THE STATE OF NEW HAMPSHIRE
SUPREME COURT

In the Matter of the Liquidation of
The Home Insurance Company

No. 2005-0740

APPEAL FROM THE FINAL DECISION OF THE
MERRIMACK COUNTY SUPERIOR COURT

REPLY BRIEF FOR APPELLANTS CENTURY INDEMNITY COMPANY, ACE PROPERTY AND CASUALTY INSURANCE COMPANY, PACIFIC EMPLOYERS INSURANCE COMPANY AND ACE AMERICAN REINSURANCE COMPANY

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

SUMMARY OF ARGUMENT 1

ARGUMENT 2

I. THE LIQUIDATOR MISSTATES THE STANDARD OF REVIEW 2

II. THE LIQUIDATOR CANNOT SHOW THAT THE PROPOSED PAYMENTS TO THE AFIA CEDENTS ARE PERMITTED UNDER NEW HAMPSHIRE LAW 2

A. The Liquidator Has Admitted That The Proposed Payments Would Directly Relate To, And Would Be On Account Of, The AFIA Cedents' Pre-Liquidation Claims 2

B. The General Power Of The Liquidator To Make Administrative Expense Payments To Lower Priority Creditors Is Irrelevant Here 3

C. The Proposed Claims Payments To The AFIA Cedents Cannot Be Classified As "Costs Of Administration" 5

D. The ACE Companies' Position Is Fully Consistent With The Act 6

III. THE SUPERIOR COURT PLAINLY ERRED IN HOLDING THAT THE PROPOSED AGREEMENT IS FAIR AND REASONABLE, AND THAT IT IS NECESSARY UNDER RSA 402-C:25 7

CONCLUSION 10

TABLE OF AUTHORITIES

New Hampshire Cases:

Blackthorne Group v. Pines of Newmarket, 150 N.H. 804, 806 (2004) 2

Cases from Other Jurisdictions:

In re Food Barn Stores, Inc., 175 B.R. 723, 727-730 (Bankr. W.D. Mo. 1994) 5

Oxendine v. Commissioner of Ins. of N.C., 494 S.E.2d 545 (Ga. App. 1997) 1, 5, 6

Woburn Assocs. v. Kahn (In re Hemingway Transport, Inc.), 954 F.2d 1 (1st Cir. 1992) ...... 5 and n.4

Statutes:

N.H. RSA 402-C:1, IV 6

N.H. RSA 402-C:25 .... 6, 7, 8

N.H. RSA 402-C:44 .... 1, 3, 4, 6, 7

Other:

Insurer Receivership Model Act ("IRMA") 4, 5 n.4

SUMMARY OF THE ARGUMENT[1]

In their initial brief, the ACE Companies demonstrated that the proposed payments to the AFIA Cedents violate RSA 402-C:44 because, by the Liquidator's own admission, those payments would be distributions on account of the AFIA Cedents' pre-liquidation claims against Home. The Liquidator attempts to gloss over this critical fact by arguing that, as a matter of general principle, a liquidator may make payments to persons as Class I creditors under the "costs of administration" provisions of RSA 402-C:44, even if the recipients are creditors who have unrelated, lower-priority claims against the estate. That, however, is not the issue before the Court. This case does not present a situation where a creditor with a pre-liquidation claim performs unrelated services for the estate post-liquidation and requests payment for those services as administration costs. Here, the proposed payments arise as a direct result of the AFIA Cedents' pre-liquidation claims. The law is clear that such pre-liquidation claims cannot form the basis of payments for post-liquidation "costs of administration." *See, e.g., Oxendine v. Commissioner of Ins. of N.C.*, 494 S.E.2d 545 (Ga. App. 1997). In *Oxendine*, which the Liquidator fails to distinguish in any meaningful way, the court found that the reclassification of settlement payments as administrative expenses would subvert the mandatory order of priority. This Court should similarly reject the Liquidator's effort to circumvent RSA 402-C:44, and reverse the Superior Court's finding that the proposed payments would be "costs of administration."

The Court should also reverse the Orders on the grounds that the Superior Court applied the wrong standards to the issues of fairness, reasonableness and necessity, and disregarded undisputed evidence in approving the Proposed Agreement. The Liquidator has not shown how the September 2005 Order complied with this Court's directives in the September 2004 Order. Indeed, the Liquidator suggests that the Superior Court was free to ignore the Court's requirement

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[1] Any capitalized terms in this brief that are not defined shall have the same meaning as in the ACE Companies' initial brief.

that it evaluate the fairness and reasonableness of the Proposed Agreement under the standards set forth in the September 2004 Order. When the proper standards for fairness, reasonableness and necessity are applied to the evidence, it is clear that the September 2005 Order must be reversed and that the Proposed Agreement is not fair, reasonable and necessary.

ARGUMENT

I. THE LIQUIDATOR MISSTATES THE STANDARD OF REVIEW

The Liquidators suggests that the Superior Court's approval of the Proposed Agreement should be reviewed for "abuse of discretion." (*See* Liquidator's Br. at 19.) That is wrong. In the Orders, the Superior Court was interpreting the Insurers Rehabilitation and Liquidation Act (the "Act"). It is well established that a trial court's interpretation of a statute must be reviewed *de novo*. *E.g.*, *Blackthorne Group v. Pines of Newmarket*, 150 N.H. 804, 806 (2004).

II. THE LIQUIDATOR CANNOT SHOW THAT THE PROPOSED PAYMENTS TO THE AFIA CEDENTS ARE PERMITTED UNDER NEW HAMPSHIRE LAW

A. The Liquidator Has Admitted That The Proposed Payments Would Directly Relate To, And Would Be On Account Of, The AFIA Cedents' Pre-Liquidation Claims

In the motion for approval of the Proposed Agreement (the "Approval Motion") and the Agreement itself, the Liquidator made it clear that the payments to the AFIA Cedents would be distributions in partial satisfaction of the AFIA Cedents' pre-liquidation claims against Home. The Liquidator described the Proposed Agreement as a "settlement" or "compromise" of threatened litigation by the AFIA Cedents to collect on their pre-liquidation claims. (*See, e.g.*, Jt. App. at 60, 65, 71, Approval Mot. at 1, 6 (¶ 8), 12 (¶ 21).) The Proposed Agreement itself states that it is a "compromise" of those claims. (Jt. App. at 75, Proposed Agreement at ¶ 1.1.)

Even more importantly, the Approval Motion repeatedly draws a direct connection between the proposed payments, which it describes as "distributions," and the AFIA Cedents' pre-liquidation claims. The Approval Motion, for example, states that the Proposed Agreement would result in "the allocation of a portion of the net proceeds received from the ACE Group ...[,] <u>in</u>

respect of the AFIA Cedents' claims[,] for distribution to the AFIA Cedents." (Jt. App. at 67, Approval Mot. at 8 (¶ 12); emphasis added.)[2] In other words, according to the Liquidator, the proposed payments to the AFIA Cedents would be "in respect of" their claims against Home and would constitute distributions for those claims.

The Liquidator argues that the reference to the AFIA Cedents' pre-liquidation claims "is merely a method of dividing up" the net reinsurance proceeds and that the payments would only be "costs of administration." (Liquidator's Br. at 26.) This argument is belied by the Liquidator's statements that the payments would be "in respect of" (*i.e.*, on account of) the AFIA Cedents' claims. The Proposed Agreement, moreover, provides that in the event the AFIA Cedents are subsequently entitled to "a distribution as a creditor of Home in the New Hampshire proceeding the distributions to AFIA Cedents under the [Proposed Agreement and related] Scheme will be taken into account in determining appropriate New Hampshire distributions." (Jt. App. at 70, 77, Approval Mot. at 11 (¶ 18); Proposed Agreement at ¶ 1.5.2.) If the proposed payments to the AFIA Cedents were in fact "costs of administration" and payable as Class I claims, they would not be deducted from the AFIA Cedents' Class V claims. Thus, despite the Liquidator's efforts to avoid his previous admissions, it cannot be denied that the proposed payments to the AFIA Cedents are distributions on account of their pre-liquidation claims.

B. The General Power Of The Liquidator To Make Administrative Expense Payments To Lower Priority Creditors Is Irrelevant Here

The Liquidator tries to downplay these concessions by focusing on the power of a liquidator to make Class I claims payments (under the "costs of administration" provisions) to creditors who also have lower priority claims. The Liquidator argues that the payments under the Proposed Agreement do not violate RSA 402-C:44 because "the priority statute contains no bar on payment of administration costs to lower priority creditors in order to collect an asset."

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2 *See also* Jt. App. at 72, Approval Mot. at 13 (¶ 21) (stating that under the scheme the AFIA Cedents would "receive a portion of the net proceeds received on their claims").

(Liquidator's Br. at 21.) To the extent that the Liquidator is referring to a creditor who has a lower priority, pre-liquidation claim and then provides unrelated, post-liquidation services that otherwise meet the definition of "costs of administration," the priority statute does not seem to bar a creditor from receiving a payment of the Class I claim (so long as the payment is not in satisfaction of a pre-liquidation claim). However, the Liquidator's abstract statements regarding the payment of administration costs completely avoid the real issue here. This appeal turns on whether the Liquidator may reclassify, as "costs of administration," proposed payments that would in fact be distributions on account of the AFIA Cedents' pre-liquidation claims. As the ACE Companies demonstrated in their initial brief, such a reclassification of the AFIA Cedents' claims is barred by the plain language of RSA 402-C:44 and the applicable case law.[3]

The Liquidator attempts to rely on a revised provision (and drafting note) in the Insurer Receivership Model Act ("IRMA") that was recently adopted by the National Association of Insurance Commissioners ("NAIC"). The provision referred to by the Liquidator (which has not been accepted by any state) is outside the record on appeal and irrelevant because it was adopted after the issuance of the Orders being appealed here. Accordingly, the ACE Companies have moved to strike the Liquidator's reference to the administrative expense provision in IRMA (as well as the portions of NAIC's *amicus curiae* brief discussing the same provision). Even if the Court does not grant the ACE Companies' motion, it should disregard the provision and the drafting note that the Liquidator cites. The provision itself is nothing more than a restatement of a liquidator's power to pay administration costs. (L.A. 597.) The drafting note — which is not a part of IRMA itself and was intentionally omitted from IRMA — simply states, as the Liquidator does in his brief, that there is no general prohibition against making payments for administrative

[3] The Liquidator misstates the ACE Companies' argument, contending that it "amount[s] to an assertion that the priority statute prohibits administration cost payments to a person who is also a lower priority creditor." (*Id.* at 21.) The ACE Companies object to the proposed payments because they are claims distributions dressed up as administration costs, not simply because they would be made to the AFIA Cedents.

expenses to creditors who also have lower priority claims. (L.A. 601.) As discussed above, that is a completely different question from the issue in this case, which is whether the Liquidator may make Class I payments totaling tens of millions of dollars to the AFIA Cedents in direct relation to, and on account of, their pre-liquidation claims against Home.[4]

C. The Proposed Claims Payments To The AFIA Cedents Cannot Be Classified As "Costs Of Administration"

The Liquidator argues that the proposed payments would be "costs of administration" because this case involves a "post-liquidation transaction" (*i.e.*, the Proposed Agreement) resulting in a benefit to the estate. (*See* Liquidator's Br. at 25-26.) The critical test, however, is whether the right to payment arises from a pre-liquidation transaction, not whether the post-liquidation transaction would be beneficial. *Woburn Assocs. v. Kahn (In re Hemingway Transport, Inc.)*, 954 F.2d 1 (1st Cir. 1992).[5] Because the Liquidator has conceded that the proposed payments to the AFIA Cedents are on account of their pre-liquidation claims (which arose out of the pre-liquidation contracts between the AFIA Cedents and Home), any such payments may not be passed off as "costs of administration." *See, e.g., In re Food Barn Stores, Inc.*, 175 B.R. 723, 727-730 (Bankr. W.D. Mo. 1994) (refusing to recognize post-petition indemnification claim as administrative expense because events triggering the claim occurred pre-petition.).

This case is exactly like *Oxendine v. Commissioner of Ins. of N.C.*, 494 S.E.2d 545 (Ga. App. 1997), because it involves an effort to recast payments on pre-liquidation claims as administrative expenses. The Liquidator attempts to distinguish *Oxendine* on the grounds that (a)

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4 The National Conference of Insurance Guaranty Funds (the "NCIGF") has submitted an *amicus curiae* brief requesting that this Court affirm the September 2005 Order. However, in July 2005, during the drafting of IRMA, the NCIGF joined in a proposed amendment that would have removed the administrative expense provision and drafting note on which the Liquidator relies. Either the NCIGF is taking contrary a position now or it does not read the IRMA provision and drafting note as supportive of the Liquidator's position.

5 In *Woburn*, which the Liquidator cites, the First Circuit denied administrative status to a claim that arose from a pre-petition transaction, even though the trustee anticipated that there would be a benefit to the estate. *Id.* at 6-7. Thus, the controlling factor is whether the claimant would have a claim in the absence of the pre-liquidation transaction. The answer here is clearly "no."

"there was no post-liquidation transaction" in *Oxendine*; and (b) the Proposed Agreement here would bring a benefit to the estate, whereas, the Liquidator claims, the settlement in *Oxendine* would not have provided such a benefit. (*See* Liquidator's Br. at 26-27.) In *Oxendine*, the payments claimed as administrative expenses arose from a pre-liquidation transaction, just as they do here. That fact alone means that the payments cannot be classified as "costs of administration." In any event, the claimants in *Oxendine* (as in this case) tried to justify the payments on the grounds that they would benefit the estate. The *Oxendine* court, however, found that no "reasonable definition" of administration costs can include settlement payments and that allowing the reclassification of such payments as administrative expenses would "render meaningless" the priority of claims established by the legislature. *Id.* at 607. This Court should similarly reject the Liquidator's unlawful attempt to transform claims distributions into "costs of administration."[6]

D. The ACE Companies' Position Is Fully Consistent With The Act

The Liquidator claims that the ACE Companies' position is contrary to a liquidator's "broad authority" under RSA 402-C:25 to collect assets of the estate and thereby minimize "unavoidable loss." (Liquidator's Br. at 22.) The "unavoidable loss" language cited by the Liquidator comes from RSA 402-C:1, IV, which states that one of the purposes of the Act is the "[e]quitable apportionment of any unavoidable loss" as a result of an insurer's rehabilitation or liquidation. The Liquidator, however, does not have the unfettered power to determine how the loss will be apportioned. He must follow the order of priority set forth in RSA 402-C:44.

As the NAIC noted in its *amicus curiae* brief:

> [The apportionment of unavoidable loss] is accomplished through the priority of distribution. ... "Apportionment of any unavoidable loss" does not mean that a court sitting in equity determines what is equitable and

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[6] The Liquidator also argues that the proposed payments to the AFIA Cedents are analogous to "finders' fees" in the bankruptcy context. (*See* Liquidator's Br. at 24-25.) However, the cases cited by the Liquidator are distinguishable because they all involve payments to persons who did not have other, related claims. The Liquidator's cases do not hold, or even remotely suggest, that a creditor may be paid a finders' fee for filing a claim against a debtor's estate.

> apportions payments accordingly. ... [I]t means that creditors will share based on the equities established in the statutory priority system.

(NAIC's Br. at 9-10; emphasis added.) Thus, the ACE Companies' position in this case is fully consistent with the Act, which requires that any payments to creditors must be in accordance with the order of priority provisions in RSA 402-C:44. It is not for the Liquidator, nor the supervising court, to determine under equitable principles whether the AFIA Cedents should be paid before higher priority creditors or other Class V creditors. The Superior Court recognized as much when it ruled in the Order on Remand that the equitable doctrines raised by the Liquidator do not override RSA 402-C:44. (*See* Jt. App. at 20-21, 24.) The Liquidator did not appeal this ruling.

III. THE SUPERIOR COURT PLAINLY ERRED IN HOLDING THAT THE PROPOSED AGREEMENT IS FAIR AND REASONABLE, AND THAT IT IS NECESSARY UNDER RSA 402-C:25

The ACE Companies demonstrated in their initial brief that the Superior Court (a) ignored the controlling standard for fairness and reasonableness set forth in this Court's September 2004 Order; (b) invented a reasonableness standard for evaluating the necessity of the Proposed Agreement; and (c) reached conclusions that are unsupported and contradicted by other findings of fact that it made. (*See* ACE Companies' Br. at 7-15, 28-34.) The Liquidator utterly fails in his attempt to correct the Superior Court's multiple errors.

The Liquidator tries to avoid the Superior Court's undisputed failure to apply this Court's multi-factored standard for evaluating fairness and reasonableness by arguing that the main purpose of the Proposed Agreement was to provide an incentive for the AFIA Cedents to file and prosecute their claims rather than to settle any anticipated litigation over the AFIA Cedents' claim. (*See* Liquidator's Br. at 33-34.) The Liquidator thus suggests that the Superior Court was not required to follow the cases cited by this Court in the September 2004 Order, which relate to the settlement of litigation.

The Superior Court, however, was not free to fashion its own standard for reviewing the fairness and reasonableness of the Proposed Agreement. This Court set forth the standard to be followed on remand, and the Superior Court chose to disregard it. Moreover, the Liquidator cannot portray the Proposed Agreement as principally focused on non-litigation, "business" issues. The Approval Motion is styled as a "compromise" and the Liquidator stressed that it had been entered into "in an effort to avoid costly, uncertain and protracted multi-jurisdictional litigation." (Jt. App. at 60, Approval Mot. at 1; *see also id.* at 71, Approval Mot. at 12, ¶ 21 ("[The Proposed Agreement] is a settlement of disputed positions regarding the AFIA Cedents' claimed right to direct access to proceeds otherwise payable to Home under the INA Agreement and under other reinsurances protecting the AFIA Treaties and the suggestion that those proceeds otherwise should only be collected and distributed in the UK proceedings.").) The Liquidator, therefore, cited the risk of litigation as a major impetus for the Proposed Agreement. The ACE Companies showed during the July 2005 evidentiary hearing that, as a practical matter, the alleged threats and litigation cited by the Liquidator were in fact non-existent, and that no reasonable liquidator would have entered into the Proposed Agreement based on those "threats." The Superior Court plainly erred in failing to evaluate the evidence presented by the ACE Companies on the purported litigation risk under the standard articulated by this Court in the September 2004 Order.

The Superior Court also applied the wrong standard to the necessity issue, stating that the test is whether a reasonable liquidator would have concluded that the Proposed Agreement is necessary under RSA 402-C:25. (*See* Jt. App. at 53-54.) The Superior Court cited no authority for this "reasonable liquidator" standard, and the Liquidator has failed to identify any. Instead, the true standard is a "but for" test, *i.e.*, whether the AFIA Cedents would have filed and prosecuted their claims in the absence of the Proposed Agreement. (ACE Companies' Br. at 32-33.)

The Liquidator does not challenge the applicability of the "but for" test, but he claims that the Superior Court properly found that the Proposed Agreement is also necessary under that

standard. (Liquidator's Br. at 29.) However, there is no evidence in the September 2005 Order that the Superior Court applied anything other than the newly created "reasonable liquidator" test. The Superior Court based its conclusion on the subjective beliefs of the Liquidator's witnesses regarding the AFIA Cedents' filing and prosecution of claims. (*See id.* at 29-30.)

In discussing necessity in the September 2005 Order, the Superior Court ignored the wealth of objective evidence submitted by the ACE Companies showing that the AFIA Cedents would have filed and prosecuted their claims (even though the Superior Court had accepted much of the evidence in its findings of fact and conclusions of law). For example, the Superior Court found that (a) creditors in the position of the AFIA Cedents routinely file proofs of claims; (b) the preservation of setoff, the uncertainty regarding the eventual distribution by the estate and potential tax implications under U.S. laws provide strong incentives to file claims; (c) the proofs of claims submitted by Class V creditors in the Home estate include amounts that are well beyond the claimants' potential setoff; (d) once proof of claims are submitted to the estate, the Liquidator (and the Joint Provisional Liquidators) have the power to compel the production of information relating to the claims. (*See* Jt. App. at 58-59, September 2005 Order at 34-35.)

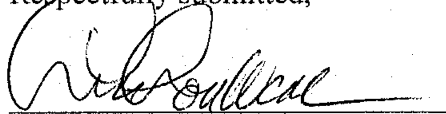
The ACE Companies submitted other evidence showing that (a) the AFIA Cedents will not know the amount of the setoff for many years and thus cannot simply stop prosecuting their claims once setoff is reached, as the Liquidator alleges; (b) the burden of prosecuting claims is minimal because they relate to the same losses that brokers have also submitted, on the AFIA Cedents' behalf, to other reinsurers; and (c) the Claims Protocol establishes a streamlined procedure for prosecuting claims and it places most of the prosecution responsibility on the Liquidator, who has an incentive to have the claims adjudicated. (*See* ACE Companies' Br. at 9-10.) Because the Superior Court improperly focused on the Liquidator's subjective beliefs, it failed to take all of this evidence regarding the filing and prosecution of claims into account.

Finally, the Liquidator argues that the Superior Court's necessity ruling was proper because it refers to the alleged uncertainty over direct dealing between the ACE Companies and the AFIA Cedents. (*See* Liquidator's Br. at 31-33.) As noted in the ACE Companies' initial brief, the Superior Court's cursory discussion of the alleged threat of direct dealing cannot take the place of a proper evaluation under the multi-factored test required by this Court. Moreover, the evidence cited by the Superior Court does not come close to supporting a finding that the purported threat was realistic. (*See* ACE Companies' Br. at 33-34.)

CONCLUSION

For the foregoing reasons, as well as the reasons stated earlier in this appeal, the ACE Companies respectfully request that the Court grant the relief set forth in their initial brief.

Respectfully submitted,



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