STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

BEFORE THE COURT-APPOINTED REFEREE
IN RE THE LIQUIDATION OF THE HOME INSURANCE COMPANY
DISPUTED CLAIMS DOCKET

In Re Liquidator Number:	2011-HICIL-50 2011-HICIL-51
Proof of Claim Number:	GOVT 18901-11 GOVT 18901-12
Claimant Name:	Arizona Property and Casualty Insurance Guaranty Fund

LIQUIDATOR'S SECTION 15 SUBMISSION

Roger A. Sevigny, Insurance Commissioner of the State of New Hampshire, as Liquidator ("Liquidator") of The Home Insurance Company ("Home"), submits this brief regarding the claim of the Arizona Property and Casualty Insurance Guaranty Fund ("Arizona Fund" or "Fund") for administrative expenses in accordance with § 15 of the Restated and Revised Order Establishing Procedures Regarding Claims Filed with The Home Insurance Company in Liquidation dated January 19, 2005 ("Claims Procedures Order").

Introduction

This consolidated proceeding presents two disputes concerning the Arizona Fund's claim for administrative expenses. The first is whether the Arizona Fund's allocation of expenses to Home for the 2008 and 2009 years is reasonable. The Arizona Fund is one of the small number of guaranty funds that allocates overhead expenses based on numbers of "open claims" for each pending insolvency proceeding. While the Liquidator has accepted the Fund's allocation for other years, it produces unreasonable results for the two years in question that do not reflect effort or expense actually devoted to Home matters. The Fund's allocation results in over 40% of its overhead expenses for those two years being allocated to Home, as compared to 5% to 7%

for 2006, 2007 and 2010. The $498,222.64 in claimed administrative expenses for 2008 and 2009 is ten times the total of loss and allocated loss adjustment expense paid by the Arizona Fund under Home policies (on other claims) for the two years ($48,170.51). As a Missouri appellate court observed with respect to another Arizona Fund claim for administrative expenses, such a disparity "lack[s] credibility." Huff v. Integral Ins. Co., 354 S.W.3d 228, 233 (Mo. App. 2011).

The Arizona Fund bases its allocation for those two years on 80 "open" claim files regarding methyl tertiary butyl ether ("MTBE") lawsuits against Home policyholder Giant Industries, Inc. ("Giant"). While the Arizona Fund may choose to maintain files in this manner for its own purposes, the 80 "open claims" are not a reasonable basis for allocating expense to Home because the Giant matters raised and were resolved based on a single, common timeliness issue. The Fund immediately identified the common time bar issue when the underlying lawsuits were noticed to the Fund in February 2008, and the Fund promptly denied them on that ground in early March 2008. When the Arizona Fund was named in a coverage action in April 2008, it raised the time bar issue in a summary judgment motion and was then dismissed by agreement in January 2009. The Fund paid its lawyers only $28,817.38 in defending that action. Given the minimal resources devoted to the Giant matters, the Arizona Fund's allocation of its overhead expenses to Home based on 80 "open claims" from March 2008 to June 2009 is unreasonable. The Liquidator properly reduced the amounts for 2008 and 2009 to the amount claimed in 2007.

The second question is the proper priority for the Arizona Fund's claim for its dues to the National Conference of Insurance Guaranty Funds ("NCIGF"). The Liquidator classified the NCIGF dues as Class V under RSA 402-C:44 because they are not expenses "in handling claims" as required for Class I priority by RSA 404-B:11, II. The NCIGF does not handle

claims. It is a national association that has many activities, including lobbying on behalf of guaranty funds before Congress, state legislatures and the National Association of Insurance Commissioners ("NAIC"), as well as other outreach and educational activities. While some portion of the NCIGF's activities may support guaranty fund efforts concerning claims, the NCIGF and the Arizona Fund have made no attempt to determine what portion of the dues relate to those efforts or to Home. Instead, they assert that the entirety of the NCIGF dues is Class I expenses reimbursable by the Home liquidation. This does not comport with the statute, which provides Class I priority only for expenses "in handling claims." Because the Fund failed to substantiate its position that the NCIGF dues in their entirety concern claim handling, the Liquidator's classification of the NCIGF dues as Class V is proper.

A. Issues Presented. These consolidated disputed claim proceedings present two issues arising from the claims of the Arizona Fund for asserted Class I administration expenses:

1. Is the Arizona Fund's allocation of its general overhead expense as an administration cost of the Home liquidation for 2008 and 2009 reasonable?

2. As submitted by the Arizona Fund, are the dues paid for its membership in the National Conference of Insurance Guaranty Funds expenses "in handling claims" entitled to Class I priority or general expenses properly assigned to Class V?

B. List of Exhibits. The Liquidator relies upon the Liquidator's Exhibits ("Liq. Ex.") included in the Appendix of Liquidator's Exhibits and listed on the Schedule of Exhibits attached to this brief.

Background

A. The Statutory Framework

1. The liquidation statute. The New Hampshire Insurers Rehabilitation and Liquidation Act, RSA 402-C ("Act"), provides for the payment of claims against insolvent insurers in successive priority classes. RSA 402-C:44.[1] The first priority ("Class I") is for administration costs:

> I. Administration Costs. The costs and expenses of administration, including but not limited to the following: the actual and necessary costs of preserving or recovering the assets of the insurer; compensation for all services rendered in the liquidation; any necessary filing fees; the fees and mileage payable to witnesses; and reasonable attorney's fees.

RSA 402-C:44, I. There are then three classes of preferred claims: policy related claims, federal government claims, and wages. RSA 402-C:44, II-IV. The policy related claims class includes claims of guaranty associations for their payments under policies of the insolvent insurer:

> Class II. Policy Related Claims. All claims by policyholders, including claims for unearned premiums in excess of $50, beneficiaries, and insureds arising from and within the coverage of and not in excess of the applicable limits of insurance policies and insurance contracts issued by the company, and liability claims against insureds which claims are within the coverage of and not in excess of the applicable limits of insurance policies and insurance contracts issued by the company and claims of the New Hampshire Insurance Guaranty Association, the New Hampshire Life and Health Insurance Guaranty Association and any similar organization in another state. . . . .

RSA 402-C:44, II (emphasis added). All other claims (expect for certain categories of claims not relevant here) fall in the Class V residual priority:

> V. Residual Classification. All other claims including claims of any state or local government, not falling within other classes under this section. . . . .

RSA 402-C:44, V.

[1] The New Hampshire priorities control distributions in this domiciliary liquidation proceeding for Home. See RSA 402-C:60 (in liquidations involving reciprocal states, "the order of distribution of the domiciliary estate shall control").

2. The guaranty association statute. Guaranty association priority is also addressed in the New Hampshire Insurance Guaranty Association Act, RSA 404-B ("NHIGA Act"). The NHIGA Act establishes New Hampshire Insurance Guaranty Association ("NHIGA"), which is "obligated to the extent of the covered claims" under insurance policies issued by an insolvent insurer, subject to certain limitations. See RSA 404-B:8, I(a), (b); RSA 404-B:5, IV (definition of "covered claim"). NHIGA is funded by assessments on its member insurers, see RSA 404-B:8, I(c), who are authorized to recoup the assessments in the "rates and premiums charged for insurance policies." RSA 404-B:16.

The NHIGA Act provides that: "The expenses of [NHIGA] or similar organization in handling claims shall be accorded the same priority as the liquidator's expenses." RSA 404-B:11, II (emphasis added). Guaranty associations' expenses "in handling claims" thus have Class I priority under RSA 404-C:44, I.

The meaning of the phrase "expenses . . . in handling claims" in RSA 404-B:11, II, is illuminated by other sections of the NHIGA Act. NHIGA is authorized to "[h]andle claims" through its employees or through one or more insurers or other persons designated as servicing facilities. RSA 404-B:8, I(f). The actual activities involved in "handling claims" are indicated by the authority to "[i]nvestigate claims brought against [NHIGA] and adjust, compromise, settle, and pay covered claims to the extent of the association's obligation and deny all other claims." RSA 404-B:8, I(d).

The NHIGA Act recognizes that guaranty associations have duties other than handling claims. It specifies that NHIGA is to aid in the detection and prevention of insurer insolvencies, RSA 404-B:13, and respond to examination by the Commissioner, RSA 404-B:14. It authorizes NHIGA to "[e]mploy or retain such persons as are necessary to handle claims and perform other

duties of the association." RSA 404-B:8, II(a) (emphasis added). It also refers to expenses "in handling claims" as one of several expense categories. NHIGA is to assess members for "amounts necessary to pay the obligations of [NHIGA] under paragraph I(a) subsequent to an insolvency, the expenses of handling covered claims subsequent to an insolvency, the cost of examinations under RSA 404-B:13 and other expenses authorized by this chapter." RSA 404-B:8, I(c) (emphasis added). Similarly, NHIGA is to reimburse servicing facilities for "obligations of the association paid by the facility and for expenses incurred by the facility while handling claims on behalf of [NHIGA] and shall pay the other expenses of the association authorized by this chapter." RSA 404-B:8, I(g) (emphasis added).

3. The Arizona statute. The Arizona Fund statute is quite similar to the NHIGA Act. The Arizona Fund is to "[i]nvestigate claims brought against the fund and adjust, compromise, settle and pay covered claims to the extent of the fund's obligation and deny all other claims." Arizona R.S. § 20-664(A)(1); Arizona R.S. § 20-661(3) (definition of "covered claim"). It is to "[h]andle claims" through its employees or through servicing facilities. Arizona R.S. § 20-664(A)(6). The Fund also has duties regarding "the prevention and detection of insolvencies," Arizona R.S. § 20-665(D), (E), and is subject to examination. Arizona R.S. § 20-678. It is to reimburse each servicing facility for the claims paid by the facility "and for expenses incurred by the facility while handling claims on behalf of the fund and pay the other expenses of the fund authorized pursuant to this article." Arizona R.S. § 20-664(A)(7) (emphasis added). The Fund is authorized to "[e]mploy or retain such persons as are necessary to handle claims and perform other duties of the fund." Arizona R.S. § 20-664(B)(2) (emphasis added). It is funded by assessments of its member insurers, see Arizona R.S. § 20-664(A)(4), and the assessments are to be "in such amounts as are necessary to pay the obligations of the fund pursuant to section 20-

667 subsequent to an insolvency, the expenses of handling covered claims subsequent to an insolvency, the cost of examinations and other expenses authorized pursuant to this article." Arizona R.S. § 20-666(A) (emphasis added).

Unlike the NHIGA Act, the Arizona statute provides that the Arizona Fund "may by resolution bar known claims, whether liquidated or unliquidated, not filed within four months from the date of notice to creditors." Arizona R.S. § 20-679. The NHIGA Act does not have any such filing deadline. The Arizona statute also provides for member insurers to recoup assessments not through premiums but through a premium tax offset. Arizona R.S. § 20-674.

B. Factual Background

1. The Arizona Fund's Claim and Liquidator's Determinations

This proceeding presents questions regarding the Arizona Fund's claim for administrative expenses from the Home estate. See Liq. Ex. 1 (Proof of Claim). The Arizona Fund attempts to recover its entire overhead costs from the insolvent insurers whose claims it handles. Liq. Ex. 10 (Arizona Fund Interrogatory Answers), Int. 1. These costs include numerous categories: accounting, legal, administrative fees, miscellaneous office expenses, travel, office expense, postage, rent, telephone, NCIGF dues, banking fees, investment fees. See, e.g., Liq. Ex. 21 (Arizona Fund claim worksheets).

The Arizona Fund sought to recover $608,773.55 from the Home estate as administrative expenses for the years 2006 through 2010. Liq. Ex. 8 (Liquidator summary, see Affidavit of James Hamilton ¶ 3 (Liq. Ex. 33)). This sum represents an allocation to the Home estate of a varying percentage of the Arizona Fund's total overhead expenses for those years. See Liq. Ex. 22 (calculation) (see Hamilton Aff. ¶ 5).

The Arizona Fund determined its percentage allocation to the Home liquidation by applying the ratio of the number of "open claims" it was handling with respect to Home to its

total number of open claims. See Liq. Ex. 9 (Arizona Fund Mandatory Disclosures) at 2. For the 16-month period from March 2008 through June 2009, the Arizona Fund used an asserted "open claims" count of 82 or 83 with respect to Home. See Liq. Ex. 8. As discussed below, 80 of these claims reflected 40 claim letters submitted in February 2008 by Western Refining, Inc. ("Western Refining"), the parent of Home policyholder Giant.

The Arizona Fund's use of allocation percentages based on these 80 asserted "open claims" resulted in administrative expense allocations to Home for 2008 and 2009 of $259,348.48 and $238,874.19, amounts more than five times greater than those for 2006, 2007 or 2010 ($43,064.80, $35,001.36 and $32,484.72, respectively). See Liq. Ex. 8. It also resulted in allocations that billed Home for over 40% of the Arizona Fund's total operating expenses for those years,, as compared to 5% to 7% for 2006, 2007 and 2010. See Liq. Ex. 22.[2]

The Liquidator viewed the Arizona Fund's allocation for 2008 and 2009 as unreasonable. Liquidation staff had only opened two claims files on the Giant matters (one for each primary policy Home issued to Giant). Liq. Ex. 13 (Arizona Fund note of March 4, 2008 call with liquidation staff). The Liquidator raised issues concerning the allocation with the Arizona Fund and asked it to reconsider in calls and a letter dated December 24, 2009. Liq. Ex. 2. The Liquidator asked the Arizona Fund to revise the claim counts and allocation of overhead expenses and also raised the priority of NCIGF dues in a letter to the Arizona Fund dated May 12, 2011. Liq. Ex. 3. The Arizona Fund did not respond to the Liquidator's letters.

The Liquidator accordingly proceeded to determine the claim. Liq. Exs. 4 and 5 (Notices of Determination). The Liquidator noted that the Arizona Fund had denied the Giant claims as late-filed and the coverage action was dismissed because of late notice, so the Fund had not

[2] The numbers in this paragraph include both NCIGF dues and investment management fees in order to present the total effect of the Fund's proposed allocations.

conducted work on a "claim-by-claim basis." However, the Fund had opened 80 claims which resulted in a large increase in the administrative expenses sought from Home. Liq. Ex. 4 at 7-8. Since the Arizona Fund had only two or three non-Giant claims open for Home during 2008 and 2009, the Liquidator concluded that a claim count of five for allocation purposes was appropriate for those years. Id. at 8. As there were five open Home claims with the Arizona Fund in 2007, and the Arizona Fund's expense allocation to Home for that year was $31,084.00, the Liquidator determined to use $31,000 for 2008 and 2009 as well. Id. The Liquidator accepted the Arizona Fund's expense allocation numbers for the 2006, 2007 and 2010 years. Using the Arizona Fund's numbers for 2006, 2007 and 2010 and the Liquidator's revised numbers for 2008 and 2009 resulted in a Class I allowance of $150,694.92 (excluding NCIGF dues and investment management fees). Id.at 8-9 (Liquidator's worksheet); Liq. Ex. 8.

The Arizona Fund's claim for administrative expenses included $75,881.97 of NCIGF dues. Use of the Arizona Fund's allocation percentage based on the 80 open claim count for 2009 resulted in an allocation of NCIGF dues for that year of $52,572.44, which was five to thirteen times greater than for 2006, 2007, 2008 or 2010 ($5,930.75; $3,917.36; $4,365.72; and $9,095.70 respectively). See Liq. Ex. 5 at 6.[3] The Liquidator determined to use the Arizona Fund's $4,365 NCIGF dues number from 2008 for the 2009 year as well. The Liquidator accepted the Arizona Fund's numbers for 2006, 2007, 2008 and 2010. This resulted in an NCIGF dues allocation of $27,674.53. Id. Because these dues are not expenses "in handling claims," the Liquidator assigned them to Class V. Id.

[3] The allocation of NCIGF dues for 2008 was not affected by the Giant matter because the dues were billed in January and Western Refining's letters were received in February.

The Liquidator allowed a total of $178,369.45: a Class I claim in the amount of $150,694.92 and $27,674.53 of NCIGF dues at priority Class V. Liq. Exs. 4 and 5.[4]

2. The Giant Lawsuits and Allocation of Administrative Expenses

In late February 2008, the Arizona Fund received 40 essentially identical letters from Western Refining notifying the Arizona Fund that Western Refining's subsidiary Giant, a Home insured, had been served with lawsuits. E.g., Liq. Ex. 14 (sample letters). The lawsuits all alleged contamination by MTBE. See Ex. 13 (Arizona Fund February 29, 2008 email). The letters requested that the Arizona Fund determine whether, in light of Home's liquidation, benefits are available from the Arizona Fund.

Immediately following receipt of the first letters, on February 26, 2008, the Arizona Fund contacted the Liquidator and asked for policy information. Liq. Ex. 12. In that email, Fund staff noted that "[i]f these are the first notices of the lawsuits, they are obviously past the bar date" and that if the Liquidator did not find claims "we will be denying for bar date". Id. Liquidation staff advised that they would assign two claim numbers, one for each primary policy, to the related cases as a group. Liq. Ex. 13 (handwritten note). The Arizona Fund, however, assigned two claim numbers to each of the 40 cases.

Approximately two weeks later, between March 5 and 14, 2008, the Arizona Fund sent Western Refining 40 essentially identical one-page letters denying coverage for the Giant matters because they were late-filed. Liq. Ex. 10, Int. 9. E.g., Ex. 15 (sample letters). The letters

[4] These allowances do not address $22,344.98 in investment management fees, as the Liquidator had requested but not received information regarding those expenses. (They have subsequently been denied for lack of substantiation, but they are not at issue in this proceeding.) The Liquidator had previously allowed the Arizona Fund's claim for administrative expenses for the years 2003 through 2005 in the amount of $163,806.95 at Class I, which the Fund accepted, and $11,104.60 in NCIGF dues at Class V. As the Arizona Fund notes in its brief ("AF Br.") at 2 n.1, the Fund filed a request for review of the priority classification of the $11,104.60 of NCIGF dues, and that issue will be determined by this proceeding.

advised Western Refining that the claims were late because notice had not been given to the Liquidator of Home prior to the June 13, 2004 "bar date" established in the liquidation order and that, under a resolution adopted by the Arizona Fund, matters that were not filed with the receiver or the Arizona Fund by the "bar date" are barred as to the Fund. Liq. Ex. 15. The Fund denied the claim on that ground:

> Notice of this claim was not provided prior to the bar dated established. For that reason, we will not be able to extend coverage for this matter under the Fund.

Id. Because the claims were denied on grounds of timeliness, the Arizona Fund did not address the underlying facts of the various lawsuits or any policy issues. It merely "reserve[d] all statutory and/or policy defenses." Id.

Shortly thereafter, Western Refining and Giant filed a coverage action against the AIG insurance companies and others, including the Arizona Fund, seeking coverage for over 50 lawsuits alleging damages from MTBE. Western Ref. Southwest, Inc. et al. v. National Union Fire Ins. Co. of Pittsburgh, PA, et al., No. CV2008-07299 (Superior Court for Maricopa County, Arizona) (the "coverage action"). Liq. Ex. 10, Int. 10. See Liq. Ex. 16 (parts of complaint).[5]

On September 3, 2008, the Arizona Fund moved for summary judgment on the claims against it in the coverage action "on the basis that the claims were filed subsequent to the bar date." Liq. Ex. 10, Int. 11; Liq. Ex. 18 (Arizona Fund motion for summary judgment). The Arizona Fund contended that the claims against the Arizona Fund were barred because the claims were filed after the June 13, 2004 claim filing deadline in the Home liquidation proceeding. See Liq. Ex. 18 at 5-6. Because the motion concerned only timeliness issues, the

[5] The complaint stated that the underlying lawsuits had "almost all" been consolidated in the United States District Court for the Southern District of New York "in a single proceeding as part of the multi-district litigation, In re: Methyl Tertiary Butyl Ether ("MTBE") Products Liability Litigation, No. 1:00-1898 MDL 1358 (S.D.N.Y.)." Liq. Ex. 16, ¶ 26.

Arizona Fund did not need to investigate or address the underlying claims and any coverage issues they might present. The motion reserved such issues. Id. at 5.

Western Refining never responded to the Arizona Fund's motion. Instead, there were discussions which resulted in an agreement on December 3, 2008. See Liq. Ex. 10, Int. 10. The plaintiffs "agreed to waive any MTBE claims against Home, APCIGF and any other insolvent carrier, and APCIGF agreed to waive attorneys' fees and costs." Liq. Ex. 10, Int. 11. The Court entered an order dismissing the Arizona Fund from the coverage action on January 21, 2009, which was received by the Arizona Fund on January 23, 2009. Liq. Ex. 10, Int. 10; Liq. Ex. 19.

Notwithstanding the January 2009 order of dismissal, the Arizona Fund kept its 80 claims "open" on its books until June 2009. Liq. Ex. 10, Int. 12. The Arizona Fund spent a total of $28,817.38 in defense of the coverage action. Liq. Ex. 20 (summary) (see Hamilton Aff. ¶4).

3. The NCIGF Dues

The Arizona Fund's administrative expense claim includes $75,881.97 for NCIGF dues allocated to Home for the years 2006 through 2010. Liq. Ex. 8. During those years, the Arizona Fund's NCIGF dues ranged from a low of $60,309 for 2008 to a high of $69,618 for 2007. Liq. Ex. 24 (NCIGF dues billings). The Arizona Fund's NCIGF dues totaled $327,187.47 for the years 2006 – 2010. Id. The dues fund the NCIGF's annual budget. They consist of two parts: a per capita "fixed annual membership fee" applicable to each guaranty association and then a pro-rata portion based upon the ratio of premium written by insurers in the guaranty association's state to the premium written in all states, subject to per fund and per state caps. Liq. Ex. 10, Int. 14; Liq. Exs. 25 at 2, 26 at 2, 27, 28 (NCIGF explanations). The dues thus do not reflect any particularized assessment of how NCIGF activities relate to any particular fund, nor to any particular estate.

The NCIGF does not handle claims. Its website specifically advises that:

> The NCIGF does not process or pay claims. Questions about individual claims are best directed to your state's department of insurance or guaranty association.

Liq. Ex. 31 (www.ncigf.org/public/claimsquestions (visited August 24, 2012) (emphasis added).

The NCIGF website describes the NCIGF as:

> [a] non-profit, member funded association that provides national assistance and support to the property and casualty guaranty funds located in each of the fifty states and the District of Columbia. Incorporated in December 1989, the NCIGF monitors national insurance activities, coordinates information for multi-state insolvencies and provides legal, informational, administrative, communications and public policy and administrative support to our members. The NCIGF works in close cooperation with the property and casualty insurance trade associations to monitor and respond to issues that might impact state guaranty funds. The group serves as a trusted expert, informing trade and other organizations as they develop model legislation related to state guaranty fund laws.

Liq. Ex. 32 (www.ncigf.org/about (visited August 24, 2012).

As summarized in the "Benefits of Your NCIGF Membership" from the 2008 NCIGF dues package (Liq. Ex. 27 at 7-9), the NCIGF conducts activities in a number of areas:

- Communications. The NCIGF "is accomplishing its mission on communications with the guaranty association community when guaranty associations, primary insurers and their trade associations are receiving timely and relevant communications on important insolvency issues and also critical information needed to make decisions on common issues". This involves maintaining a website and publishing bulletins and quarterly commentary.
- Coordinating Committees. The NCIGF supports coordinating committees "organized for multi-state insolvencies in which issues affecting a number of guaranty funds are present." This involves assigning staff to provide "critical assistance and support by doing whatever is necessary to ensure that guaranty fund interests are properly treated with respect to a particular insolvency."
- Model Legislation. The NCIGF works to fashion "legislative and other solutions to problems encountered in insurance insolvencies." This involves preparing an NCIGF Model Guaranty Association Act and working on efforts to enact legislation in various states.
- Congressional Education Program. The NCIGF conducts "a program of educating and informing key members of Congress and their staffs about the functioning of the state-based guaranty association system." It serves as a "technical resource to Congressional staff members on issues affecting guaranty associations."

- Liaison to NAIC. The NCIGF has worked with the National Association of Insurance Commissioners on NAIC model legislation "to do what is possible to ensure guaranty fund issues are fairly treated."
- Educational Forums for the Guaranty Fund Community. The NCIGF conducts various educational meetings.
- Uniform Data Standards. The NCIGF is involved in "the development of uniform standards for the transfer of data between guaranty associations and Liquidators."
- Data Communication. The NCIGF "has become a clearinghouse of data transmissions both from the Liquidator to the Guaranty Funds" including loss, claim, and unearned premium data for multi-state insolvencies as well as premium, historical expense, and assessment data.
- Data Security. The NCIGF has developed a data security and privacy policy.

ARGUMENT

THE ARIZONA FUND'S ADMINISTRATIVE EXPENSE CLAIM IS BASED ON AN UNREASONABLE ALLOCATION AND SEEKS TO RECOVER NCIGF DUES THAT ARE NOT EXPENSES "IN HANDLING CLAIMS."

This disputed claims proceeding presents two questions concerning the Arizona Fund's claim for administrative expenses from the Home estate. The first is whether the Arizona Fund's allocation of overhead expense to Home is reasonable; the second is whether NCIGF dues are properly Class I expenses in handling claims. The Arizona Fund has sought to bill the estates of insolvent insurers 100% of its overhead expenses and, for the period 2006 through 2010, it allocated $608,773.55 of its expenses to Home, including $75,881.97 of NCIGF dues.

Before turning to the specific issues, the Liquidator notes that the New Hampshire statutes do not provide for the NHIGA or any other guaranty association to have the entirety of its overhead expenses paid by the estates of insolvent insurers as Class I administration costs. The Act does not provide for guaranty association administrative expense claims at all. See RSA 402-C:44. The NHIGA Act only provides priority for "expenses . . . in handling claims." RSA 404-B:11, II. While the Arizona Fund takes the position that all of its expenses are entitled to Class I priority (Liq. Ex. 10, Int. 15; AF Br. 12-13), the New Hampshire Legislature plainly

intended the phrase "in handling claims" to limit the guaranty associations' expenses given Class I priority. The Arizona Fund's position disregards that phrase, contrary to the well-established rule that all statutory language is to be given meaning and that none is surplusage. See Garand v. Town of Exeter, 159 N.H. 136, 141 (2009) ("The legislature is not presumed to waste words or enact redundant provisions and whenever possible, every word of a statute should be given effect.").[6]

The Liquidator recognizes that the line separating expenses "in handling claims" from other expenses is not always clear, that the guaranty associations' most significant role is in addressing claims under policies issued by insolvent insurers, and that expending the Home estate's limited resources attempting to draw fine distinctions, track individual expenses, and parse priorities is generally not productive. Accordingly, the Liquidator has accepted most categories of guaranty association expenses as related to claims handling and has accepted most

[6] Other provisions of the NHIGA Act demonstrate that the Legislature intended the phrase "in handling claims" to refer to some but not all of a guaranty association's activities. See Mortgage Specialists, Inc. v. Davey, 153 N.H. 764, 774 (2006) ("We examine the language of the statute, ascribing to its words their plain and ordinary meanings, and interpret it in the context of the overall legislative scheme and not in isolation."). First, the Legislature gave NHIGA both claim and non-claim responsibilities. NHIGA is to "[h]andle claims" through its employees or through servicing facilities, RSA 404-B:8, I(f), but it is also to perform other, non-claim functions. See, e.g., RSA 404-B:13 (aiding in detection and prevention of insurer insolvencies); RSA 404-B:14 (responding to examination). NHIGA is thus authorized to "[e]mploy or retain such persons as are necessary to handle claims and perform other duties of the association." RSA 404-B:8, II(a) (emphasis added). Second, the Legislature expressly distinguished between claim and non-claim expenses. See RSA 404-B:8, I(c) (NHIGA is to assess members for "amounts necessary to pay the obligations of [NHIGA] under paragraph I(a) subsequent to an insolvency, the expenses of handling covered claims subsequent to an insolvency, the cost of examinations under RSA 404-B:13 and other expenses authorized by this chapter.") (emphasis added); RSA 404-B:8, I(g) (NHIGA is to reimburse servicing facilities for "obligations of the association paid by the facility and for expenses incurred by the facility while handling claims on behalf of [NHIGA] and shall pay the other expenses of the association authorized by this chapter.") (emphasis added). Guaranty associations thus may obtain Class I reimbursement only for their expenses incurred "in handling claims" for the insolvent insurer, not for all overhead expenses. Cf. In the Matter of Liquidation of The Home Ins. Co., 158 N.H. 396, 399 (2009) (the term "administration" in RSA 402-C:44, I, refers to "authorized activities undertaken in furtherance of the liquidation.").

guaranty association allocations of administrative expenses to the Home estate. However, some allocations are plainly unreasonable and some categories of expenses are plainly not expenses "in handling claims." The Arizona Fund's claim presents both.

A. THE ARIZONA FUND'S ALLOCATION OF EXPENSES BASED ON TREATING THE GIANT MATTERS AS EIGHTY "OPEN CLAIMS" IS UNREASONABLE.

The Arizona Fund attempts to portray this matter as a dispute over whether it was correct to open 80 claim files for the underlying Giant lawsuits. E.g., AF Br. 2-3, 4-5. This mischaracterizes the issue. The question is not whether the Arizona Fund acted consistently with its internal procedures but whether the use of 80 "open claims" results in an unreasonable allocation of expenses to Home. Any allocation of expenses to the Home estate should reflect the purpose of RSA 404-B:11, II, to give priority only to expenses in "handling" claims under Home's policies. Language in allocation statute must be viewed "within the context of the whole statute and in relation to the purpose of [the section]." Pandora Indus., Inc. v. Department of Revenue Admin., 118 N.H. 891, 894-95 (1978). Thus, whatever allocation methodology is used should reflect the effort devoted to Home claims in order to approximate the Fund's expenses "in handling" Home claims as opposed to handling other claims or conducting other business of the Fund. Indeed, most guaranty funds – 39 of 52 – allocate expenses based on hours of staff time devoted to Home claims compared with the hours spent on claims respecting other insurers in liquidation. Liq. Ex. 23 (chart) (see Hamilton Aff. ¶ 6). The Arizona Fund's allocation of overhead based on "open claims" is only a proxy – as shown below, a flawed proxy – for more direct measures of the relative resources devoted to handling Home claims.

While the Liquidator has accepted the "open claims" allocation for other years, as applied to 2008 and 2009 it results in an allocation of over 40% of the Arizona Fund's overhead

expenses to Home, an amount which is ten times the loss and ALAE payments for those years, based on a group of claims against one policyholder resolved on a single, common and preliminary issue. The Arizona Fund's allocation for 2008 and 2009 is clearly unreasonable, and the Liquidator's adjustment of the allocated amount for those years should be sustained. See Boston & Maine Corp. v. State, 109 N.H. 547, 550 (1970) (upholding Public Utilities Commission allocation where "[t]he basic facts found by the commission may be reasonably considered to warrant the conclusion reached.").

1. The Use Of 80 "Open Claims" As A Proxy Does Not Correspond To The Effort Devoted To Addressing The Giant Matters.

The Arizona Fund's use of 80 claims for purposes of allocation is inappropriate because it does not reflect the effort involved in actually handling the Giant matter.

a. The claims for coverage of the 40 Giant lawsuits do not warrant weighting as 80 "open claims" because they were denied based on the single, common timeliness issue and ultimately resolved for no payment after that issue was presented in the single coverage action.

The Arizona Fund's use of 80 claims greatly overstates the effort spent in denying and resolving the claims. The Fund treated each of the 40 lawsuits against Giant as a separate claim and assigned each suit two numbers because two Home policies were potentially implicated. This may accord with the Fund's administrative practices, but it does not reflect the actual effort it expended on the claims. All of the matters presented one common issue: whether Giant's claims were time barred under the Arizona Fund statute and the Board's resolution. That issue was promptly raised, answered and the claims denied. Contrary to the suggestion in the Arizona Fund's brief (AF Br. 11), the Arizona Fund did not spend time and resources analyzing the allegations and facts of 40 separate lawsuits and applying the terms of two policies to those numerous factual situations.

The Arizona Fund's claims manager identified the lateness issue and advised the Liquidator of the potential denial within days of receiving the first claim letter. See Liq. Ex. 12 (February 26, 2008 email: "If these are first notices of the lawsuits, they are obviously past the bar date.") The notice letters are virtually identical. The Liquidator provided the answer to the only factual question – whether notice had been given to the Liquidator of lawsuits before June 13, 2004 – the next day. See Liq. Ex. 13 (February 27, 2008 email advising "the initial claim [was] submitted in April 2007."). The Arizona Fund then issued denial letters between March 5 and 12, 2008. Liq. Ex. 10, Int. 9. See, e.g., Liq. Ex. 15. As the Arizona Fund acknowledges, "[t]he claims were denied because the claims were filed after the bar date adopted by the Fund pursuant to its enabling act and a resolution by the Fund's Board of Directors." Liq. Ex. 10, Int. 9. Issues beyond late-filing were simply reserved. Liq. Ex. 15. There was no individualized effort that could warrant treating the claims as 80 separate matters for allocation purposes. They are properly treated as a group of related lawsuits potentially implicating two policies.

After the denials, Western Refining included the Arizona Fund in the coverage action in April 2008. Liq. Ex. 10, Int. 10. That coverage action was a single proceeding, and it did not warrant treating the underlying lawsuits separately for allocation purposes. Indeed, the complaint alleged that the underlying cases had almost all been consolidated into a "single proceeding." Liq. Ex. 16, ¶ 26. Further, when the coverage action was filed, the Arizona Fund determined to use one file (for the Albertson Water District claim) "as the Master File and [to] keep all further notes and pay all bills from that file." Liq. Ex. 17 at 3; Liq. Ex. 10, Ints. 5-6. This is a very practical demonstration that the matters were for all intents and purposes one.

The Arizona Fund responded to the complaint on the preliminary and common ground of timeliness. It moved for summary judgment "on the basis that the claims were filed subsequent

to the bar date." Liq. Ex. 10, Int. 11; AF Ex. 18 at 5-14.[7] Giant then agreed to dismiss the case before responding to the Fund's motion. See Liq. Ex. 10, Int. 10, 11; Liq. Ex. 19. Again, there was no individualized effort. Because the motion concerned only timeliness issues, the Arizona Fund did not need to investigate or address the underlying claims and any coverage issues they might present. Indeed, the Arizona Fund stated that it did not need to address those issues:

> "[W]hile there is likely to be a great amount of time and effort devoted in this case to exploring the terms and exclusions contained in the numerous underlying insurance policies at play, none of those issues need be dealt with in this Motion."

Ex. 18 at 5.

While the Arizona Fund notes that it reserved the right to assert policy defenses in its denial letters and the summary judgment motion (AF Br. 12), it never had to do so. (Indeed, as of the date the coverage action complaint was received, the Arizona Fund did not have a copy of the policy language and could not "outline" policy defenses. Liq. Ex. 17 at 2.) The Giant claims presented a single issue that was promptly identified as the basis for denial and the motion for summary judgment, and the Arizona Fund was dismissed from the coverage action accordingly. The claims were treated by the Arizona Fund as one. Weighting them as 80 is inappropriate and grossly disproportionate to the effort involved in denying and resolving them based upon a single, common issue for no payment.[8]

[7] The Fund also asserted that the claim was premature because the claimant was required to exhaust other insurance. Liq. Ex. 18 at 14-15.

[8] The Arizona Fund contends there was no basis for the Liquidator's assertion that the Fund did not conduct work on a claim-by-claim basis (AF Br. 11 & n.5), but its submission does not identify any work beyond conferring with the Liquidator to confirm that the claims were late filed, issuing 40 identical letters denying the claims on that basis and then preparing a single summary judgment motion.

b. The Arizona Fund's arguments concerning the strength or weakness of its time bar position are irrelevant.

The Arizona Fund makes the surprising argument that the time bar position it asserted in denying the claims and in moving for summary judgment was potentially flawed. AF Br. 7-11. However, the strength or weakness of the argument is entirely irrelevant. Whether the Arizona Fund might have lost if the issue had been litigated has no bearing on whether the underlying suits should be treated as 80 "open claims" for purposes of allocating expenses to Home.

The Fund contends that the Liquidator erroneously assumes that it was "evident and beyond dispute" that the Giant claims were time-barred, and it advances arguments against its own claim denials. AF Br. 7. However, the Liquidator's position regarding allocation does not rest on the strength of the time-bar argument but its effect on the claims. As described above, the Arizona Fund asserted the time bar as the ground for denial of the claims (reserving any other issues). Liq. Ex. 10, Int. 9; Liq. Ex. 15. When sued in the coverage action, the Arizona Fund asserted the time bar claim as a basis for summary judgment (noting that this meant that other issues need not be reached). Liq. Ex. 10, Int. 11; Liq. Ex. 18 at 5. Western Refining and the Arizona Fund then reached an agreement to dismiss the Fund for no payment, and the Fund was dismissed. Liq. Ex. 10, Int. 10, 11; Liq. Ex. 19. In light of the time-bar argument that it immediately identified, the Arizona Fund never needed to (and did not) conduct individualized analysis of the underlying facts of the lawsuits and take any positions on coverage issues they may have presented.

The Liquidator's point is that the Arizona Fund treated the Giant lawsuits as presenting a single common issue, and they were resolved on that basis. For purposes of allocating expenses to Home, they are properly treated as two claims (one for each Giant policy) because they were

denied and resolved based on time bar. To allocate expenses to Home based on weighting the Giant matters as 80 open claims does not correspond to the minimal effort devoted to them.

c. The Arizona Fund used the 80 "claims" as a basis for allocation for an excessive period.

Not only was the number of claims excessive but so was the length of time they were held open. The Arizona Fund weighted its claim for administration expenses using the 80 "open claims" for the period from March 2008 through June 2009. Liq. Ex. 10, Ints. 7, 8, 12; see Liq. Ex. 8. It kept the 80 files "open" after March 2008, when it denied the claims for late-notice, even though there was only a single coverage action. Even after the coverage action was dismissed by court order in January 2009 (Liq. Ex. 10, Int. 10; Liq. Ex. 19), the Arizona Fund kept the 80 claims open for five more months, until June 2009. Liq. Ex. 10, Int. 12. The Fund contends this was to receive bills, but the last counsel invoice was paid in early February. Liq. Ex. 20. Holding 80 claims "open" for these prolonged periods is inappropriate for allocation purposes as there was only one coverage action, and after it was resolved no efforts were being devoted to the claims under Home policies.

2. The Arizona Fund's Allocation Results In A Disproportionate Allocation Of Overhead Expense To Home.

The Arizona Fund focuses its brief on the use of 80 "open claims" in its allocation methodology, but it fails to address the larger picture. It never addresses the critical question whether the result produced by its allocation is reasonable. That result – allocation of $498,222 to the Home estate for 2008 and 2009 – is unreasonable both by comparison with the expenses of resolving the claim and the substantial percentage of the Fund's expenses allocated to Home.

a. The Arizona Fund's allocation is disproportionate to the small expense of resolving the coverage action.

The actual expense in handling the Giant matter does not reasonably relate to the total overhead expense the Arizona Fund allocated to Home based on the 80 "open claim" weighting. Arizona Fund spent a total of $28,817.38 in legal expense to defend against and resolve the coverage action in 2008 and 2009. Liq. Ex. 20. However, the Arizona Fund seeks to recover $498,222 of overhead expense from Home for those two years. Liq. Ex. 8. A matter that was defended for $28,817 should not result in an administrative expense claim of seventeen times as much. The amount claimed is simply disproportionate to the effort and expense involved in resolving (for no payment) the claims that the Fund has weighted as 80. The Referee should reject the Arizona Fund's allocation on this ground alone. Indeed, the Missouri Court of Appeals denied an administrative expense claim by the Arizona Fund that involved a much smaller disparity on the ground it "lacked credibility." Huff v. Integral Ins. Co., 354 S.W.3d 228, 233 (Mo. App. 2011) (rejecting Arizona Fund claim for $16,720.74 in general administrative expenses for a claim on which the Fund paid $3,887.39 and spent an hour in administration).

b. The Arizona Fund's use of 80 "open claims" results in a disproportionate allocation to Home.

Finally, the Arizona Fund's use of 80 "open claims" results in a disproportionate amount of overhead expense being assigned to the Home estate for the 2008 and 2009 years.[9] The assignment of 80 claim numbers resulted in allocations to Home of $259,348 in 2008 and $238,874 in 2009. Liq. Ex. 8. This is clearly excessive. Those annual amounts are approximately seven times greater than the annual allocations to Home for 2006, 2007 or 2010

[9] If the Arizona Fund were handling thousands of claims, treating the Giant matter as 80 claims might not be significant. But where the 80 asserted claims are a substantial portion of the Arizona Fund's open claims (see Liq. Ex. 11), the Arizona Fund's weighting produces absurd results.

($43,084.80, $35,001.36 and $32,484.72, respectively). Liq. Ex. 8. The $498,222 in claimed administrative expenses for 2008 and 2009 is 43% of the Arizona Fund's total overhead expenses for those years, as opposed to 5% to 7% for the other years. Liq. Ex. 11; Liq. Ex. 22. It is also ten times the total of $48,170.51 in loss and allocated loss adjustment expense paid by the Fund under Home policies (on other claims) for the two years. Liq. Ex. 21 at 2 and 3 ($1,142.54 for 2009 and $47,027.97 for 2008).

That the Arizona Fund denied a batch of related claims by one Home insured on timeliness grounds does not support having Home pay over 40% of the costs of keeping the Arizona Fund in operation for two years. The Arizona Fund's basic operations are properly supported by assessment as provided in its founding statute. The expenses are not properly passed through to Home by expansive allocations unrelated to actual efforts and expenses in handling claims. The Liquidator's determination to carry forward the allocated amounts for prior years based on five open claims is reasonable and should be sustained.

II. THE NCIGF DUES ARE NOT EXPENSES "IN HANDLING CLAIMS."

The second question is whether NCIGF dues are entitled to Class I priority. As discussed at pages 14-15 above, the NHIGA Act only provides administration cost priority to guaranty associations' "expenses . . . in handling claims." RSA 404-B:11, II. That phrase does not encompass all guaranty association expenses but serves to limit the expenses entitled to priority. Otherwise the words "in handling claims" would be surplusage, contrary to the rule that "[w]hen construing a statute, [the courts] must give effect to all words in a statute and presume that the legislature did not enact superfluous or redundant words." New Hampshire Motor Transp. Ass'n Employee Benefit Trust v. New Hampshire Ins. Guar. Ass'n, 154 N.H. 618, 625 (2006) (quoting Winnacunnet Co-op. Sch. Dist. v. Town of Seabrook, 148 N.H. 519, 525-26 (2002)). See New

Hampshire Ins. Guar. Ass'n v. Pitco Frialator, Inc., 142 N.H. 573, 578 (1998). The NHIGA Act's "liberal construction mandate does not give [the courts] the authority to ignore the legislature's use of" terms or phrases. See New Hampshire Motor Transp., 154 N.H. at 625. Further, in the NHIGA Act, the Legislature provided the NHIGA with both claim and non-claim responsibilities, and it expressly distinguished expenses in handling claims from other expenses. See page 15 n. 6 above. Accordingly, the mere fact that a guaranty association incurs an expense is not enough to provide it with administration cost priority. The Arizona Fund appears to recognize this, as it contends that "all" of the NCIGF dues it pays "constitute an expense in handling claims." AF Br. 15. However, its argument fails to support that conclusion.

As an initial matter, the NCIGF does not handle claims. The NCIGF website expressly states that the NCIGF "does not process or pay claims." Liq. Ex. 30. Nor do the NCIGF dues bear any correlation to claim handling activity by the Arizona Fund. The Arizona Fund pays NCIGF dues to be a member of the NCIGF, and the dues are set by the NCIGF to support the NCIGF's annual budget. See Liq. Ex. 10, Int. 14; Liq. Ex. 26, 27, 28, 29. That budget is allocated among guaranty associations through the dues, which have two parts: a per-fund fixed fee and a pro rata share allocated by the amount of premium written in the various states. Id. The dues thus do not reflect claims handling activity by the Arizona Fund. Indeed, the affidavit from the NCIGF confirms that the dues are not tied to claim activity. Affidavit of Mark Steckbeck ¶ 7.

The Arizona Fund asserts that it received "substantial assistance" in handling Home claims on account of its membership in the NCIGF. AF Br. 16; Affidavit of Michael Surguine ¶ 19. However, the Surguine affidavit lacks any supporting detail and provides nothing more than that conclusory assertion. The Fund also makes the general argument that, while the

NCIGF does not handle particular claims, its "primary function" is to assist guaranty funds in handling claims. AF Br. 18. It contends that the NCIGF provides support by coordinating, distributing information, educating guaranty association personnel, assisting in compliance with federal law and compiling case law. AF Br. 17; Steckbeck Aff. ¶¶ 3-5. With the possible exceptions of coordinating guaranty fund's actions regarding certain large claims, allocating claims among guaranty associations or facilitating transmission of claims data, however, these activities are informational and so general that to grant them priority would render meaningless the "in handling claims" limitation established by RSA 404-B:11, II.

The Arizona Fund's broad-brush approach also obscures the fact that the NCIGF works to generally advance guaranty association interests in ways wholly unrelated to the handling of claims. While the Fund concedes that "certain activities of the NCIGF may not constitute assistance relating to the handling of claims" (AF Br. 18), its materials omit any reference to these other significant NCIGF activities. Most prominently, the NCIGF serves as an advocate for guaranty association interests before Congress and other federal policymakers, before state legislatures, and with members of the NAIC. The organizational summary and 2008 "benefits" handout quoted at pages 13-14 above identify NCIGF activities in model legislation, congressional education, and liaison to the NAIC. Liq. Ex. 31; Liq. Ex. 27 at 8. The 2006 description of activities mentions addressing state legislatures over the introduction of the Insurance Receivership Model Act ("IRMA"), working with the NAIC over its model property-casualty guaranty association law, and congressional outreach. Liq. Ex. 25 at 2-3. The 2007, 2008 and 2010 correspondence describes numerous activity categories relating to communications, education, outreach and public policy development. Liq. Ex. 26 at 4-5, 26 at 4-5, 29 at 3, 6.

These functions, valuable as they may be to the guaranty associations, are principally in the service of the guaranty fund system as a whole. Indeed, the NCIGF has increased its budget specifically to support its efforts to respond to federal scrutiny of guaranty funds and federal rules that might affect them. Liq. Ex. 30 at 1-2, 4-5. Such advocacy of guaranty fund interests in various forums is quite removed from the handling of claims. Where the NCIGF devotes significant resources to such activities, its dues do not constitute expenses "in handling claims."

At bottom, the Arizona Fund's argument rests on the premise that insolvent estates, including the Home estate, are required to support the entire guaranty fund system, including the funds' own association, at Class I priority payable before any creditors. This is inconsistent with the NHIGA Act, which limits that priority to guaranty funds' expenses "in handling claims." The Arizona Fund has not shown that "all" the dues it pays to the NCIGF fit in that category. At most, it has suggested that some NCIGF activities assist the guaranty association system in dealing with claims. This does not satisfy the Arizona Fund's burden of supporting its claim. That some unspecified part of the NCIGF dues could potentially support the Arizona Fund in handling claims does not mean that the entire amount of NCIGF dues is entitled to Class I priority. This is particularly the case where the NCIGF disclaims making such an allocation. See Steckbeck Aff. ¶ 7. Without specification of the amounts that fit within the statute, the Fund's claim to Class I priority for NCIGF dues fails. The Liquidator thus properly classified the NCIGF dues as Class V priority.

Conclusion

For these reasons, the Referee should sustain as reasonable the Liquidator's determination of the Arizona Fund's overhead expenses allocable to Home as administration costs for the years 2006 through 2010 and the assignment of NCIGF dues to priority Class V.

Respectfully submitted,

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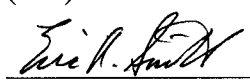

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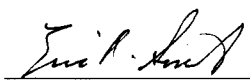
August 29, 2012

Certificate of Service

I hereby certify that the foregoing § 15 submission and the appendix of Liquidator's exhibits was served by email on counsel for the Arizona Property and Casualty Insurance Guaranty Fund this 29th day of August, 2012.



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Schedule of Exhibits

Document **Exhibit #**