 968 F.2d at 969 (applying Montana insurance law); *Schacht v. Beacon Ins. Co.*, 742 F.2d 386 (7th Cir. 1984); *Koken v. Cologne Reins. (Barbados) Ltd.*, 34 F. Supp. 2d at 246-50 (applying Pennsylvania insurance law); *Costle v. Fremont Indem. Co.,* 839 F. Supp. 265, 272-75 (D. Vt. 1993) (Vermont insurance law); *Garamendi v. Caldwell*, No. CV-91-5912-RSWL, 1992 U.S. Dist. LEXIS 11678 (C.D. Cal. May 4, 1992) (California law); *Phillips v. Lincoln Nat'l Health & Cas. Ins. Co.*, 774 F. Supp. 1297 (D. Colo. 1991) (Colorado law); *Schacht v. Hartford Fire Ins. Co.*, No. 91-C-2228, 1991 U.S. Dist. LEXIS 16430 (N.D. Ill. Nov. 7, 1991); *Ainsworth v. Allstate Ins. Co.*, 634 F. Supp. 52 (W.D. Mo. 1985) (Missouri law); *Bernstein v. Centaur Ins. Co.*, 606 F. Supp. 98 (S.D.N.Y. 1984) (New York law); *Everest Reinsurance Co. v. Howard*, 950 S.W.2d 800 (Tex. App. 1997) (Texas law); *Foster v. Phila. Manufs.*, 592 A.2d 131, 133 (Pa. Commw. Ct. 1991) (Pennsylvania law).

Indeed, a New Jersey appellate court recently rejected Integrity's proposed Final Dividend Plan because it would have rendered certain disputes between Integrity and its reinsurers non-arbitrable, despite the presence of arbitration clauses in the reinsurance contracts. *In re Liquidation of Integrity Ins. Co.*, 2006 WL 2795343 (N.J. Super. Ct. App. Div., Oct. 2,

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[8] In *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 729 (1996), the Supreme Court noted that the "emphatic federal policy in favor of arbitral dispute resolution" was not overridden by a case that – even though brought by an insurance liquidator – "appears at first blush to present nothing more than a run-of-the-mill contract dispute" (internal quotations omitted). Under such circumstances, the court found that arbitration of the dispute would not interfere with the comprehensive state regulatory scheme.

2006), *aff'd in part and vacated as moot in part*, 935 A.2d 1184 (2007). The court held that federal laws applicable to the contracts (including the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (the "FAA")) "require contractual arrangements for arbitration to be enforced." *In re Integrity*, 2006 WL 2795343 at 6.

These persuasive decisions recognize that the parties' agreement on an arbitral forum should be respected, particularly where, as here, the dispute is a contractual one. They also reflect the strong state and federal policies that favor arbitrations. The arbitration provision in the Insurance and Reinsurance Agreement should therefore be enforced as a matter of New Hampshire and federal law, and CIC should be allowed to arbitrate Home's alleged breach of contract.

1. The Insurance And Reinsurance Agreement's Arbitration Provision Must Be Enforced As A Matter Of New Hampshire Law

In enacting New Hampshire's arbitration statute, the legislature has mandated that arbitration provisions like that found in the Insurance and Reinsurance Agreement be enforced[9]:

> A provision in any written contract to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or equity for the revocation of any contract.

RSA 542:1. In addition, New Hampshire courts have repeatedly enforced arbitration agreements, holding that New Hampshire public policy encourages arbitration. Indeed, just last year, the New Hampshire Supreme Court reaffirmed this policy when it held that "there is a presumption of arbitrability if the contract contains an arbitration clause." *State v. Philip Morris USA, Inc.*, 155 N.H. 598, 604 (2007). *See also Cookson Co. v. N.H. Ball Bearings, Inc.*, 147 N.H. 352, 355 (2001) (holding that there is a presumption of arbitrability when a contract

[9] Although the Insurance and Reinsurance Agreement is governed by, construed and enforced in accordance with New York law, the law of the forum state (here, New Hampshire) determines if the arbitration provision is enforceable. *Klinedinst v. Tiger Drylac, U.S.A., Inc.*, 2001 D.N.H. 212 LEXIS 20551 (D.N.H. Nov. 28, 2001).

contains an arbitration provision); *Pine Gravel v. Cianchette*, 128 N.H. 460, 464 (1986) (noting that RSA ch. 542 changed the common law by barring any legal action when a contract contains an arbitration clause); *Pittsfield Weaving Co. v. Grove Textiles, Inc.*, 121 N.H. 344, 348 (1981) (noting that New Hampshire courts "value the saving of scarce and valuable legal and judicial time and talent that results from this method of settling controversies"); *J. Dunn & Sons, Inc. v. Paragon Homes of New England, Inc.*, 110 N.H. 215 (1970) (noting that courts should enforce arbitration agreements).

Home agreed to arbitrate any dispute arising out of the Insurance and Reinsurance Agreement; the Liquidator, who stands in Home's shoes, is thus bound by the arbitration provision. *See Costle*, 839 F. Supp. at 265 (liquidator bound by insured's pre-insolvency contracts, including arbitration provisions). Further, since the Liquidator's demand for payment is based on the Insurance and Reinsurance Agreement, the Liquidator cannot embrace the Insurance and Reinsurance Agreement's rights and disavow its duties. "If a liquidator seeks to enforce an insolvent company's rights under a contract, she must also suffer that company's contractual liabilities." *Id.* at 272.

2. The Insurance Code Does Not Affect The Arbitrability Of CIC's Claim.

New Hampshire's strong public policy favoring arbitration is unaffected by the fact that Home is in liquidation because New Hampshire state courts are not the exclusive forum to hear disputes relating to an insolvent insurer. Rather, the liquidation statute merely states that when a New Hampshire court is considering any proceeding relating to the insolvency or rehabilitation of an insurer, the court's powers must be exercised in accordance with RSA 402-C. Because this Court does not have exclusive jurisdiction and arbitration proceedings do not violate RSA 402-C,

the arbitration provision in the Insurance and Reinsurance Agreement should be enforced and CIC and Home should be compelled to arbitrate their dispute.

Nothing in New Hampshire's insurance code or in any court decision construing its provisions suggests that arbitration should not be compelled when the parties have agreed to arbitrate. RSA 542:1, New Hampshire's arbitration statute, is not abrogated anywhere in RSA ch. 402-C. The "Exclusive Jurisdiction" provision in RSA 402-C:4 III only applies to proceedings involving the dissolution or rehabilitation of an insurer in accordance with RSA ch. 402-C,[10] not to disputes, like this one, between insolvent insurers and their reinsurers. Indeed, RSA 402-C:28, I specifically provides to the contrary:

> Whenever in the liquidator's judgment, protection of the estate of the insurer necessitates intervention in an action against the insurer that is pending outside this state, with approval of the court he may intervene in the action.

Because the liquidator may intervene in actions outside of New Hampshire, it is clear that the liquidation court does not have "exclusive jurisdiction" of all disputes relating to an insolvent insurer.[11]

As described above, in this liquidation proceeding, the First Circuit reversed the district court's remand to the liquidation court of a dispute between the Liquidator and one of Home's reinsurers and directed the parties to litigate the issues in federal court. The circuit court recognized that the Liquidation Court does not have exclusive jurisdiction over claims involving insolvent insurers, particularly, where, as here, the claim involves issues that "appear

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[10] "No court of this state shall have jurisdiction to entertain, hear or determine any complaint praying for the dissolution...[or] rehabilitation . . . of any insurer, or praying for an injunction or restraining order or other relief preliminary to, incidental to or relating to such proceedings other than in accordance with this chapter." RSA 402-C:4(III).

[11] The liquidation statute contains several provisions that confirm the non-exclusive jurisdiction of the Liquidation Court. *See, e.g.*, RSA 402-C:25, VI (the Liquidator may "institute timely actions in other jurisdictions..."); RSA 402-C:25, XII (the Liquidator may "[c]ontinue to prosecute and institute...any suits and other legal proceedings, in this state or elsewhere..."); RSA 402-C:28, I (the Liquidator "may intervene in an action...that is pending outside of this state...").

conventional...and could arise in any common-law action." *Sevigny v. Wausau*, 411 F.3d at 29. Courts in other jurisdictions with statutes similar to New Hampshire's have also found that the state court is not the exclusive forum to hear disputes relating to an insolvent insurer and have consequently required arbitration when the agreement at issue mandates it. *See, e.g., Costle*, 839 F. Supp. at 275; *Foster*, 592 A.2d at 133.

In virtually the same circumstances as are found here, the Pennsylvania court in *Foster*, 592 A.2d 131, enforced an arbitration clause in a contract between an insolvent insurer and its reinsurer. There, the statutory rehabilitator brought a breach of contract action against a reinsurer, which asserted that the contract at issue required arbitration. *Id.* at 132. The rehabilitator resisted arbitration, claiming that the state courts had exclusive jurisdiction over insurance liquidation proceedings under Pennsylvania's insolvency statutes.[12]

The *Foster* court rejected this argument, holding that, "while a private agreement to arbitrate does not have the power to divest the court of jurisdiction, it is an election by the parties to select another forum to resolve disputes," *id.* at 133, and the statute thus did not affect the insolvent insurer's obligation to arbitrate its contract claims. The court noted that Pennsylvania courts (like New Hampshire's) enforce arbitration clauses and that Pennsylvania's Supreme Court had never held that the statute in question meant that the state court was the sole forum to resolve all disputes involving an insolvent insurer. The court then wrote:

> In the absence of such authority, we are reluctant to divest parties of the opportunity to arbitrate, particularly when our Supreme Court has consistently favored contractual arbitration provisions and steadfastly held that they are to be enforced whenever possible.

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[12] 42 Pa. C.S. §§ 761(a)(3) and (b) states that "the Commonwealth Court shall have original jurisdiction of all civil actions or proceedings...[a]rising under...The Insurance Department Act of 1921" and that "the jurisdiction of the Commonwealth Court under subsection (a) shall be exclusive..." Further, 40 Pa. S. § 221.4(a) provides that "[n]o court of this Commonwealth shall have jurisdiction to entertain, hear, or determine any delinquency proceeding other than as provided in this article."

Id. at 133. As in *Foster*, New Hampshire courts have also "consistently favored contractual arbitration provisions." *See, e.g., State v. Philip Morris*, 155 N.H. at 604; *Cookson*, 147 N.H. at 355; *Pittsfield Weaving*, 121 N.H. at 348.

Likewise, in *Costle*, the court enforced an arbitration provision, holding that the liquidation order that gave the liquidator the power to pursue collection in other jurisdictions and to institute "any and all suits and other legal proceedings" meant that the Vermont state court was not the exclusive jurisdiction to hear disputes related to the insolvency. *Costle*, 839 F. Supp at 275 (citation omitted). The court also found that the phrase "other legal proceedings" included arbitration. *Id. Accord, Koken,* 34 F. Supp 2d at 252.[13]

3. Federal Law Also Requires Arbitration Of CIC's Claims

Not only does New Hampshire law and public policy encourage arbitration of disputes, but the FAA, which applies here, also expresses the strong federal policy in favor of arbitration. The FAA requires that arbitration agreements be enforced and thus supplements and reinforces New Hampshire's own statutes, case law and public policy and further supports CIC's request that this dispute be arbitrated.

(a) The Insurance And Reinsurance Agreement Is Subject To The Federal Arbitration Act

The FAA provides that arbitration clauses that are a part of a contract involving interstate commerce are "valid, irrevocable, and enforceable" unless legal or equitable grounds exist for revocation. 9 U.S.C. § 2. The effect of this section "is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). The FAA further

[13] The liquidation order in this proceeding also confirms that the Liquidation Court is not the exclusive forum for resolving disputes involving Home. For example, the Liquidator can "obtain leave to intervene" in actions against Home "whether in this state or elsewhere" as he "sees fit." Stay Order at 3, ¶ m.

provides that courts must stay proceedings if the issues presented are covered by an arbitration agreement, and courts may compel arbitration if there is a failure or refusal to comply with an agreement to arbitrate. 9 U.S.C. at §§ 3-4. These provisions have been construed as integral and interrelated parts of a liberal federal policy favoring arbitration. *Bernhardt v. Polygraphic Co. of Am., Inc.*, 350 U.S. 198, 201 (1956).

Since the Insurance and Reinsurance Agreement is indisputably a contract that involves interstate commerce, it is "within the coverage of" the FAA, which thus governs the enforceability of its arbitration provision. The FAA compels arbitration when a contract with an arbitration clause falls within its purview and this court is bound to apply the FAA's pro-arbitration provisions and policy here. *See, e.g., Cadreact v. Citation Mobile Home Sales, Inc.*, 147 N.H. 620 (2002) (the provisions of the FAA are binding on the states and must be applied by a New Hampshire state court). *See also In re Integrity Ins. Co., supra*, 2006 WL 2795343 at 6 (with the FAA, "Congress...withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.")

Under the scheme set forth in the FAA, a court must first determine whether a particular dispute is arbitrable and, if so, whether the claims are encompassed within the scope of the arbitration agreement. *Progressive Cas. Ins. Co. v. C.A. Reaseguradora Nacional De Venezuela*, 991 F.2d 42, 45 (2d Cir. 1993). As a preliminary matter, where a contract contains an arbitration clause, there is a presumption of arbitrability that can be overcome only by a definitive showing that the dispute in question is outside the coverage of the arbitration clause. *Assoc. Brick Mason Contractors of Greater New York, Inc. v. Harrington,* 820 F.2d 31, 35 (2d Cir. 1987). A court must resolve all doubts in favor of arbitration when interpreting an agreement covered by the

Act. *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 475-76 (1989).

Here, CIC's defense, based upon the Liquidator's breach of the Insurance and Reinsurance Agreement, is clearly arbitrable, as the Insurance and Reinsurance Agreement broadly provides that "any dispute" regarding the parties' rights shall be submitted to arbitration. Pursuant to the FAA, "courts are required to 'rigorously enforce agreements to arbitrate.'" *Bennett*, 968 F.2d at 971 (quoting *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987)). *See also Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25 ("questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration" and "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . ."). In accordance with the FAA, the Liquidator must arbitrate CIC's claims for breach of the Insurance and Reinsurance Agreement.

(b) Arbitration Of CIC's Claim Would Not Interfere With New Hampshire's Insurance Insolvency Statutes

The New Hampshire Arbitration Act (RSA 542:1) requires arbitration of this dispute as a matter of state law. Moreover, there is nothing in the liquidation statute (RSA 402-C:1, *et seq.*) that prevents arbitration of a dispute with an insolvent insurer. Accordingly, since RSA 542:1, a state law, requires Home and CIC to arbitrate this dispute, there is no conflict with the FAA and thus no need to conduct an analysis under the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) ("[n]o act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance..."). Conducting such an analysis, however, demonstrates that McCarran-Ferguson does not apply here.

CIC's demand for arbitration arises in the context of the Liquidator's assertion that the Insurance and Reinsurance Agreement requires CIC to pay claims submitted by the AFIA

cedents. The Liquidator's demand for payment thus arises from contract, as do CIC's defenses, and that same contract requires the parties to arbitrate their dispute. Even if RSA 402-C:4 can be construed to apply to CIC's and the Liquidator's disputes over the interpretation of the Insurance and Reinsurance Agreement (which it does not), in this context RSA 402-C:4 is not a law "regulating the business of insurance" under the McCarran-Ferguson Act; instead, it would be "regulating" the forum in which Home and CIC could litigate their contract claim. RSA 402-C:4 thus does not reverse preempt the FAA; rather, to the extent it could be interpreted to prohibit arbitration of contract claims belonging to an insolvent insurer, it is preempted by the FAA.

The McCarran-Ferguson Act is also inapplicable because the arbitration of CIC's claim would not "impair" or interfere with the New Hampshire's insurance insolvency statute. 15 U.S.C. § 1012(b). As in *Bennett, supra,* 968 F. 2d at 972-73:

> [R]ejection of the McCarran-Ferguson presumption in liquidation proceedings...should extend to the case before us because the liquidator is unable to explain why she is entitled to an advantage that the insolvent company whose position she now occupies did not have. Neither does she articulate how arbitration interferes with a valid state regulatory purpose.

Similarly, in *Suter*, the court assumed the truth of the liquidator's argument that provisions in a New Jersey statute similar to RSA 402-C:4, III were enacted for the purpose of regulating the business of insurance. The court nonetheless found that arbitration of the liquidator's suit to enforce contract rights against a reinsurer would not impair any provision of the New Jersey Liquidation Act, even if the arbitrator found for the reinsurer and the insureds received less money as a result. The court wrote:

> It is true...that if...the reinsurance agreement does not cover the disputed expenses, the estate will be smaller than if that issue was resolved in the Liquidator's favor. But the mere fact that policyholders may receive less money does not impair the operation of any provisions of New Jersey's Liquidation Act.

Suter, 223 F.3d at 161. Likewise, in *Costle, supra*, the court held that compelling arbitration would not impede or impair the liquidator's collection efforts, stating:

> [W]here a liquidation order, or statute, imposes no requirement that a liquidator proceed in a judicial forum to collect reinsurance proceeds, arbitration of disputes in that collection action do not impede nor impair a liquidator's efforts under the state-created liquidation scheme.

839 F. Supp. at 275. *Accord, Bennett, supra*, 968 F. 2d at 972.

Based on the foregoing, as CIC's defenses arise from the Liquidator's breach of contract and breach of the duty of utmost good faith and only affect the amount of proceeds to be collected by the Liquidator, arbitration of that claim will not impair New Hampshire's insurance insolvency laws. Thus, McCarran-Ferguson is inapplicable, the FAA cannot be reverse preempted, and the parties must be directed to arbitrate CIC's defenses.

V. CONCLUSION

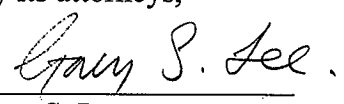
WHEREFORE, Century Indemnity Company respectfully requests that the Court modify the Stay Order, compel arbitration of CIC's defensive claims and grant such further relief as the Court deems just.

Dated: April 1, 2008

Respectfully submitted,

CENTURY INDEMNITY COMPANY

By its attorneys,



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