THE STATE OF NEW HAMPSHIRE
SUPREME COURT

In the Matter of the Liquidation of
The Home Insurance Company

No. 2007-0794

Appeal from the Final Decision of the
Merrimack County Superior Court

REPLY BRIEF FOR APPELLANT CENTURY INDEMNITY COMPANY

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INTRODUCTION

Appellant Century Indemnity Company ("CIC") submits this brief in reply to the Brief for the Insurance Commissioner as Liquidator of the Home Insurance Company (the "Liquidator's Brief").

ARGUMENT

CIC's appeal presents the issue of whether the 1995 assignment of reinsurance claims in the Reinsurance Agreement meets the statutory criteria of mutuality in RSA 402-C:34.[1] The CIC Brief demonstrated that there were mutual debts between Home and CIC, that setting off the Assigned Reinsurance Claim was proper, and that the ruling below was in error.

The Liquidator's Brief, on the other hand, fails to support the Superior Court's conclusion that the assignment of reinsurance recoverables to CIC was conditional, thus defeating mutuality. Both the facts and the law show that there is mutuality because the assignment was absolute. First, the case law is clear that continued control by the *assignor*, *i.e.*, the Cedents, over the property assigned is the hallmark of a conditional assignment. That is not the case here, where the Cedents gave up all rights to the assigned reinsurance and retained no control over it. Second, the return of any reinsurance to the Cedents is at *CIC's* discretion, again demonstrating that CIC – not the Cedents – control the Assigned Reinsurance Claim. According to the plain language of the Reinsurance Agreement, CIC must "deem" the reinsurance "uncollectible" to trigger its "return…for face value." (App. at 71, ¶ 1). This means that CIC must believe that the reinsurance is uncollectible before it reverts to the Cedents. How would CIC manifest that belief? By abandoning collection efforts, of course. But CIC has not abandoned the Assigned Reinsurance Claim and is actively pursuing collection here.

Moreover, the purposes of the Liquidation Statute (RSA 402-C:1, *et seq.*) are not furthered by denying CIC's setoff of the Assigned Reinsurance Claim. Setoff is broadly permitted, not only in New Hampshire but nationwide, and RSA 402-C:34, I, entitled "SETOFFS ALLOWED IN GENERAL,"

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[1] Capitalized terms have the same meanings as in the CIC Brief, filed January 4, 2008.

reflects the Legislature's judgment that setoff is an approved alternative to the statutory preferences in RSA 402-C:44.

Finally, as fully set forth in CIC's Motion to Strike Portions of the Liquidator's Brief, the Liquidator's further arguments – that the assignment was "with a view to setoff" and that the Referee had discretion to disallow setoff on equitable grounds – are outside of the scope of CIC's appeal and should not be considered by this Court. Even if these issues had been properly raised (which they were not), they are without merit. First, the assignment in the Reinsurance Agreement occurred in 1995, years before Home was declared insolvent, so it could not have been made "with a view to" setoff. Second, RSA 402-C:34, I provides that "[m]utual debts or mutual credits…shall be set off and the balance only shall be paid," and thus setoff is mandatory, not discretionary. The Liquidator's argument to the contrary violates the cardinal rule of statutory interpretation in New Hampshire that statutes are to be construed according to their plain meaning. Here, the Legislature meant what it said in RSA 402-C:34 when it used the word "shall" two times in the same sentence: setoffs that meet the statutory criteria must be allowed.

I. THE ASSIGNMENT TO CIC IS ABSOLUTE, NOT CONDITIONAL

The Order and the Liquidator's Brief ignore the standards that are applicable to assignments. The law is clear that an assignment is conditional only if the assignor retains control over the assigned property so that "present transfer of title or dominion" is incomplete. *Miller v. Wells Fargo Bank Int'l Corp.*, 540 F.2d 548, 559 (2d Cir. 1976). In this case, the Cedents retained no control over the Assigned Reinsurance Claim and the assignment to CIC was thus absolute. That CIC can return claims to the Cedents if it "deems" them uncollectible does not affect the "transfer of title" to CIC that occurred in 1995.

Significantly, both the Superior Court and the Liquidator fail to cite a single case that either describes the difference between an absolute assignment and a conditional assignment, or supports the

proposition that the assignment in the Reinsurance Agreement is conditional. This is not surprising, however, because the Reinsurance Agreement effectively and immediately divested the Cedents of control over the reinsurance recoverables, and the assignor's continued control over the assigned property is necessary if an assignment is to be considered conditional, rather than absolute. As in *Uni-Com Northwest, Ltd. v. Argus Publ'g Co.*, 737 P.2d 304, 308 (Wash. Ct. App. 1987), "the [Superior] court failed to distinguish between the effect of an absolute assignment and an assignment for security." Here, the assignment is absolute because the Cedents were divested "of all control and right . . . to receive the benefits of the [reinsurance] contract between" Home and the Cedents. *Id.*

This Court has recently confirmed that "[n]o particular phraseology is required to effect an assignment." *Premier Capital, LLC v. Skaltsis*, 155 N.H. 110, 115 (2007) (citation omitted). Instead, "[t]he ultimate test [of an absolute assignment] is the intention of the assignor to give and the assignee to receive present ownership of the claim." *Id.* "[C]onsistent with New Hampshire law governing assignments generally," the question of whether an assignment is absolute is determined at the time of the assignment. *Stateline Steel Erectors, Inc. v. Shields*, 150 N.H. 332, 336-37 (2003). "In New Hampshire, 'an assignee obtains the rights of the assignor *at the time of the assignment*.' The assignee's rights are the same as those of the assignor *at the time of the assignment*." *Id.* (emphasis added; citation omitted). *See also YYY Corp. v. Gazda*, 145 N.H. 53, 61 (2000).

This reasoning is echoed in cases from other jurisdictions. For example, the *Miller* court, interpreting New York law, stated:

> An assignment at law contemplates "a completed transfer of the entire interest of the assignor in the particular subject of assignment, whereby the assignor is divested of all control over the thing assigned."...An assignment cannot exist where an assignor retains control over the fund or any authority to collect or any power to revoke.

540 F.2d at 558; citations omitted. The assignment at issue here meets these criteria. First, the Cedents assigned to CIC "all rights to reinsurance recoverables...to the extent held by the" Cedents

(App. at 71, p 1), in other words, "the entire interest" of the Cedents in the reinsurance. Second, the Cedents are "divested of all control over the" reinsurance, since its return is triggered only after CIC has "deemed" it "uncollectible" (*Id.*).

Analyzing the assignment in the Reinsurance Agreement in light of these cases "suggests how inapplicable the doctrine of 'conditional assignment' is to the present case," because the "essential feature" of a conditional assignment – that "title to the collateral…is retained by the assignor" – is absent here. *Id.* at 559-60. The "fundamental" characteristic of an absolute assignment is that "[d]ominion over the thing or right assigned must be relinquished by the assignor." *Malone v. Bolstein*, 151 F. Supp. 544, 547 (N.D.N.Y. 1956), *aff'd*, 244 F. 2d 954 (2d Cir.). In *Malone*, the court held that the assignment at issue was "in part conditional" because "it was subject to the event of a default upon the underlying principal obligation. It was a transfer of a partial, as distinguished from a complete, right." *Id.* at 548. This is the exact opposite of the assignment to CIC, where, "at the time of the assignment" (*Stateline Steel*, 150 N.H. at 337; citation omitted), the Cedents turned over all their rights to CIC as a condition to CIC's agreement "to accept a one hundred percent (100%) quota share participation in the [Cedents'] liabilities…" (App. at 71, ¶ 1).

CIC, not the Cedents, has all the indicia of ownership of the Assigned Reinsurance Claim. First, the Reinsurance Agreement assigns all of the Cedents' rights in the reinsurance to CIC, a fact that is reflected in CIC's and the Cedents' regulatory filings. (App. at 174-75, ¶¶ 5-9). Second, CIC, after paying the Cedents' liabilities, collects for its own account the reinsurance that the Cedents would otherwise be entitled to collect. (App. at 244, ¶ 7).[2] Third, CIC controls the return of the reinsurance,

[2] Thus, CIC is not an "agent for collection," as CIC does not account to the Cedents for any amount that it collects from reinsurers. *See Arthur Pew Constr. Co. v. Lipscomb*, 965 F.2d 1559, 1575 (11th Cir. 1992) ("An assignee for collection will hold the proceeds in trust for the assignor….In this case the bank was obligated to deposit the collected funds in Fenwick's account, and it did so."); *Harrison v. Adams*, 128 P.2d 9, 12 (Cal. 1942) ("Harrison must account to Russell for two-thirds of any amount he receives upon the note of Adams.").

as it must deem the reinsurance uncollectible before the recoverables revert to the Cedents. The assignment is therefore absolute, and the Liquidator is wrong when he argues otherwise.

II. DENYING SETOFF HERE DOES NOT FURTHER THE PURPOSES OF THE LIQUIDATION STATUTE

"The doctrine of set-off had its beginnings in the antiquity of Roman law." 4 Collier on Bankruptcy, ¶ 68.01 (14th ed. 1978). Setoff has long been recognized in the U.S. Bankruptcy Code and in liquidation statutes nationwide, including New Hampshire's, and is not, as the Liquidator suggests, a disfavored device that "frustrates" the purposes of New Hampshire's Liquidation Statute. Indeed, courts addressing this exact argument have regularly rejected it.

For example, in *Midland Ins. Co. v. Corcoran*, 590 N.E.2d 1186, 1191 (N.Y. 1992), the court, interpreting a statute virtually identical to RSA 402-C:34, rejected the Liquidator's argument that "public policy considerations" justified a restrictive approach to setoff, noting:

> Although permitting offsets may conflict with the statutory purpose of providing for the pro rata distribution of the insolvent's estate to creditors, the Legislature has resolved the competing concerns and recognized offsets as a species of lawful preference.

Similarly, in *In re Am. Mut. Liab. Ins. Co.*, 747 N.E.2d 1215, 1227-28 (Mass. 2001), the court recognized that the "proposed setoff of obligations between mutual debtor-creditors…proceeds outside of the statutory scheme for the liquidation of insolvent insurers…because the offset amount is deducted from what is owed to the insolvent's estate."

The California Supreme Court, in *Prudential Reinsurance Co. v. Superior Court of Los Angeles*, 842 P.2d 48 (Cal. 1992), addressed virtually every argument proffered here by the Liquidator. There, the Commissioner argued that setoff "permits reinsurers to obtain complete satisfaction of the debt they are owed," while policyholders receive only partial payment, and is thus "unfair." *Id.* at 61. Rejecting this "fairness" argument, the court noted that "the Legislature has created an exception to the general rules of priority in situations in which the claimant and the insolvent have mutual

debts…codified in section 1031. We cannot ignore its broad mandate." *Id.* at 62. The court also stated that there was "no evidence" that setoff "harms the public." *Id.*

The *Prudential Re* court also rejected the notion that setoff would abrogate the insolvency statute's stated goal of protecting policyholders and the public. Instead, the court explained the economic rationale behind setoff:

> "An important reason offset has been recognized as desirable is that it provides a form of security to insurers."…Offsetting debts not only spreads risk but also acts as mutual security for performance. "Such security is especially important for smaller insurers; if the large firms could not count on the netting of balances to satisfy obligations, they would be more likely to exclude smaller or tottering firms – making new entry harder and precipitating failures of firms in difficulty…. [Reinsurance] becomes less useful; the premiums charged to bear risk will rise."

Id. at 63; citations omitted. Finally, the court insisted that the issue was not "one that calls for judicial favoritism of one group of claimants over another on supposed 'equitable' grounds." *Id.* As in *Prudential Re*, this Court is also called on to construe "a comprehensive broadly phrased statute permitting setoff and admitting no exception for reinsurance relationships." *Id.* Accordingly, the Liquidator's claim that disallowing setoff furthers the legislative scheme should be rejected.

III. THE ASSIGNED REINSURANCE CLAIM WAS NOT TRANSFERRED WITH A VIEW TO BEING USED AS A SETOFF

CIC offered the affidavit of its President, Christopher Eskeland, in support of CIC's Submission Regarding Claim as 100% Reinsurer; in other words, Mr. Eskeland was assisting in CIC's efforts to set off the Assigned Reinsurance Claim by describing to the Referee how CIC pays the Cedents' claims and then pursues reinsurance. The Liquidator's Brief, however, seizes on Mr. Eskeland's statement that it is his "understanding that Home will pay nothing now that it is insolvent" (App. at 244, ¶ 6) to support the claim that CIC has "deemed" the Assigned Reinsurance Claim

"uncollectible," triggering the mandatory return of the reinsurance to the Cedents.[3] Relying on that false premise, the Liquidator then attempts to transform the assignment of reinsurance to CIC under the 100% Reinsurance Agreement in 1995 – *eight years* before Home was declared insolvent – into a transfer "with a view to its being used as a setoff" in Home's insolvency. Although the reinsurance collectibles at issue here were never "deemed" uncollectible by CIC or returned to the Cedents, the Liquidator nonetheless concocts a scenario – completely without basis in the record – in which "the ACE group is choosing today to have CIC assert the claims in order to obtain the benefit of immediate setoff for the group as a whole." (Liquidator's Brief at 20).

This is nonsense. In 1995, the Cedents assigned all their reinsurance – including that issued by Home – to CIC as a *quid pro quo* for CIC's agreement to assume 100% of the Cedents' pre-1987 liabilities. (App. at 71, ¶ 1). Since that time, CIC has been paying the claims submitted to the Cedents and collecting the reinsurance that was assigned to it. (*See*, *generally*, App. at 243-45). CIC's attempt to set off the Assigned Reinsurance Claim against Home is thus part of a continuum of reinsurance collection dating from 1995, not a nefarious corporate scheme hatched in 2007 or 2008 "to obtain the benefit of immediate setoff for the group as a whole." (Liquidator's Brief at 20). The "transfer" to CIC of Home's "obligation" to the Cedents, as contemplated by RSA 402-C:34, II, occurred in 1995, when Home's insolvency was years in the future. Accordingly, there is no merit to the Liquidator's claim based on this statutory exception.

IV. SETOFF IS REQUIRED BY RSA 402-C:34

RSA 402-C:34 provides that setoff is mandatory if there is mutuality: "Mutual debts or mutual credits between the insurer and another person…*shall* be set off and the balance only *shall* be allowed or paid." (Emphasis added). Despite this unambiguous language, and relying on the authority of cases

[3] The Liquidator's use of the Eskeland affidavit is nothing more than a red herring: how can a statement made while pursuing setoff be an admission that reinsurance is "uncollectible"? CIC's attempt to set off these amounts began in the claims process, and has continued before the Referee, the Superior Court and, finally, this Court.

decided under the Bankruptcy Act of 1898, the Liquidator now insists that RSA 402-C:34, I "is permissive only" and that the decision to allow or disallow setoff is discretionary. (Liquidator's Brief at 26). The Liquidator posits that the Legislature intended something other than what it said, and that "shall" means "may." This argument, however, ignores not only the language of the statute but also New Hampshire law that requires statutes be construed "according to the plain meaning of the words the legislature used." *Hull v. Town of Plymouth*, 143 N.H. 381, 383 (1999). In addition, RSA 402-C:34 was enacted – and amended – after the bankruptcy cases on which the Liquidator relies were decided. Clearly, if the Legislature intended that setoff be permissive rather than mandatory, it would have used "may" and not "shall." Finally, the Liquidator presumes that the meaning of the statute, which is clear on its face, must be "interpreted" by reference to outside authorities. This Court in this liquidation has rejected that presumption:

> We…ascribe the plain and ordinary meanings to the words used. When a statute's language is plain and unambiguous, we need not look beyond it for further indication of legislative intent, and we will not consider what the legislature might have said or add language that the legislature did not see fit to include.

In re Home Ins. Co., 154 N.H. 472, 479 (2006) (citation omitted).

The Liquidator's justification for the Referee's exercise of discretion is similarly flawed. First, as demonstrated by CIC, the setoff at issue here is not triangular: the Assigned Reinsurance Claim belongs to CIC because it agreed to assume all the Cedents' liability and, in return, the Cedents handed their reinsurance over to CIC. This situation is not even close to the affiliate setoffs that were rejected in *In re AMLICO.*, 747 N.E.2d 1215, *Koken v. Reliance Ins. Co.*, 846 A.2d 778 (Pa. Commw. Ct. 2004), *Prudential Re*, 842 P.2d 48, and *Quackenbush v. Imperial Cas. & Indem. Co.*, 48 Cal. Rptr. 2d 209 (Cal. Ct. App. 2nd Dist. 1995).

Second, the Liquidator's claim that setoff in this circumstance would "harm the interests of the creditors of Home" and "deprive the estate of reinsurance recoverables" is similarly unfounded. Any

setoff prefers one creditor that happens to owe money to the insolvent insurer over other creditors that do not. *See, e.g., Boston & Maine Corp. v. Chi. Pac. Corp.*, 785 F.2d 562, 566 (7th Cir. 1986) (noting "[e]very setoff is a preference among creditors…"). As described above, however, the legislature has authorized this preferential treatment of setoff, subject only to the restrictions in RSA 402-C:34, II. As the New York Court of Appeals held in *Midland*, 590 N.E.2d at 1191, setoff does not deprive the estate of funds because "it is 'only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent'" (citation omitted). *See also In re AMLICO*, 747 N.E.2d at 1227-28; *Prudential Re*, 842 P.2d at 59.

Third, allowing setoff is not inconsistent with equity, and the cases the Liquidator relies on for this proposition are inapposite. For example, *In re Leon Keyser, Inc.*, 98 N.H. 198, 200 (1953), disallowed setoff, not because it would be inequitable, but because "[t]he statutory provisions concerning set-off…do not apply to debts of which one, though otherwise mutual, is not yet due." Setoff was denied in *Modern Settings, Inc. v. Prudential-Bache Secs., Inc.*, 936 F.2d 640, 648 (2d Cir. 1991), not because the court took a "dim view" of the assignment, but because the court found "a lack of mutuality." Finally, setoff was denied in *U.S. Fid. & Guar. Co. v. Wooldridge*, 268 U.S. 234, 238 (1925), because the right acquired "was simply that of a depositor, a right to share with other unsecured creditors in the assets of the Bank," not "to promote the ends of justice." None of these cases supports an exercise of discretion to disallow CIC's setoff.

Since RSA 402-C:34 requires that mutual debts be set off subject only to the limitations in RSA 402-C:34, II, the statute does not give the Referee any discretion to deny setoff of the Assigned Reinsurance Claim.

CONCLUSION

As in *Prudential Re*, CIC should "prevail in this case because [the New Hampshire] Legislature has expressly and broadly recognized [its] right of setoff." 842 P.2d at 63. Accordingly, for all the foregoing reasons, and all the reasons set forth in CIC's Brief, appellant CIC respectfully requests that this Court (1) reverse the Order, (2) enter an order approving the setoff of the Assigned Reinsurance Claim, and (3) grant such other and further relief as it deems just and proper.

Dated: February 25, 2008

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CERTIFICATE OF SERVICE

I, Lisa Snow Wade, hereby certify that two copies of the foregoing brief have been forwarded to counsel of record via overnight mail on February 25, 2008.

Lisa Snow Wade