THE STATE OF NEW HAMPSHIRE

SUPREME COURT

No. 2021-0211

Appeal of Zurich Insurance plc, German Branch

INTERLOCUTORY APPEAL PURSUANT TO RULE 8 FROM AN ORDER OF THE MERRIMACK COUNTY SUPERIOR COURT

REPLY BRIEF OF THE APPELLANT, ZURICH INSURANCE PLC, GERMAN BRANCH

November 15, 2021

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GERMAN BRANCH

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Zurich Insurance plc, German Branch requests fifteen minutes of oral argument before the full court, to be presented by Peter Steffen

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I. The Superior Court's Judgment Is Unsupported, Unreasonable, and Represents an Unsustainable Exercise of Judgment

The Superior Court could not properly establish a Claim Amendment Deadline and engage in the reasonable balancing required under New Hampshire law without asset and liability data. Only the Liquidator is in the position to provide that information, and it did not. As a result, the Superior Court exceeded its discretion by approving the deadline and its order should be reversed.

A. The Deadline Does Not Protect the Interests of Class II Creditors

Without evidence of the amount of reinsurance recoveries that would be lost, the Liquidator's argument that the deadline favors the interests of the estate's Class II creditors, *see* Liquidator's Brief ("Liq. Br.") at 13-16, is merely a supposition unsupported by the record. What is undeniable fact is that enacting a deadline now would deny those creditors access to the estate's reinsurance assets.

Of course, a deadline would also completely disregard the interests of AFIA Cedents, because they would lose the ability to collect up to 50% of their claims as Class I administrative expenses, per the AFIA Agreement. The Liquidator attempts to evade this by referring to Zurich as a "Class V creditor." Liq. Br. at 14.

It is not that simple, however. In 2006, this Court approved the Liquidator's plan to accord AFIA Cedents Class I status under RSA 402-C:44 for 50% of their claims. *In the Matter of Home Ins. Co.*, 154 N.H. 472 (2006) ("*Home I"*). This was in furtherance of the Liquidator's duty to

do what is "necessary or expedient to collect, conserve or protect its assets...." *Id.* at 480 (quoting RSA 402-C:25, VI). Moreover, this Court found that the AFIA Agreement "***benefits the Class II claimants*** to Home's estate since it increases the likelihood that their claims will be paid." *Id.* at 490 (emphasis added).

By approving the deadline, the Superior Court would end that benefit. Thus, the Liquidator's argument over Zurich's class status only goes so far. Not only is Zurich obviously harmed by the imposition of a deadline now while its claims are still in the process of being reported, but so are Class II creditors harmed by the loss of an asset that will partially fund their claims, which is necessary for the "equitable apportionment of any unavoidable loss" guaranteed under New Hampshire law. RSA 402-C:1(d). The Superior Court's decision to end that benefit without any inquiry into the amount of that asset was unreasonable.

The Liquidator further argues that a deadline is necessary to facilitate "the full possible distribution on [Class II] claims." Liq. Br. at 14. Not only does this ignore the assets that would be lost, but the Liquidator ***admitted*** to the Superior Court that it can make additional interim distributions on claims while the liquidation remains open. Apx. Vol. I at 181. Class II creditors could be paid more now while the Liquidation remains open and collects more assets for all creditors. While the Liquidator avers that it must retain assets to pay its costs and ensure all claimants receive the same percentage (Liq. Br. at 15), the Liquidator currently maintains approximately $800 million in assets. Apx. Vol. II at 264. If the remaining Class II IBNR is truly minimal, the vast majority of

those assets can be released now. If the remaining IBNR is significant, an interim payment can still be made and a deadline is clearly premature.

Next, the Liquidator argues that potential claims do not warrant keeping the liquidation open indefinitely because New Hampshire law does not protect "unknown" claims. As an initial matter, Zurich does not seek to keep the liquidation open "indefinitely," as described *infra*. Second, New Hampshire law does protect unknown claims.

RSA 402-C:46 describes a reasonable balance that considers the protection of "unliquidated and undetermined claims." Courts in other states with similar statutory language have considered claims that are incurred but not reported ("IBNR") as unliquidated and undetermined. *See In re Liquidation of Am. Mut. Liab. Ins. Co.,* 747 N.E.2d 1215, 1234 (Mass. 2001) (describing a California case in which "future IBNR losses" were treated as "unliquidated or undetermined demands"); *Angoff v. Holland-America Ins. Co. Trust*, 937 S.W.2d 213, 215 (Mo. Ct. App. 1996) ("unliquidated and undetermined claims, including IBNR"); *see also* M. Veed, *Cutting the Gordian Knot: Long-Tail Claims in Insurance Insolvencies*, 34 Tort & Ins. L.J. 167, 171 (Fall 1998) (included at Apx. Vol. II at 184) (describing IBNR as "distinctly unliquidated"). Furthermore, the Scheme of Arrangement entered into with the support of the Liquidator refers to IBNR as "unliquidated." Apx. Vol. II at 83 (¶11.1).

Thus, the Liquidator cannot distance itself from its statutory obligation to reasonably balance the protection of unknown claims, including IBNR.

The deadline, however, does not only end Zurich's ability to recover IBNR that may be reported in the years ahead, but ***it also ends that ability***

for Class II creditors. This Court has recognized that the gradual release of environmental contaminants can spread over decades. *EnergyNorth Natural Gas, Inc. v. Certain Underwriters at Lloyd's*, 156 N.H. 333, 343 (2007). In the case of Zurich, asbestos claims implicating Home's coverage are still being reported. Apx. Vol. I at 264, ¶8 and 355, ¶8. Any Home policyholder with such liabilities paid premium expecting coverage. The Superior Court's order, though, would unreasonably end that protection for all claimants without any inquiry into the liabilities creditors would fully bear. Thus, the Liquidator's blithe assurance that Class II creditors' interests are protected by the imposition of a deadline now is, at minimum, unproven. Assets that will assist those creditors and AFIA Cedents would be left on the table while all creditors are left to bear all of their IBNR liabilities.

B. The Record Does Not Provide an Objective Basis Supporting the Superior Court's Order

Next, the Liquidator attempts to find support in the record for the Superior Court's order, much of which was never cited by the Superior Court itself. Liq. Br. at 16-19. While the record conspicuously lacks any information regarding the assets and liabilities that will be foregone by the deadline, the evidence that does exist in the record also demonstrates the lack of an objective basis for the order. The record shows:

- Despite now referring to IBNR as "abstract," (Liq. Br. at 16), the Liquidator provided an estimate of IBNR in 2006, which this Court relied upon in approving the AFIA Agreement. Apx. Vol. II at 55, ¶3 and fn.; *Home I*, 154 N.H. at 490.

- The Liquidator has managed its investments well. The estate reported over $21 million in investment income in each of 2018 and 2019. Apx. Vol. II at 166, 280. These income gains benefit creditors and offset inflationary or interest concerns.
- While the Liquidator argues Zurich's claims have had sufficient time to develop (Liq. Br. at 17), asbestos and environmental claims continue to be reported. Apx. Vol. I at 264, ¶8 and 355, ¶8. The length of these reporting lags was predicted by this Court in 2006 and is not unusual for large insurance insolvencies. *Home I*, 154 N.H. at 490; Appellant Br. at 33.
- While the Liquidator cites a 7-year old study as evidence that actuaries use "estimates" with "uncertainty," (Liq. Br. at 18, fn 7), that very study demonstrates that actuarial analysis is common in the insurance industry. Indeed, Milliman's own study applied 90% and 95% "confidence levels" to certain calculations. Apx. Vol. II. at 270. Seven years later, with further claim development, actuarial estimates made now should be even more precise.
- The estate has made significant reinsurance recoveries in recent years, in excess of $18.5 million in 2018 and $16.7 million in 2019. *Id.* at 166, 280. These recoveries represent all Home reinsurance (not just that on AFIA claims). Obviously, the conclusion of the estate will bring an end to such recoveries.

- Claims meriting reinsurance recoveries for the benefit of the estate continue to be resolved. For example, the Liquidator's August 2020 claims report shows more than $10 million of Class V claims (mostly outside AFIA) that month for which there would be a "partial reinsurance allowance" to the estate. *Id*. at 302-03.
- The Home's reinsurance agreements include, not just the Chubb/INA agreement, but, among others, the BAFCO reinsurance agreement, for which the Liquidator fails to address potential recoveries. *Id.* at 77 (¶8.1.2).
- While the Liquidator notes that its annual administrative budget is approximately $13 million (Liq. Br. at 19), the actual expenditures have been smaller than the budget in each of the last 10 years and are trending lower. Apx. Vol. II at 265. The budget is more than offset by the estate's reinsurance recoveries and investment income, as described above.

For these reasons, there is no objective basis supporting the order.

C. There Has Been No Demonstration that Any "Harm" to Class II Creditors Outweighs the Value of IBNR and Reinsurance Recoveries

The Liquidator also argues that there is "no requirement that the Liquidator estimate IBNR." Liq. Br. at 23. RSA 402:C-46 provides that requirement, however, as it demands a reasonable balance between expeditious completion and the protection of claims. No balance can be

reasonably performed without an estimation of IBNR and attendant reinsurance recoveries.

1. IBNR Can Be Estimated

The Liquidator asserts that IBNR liability (or the resulting reinsurance asset) cannot be estimated "reliably," but it is something that insurance and reinsurance companies do every day. *See Delta Holdings v. Nat'l Distillers & Chem. Corp.,* 945 F.2d 1226, 1229 (2d Cir. 1991) ("Under generally accepted accounting principles ('GAAP'), a reinsurer is obligated to make a reasonable estimate of IBNR liabilities."); *LGH, Ltd. v. Sullivan*, 786 F. Supp. 1047, 1050-52 (D.D.C. 1992) ("Generally, actuaries must estimate IBNR in order to set insurance rates" and "it cannot be true that the inability to quantify the amount of IBNR liability with exactitude renders the costs speculative."). Notably, the Liquidator estimated IBNR for this Court in 2006 and the Ambassador liquidator estimated it for the Vermont Supreme Court as well. *In re Ambassador Ins. Co.*, 114 A.3d at 492, 494 (Vt. 2015) (at ¶7).

Furthermore, the Scheme of Arrangement entered into with the support of the Liquidator envisages the use of IBNR. Apx. Vol. II at 81 (¶5.2), 83 (¶11.1), 114 (¶2.12.2(a)), and 117 (¶3.2.7). Indeed, when parties settle their liabilities with the Liquidator, the estate pays for future liabilities.[1]

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[1] The Enstar commutation motion cited by the Liquidator describes a commutation value that included future claims. Motion for Approval of Commutation Agreements with Enstar Companies ¶3 (May 28, 2015) (available at: http://www.hicilclerk.org/DocsDB/2015.nsf/8AEDD34748A703BD85257E

The Liquidator further claims that because AFIA Cedents and Chubb disagreed during commutation discussions in 2012, IBNR must be unreliable. Liq. Br. at 24. This only proves that adverse parties stake out divergent positions during negotiation and does nothing to dispel the truth that IBNR can be estimated. The Liquidator has that ability, but its failure to provide the Superior Court with such information speaks volumes as to what those numbers may show. Without that information, approval of the deadline (which effectively commutes IBNR to zero) was unreasonable. IBNR can and should be estimated here so a proper balancing of the estate's liabilities and assets can be considered.

2. The Record Reflects the Materiality of Reinsurance

The Liquidator next argues that AFIA reinsurance is of "limited value." Liq. Br. at 25-28. The Liquidator's cited $900,000/year figure is woefully incomplete, however. First, it expressly excludes the $14.3 million Enstar commutation, which included IBNR. Apx. Vol. II at 316, n. 7. If Zurich and other AFIA Cedents are able to commute remaining liabilities at once, then there will be similar influxes of reinsurance. Unfortunately, however, Chubb has no reason to commute IBNR if it can rely on the Liquidator to establish a deadline to cut off IBNR.[2] Indeed, as the Liquidator once recognized, Chubb stands to benefit from the

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[2] Hence, the Policyholder-Appellees' argument that there should have been a commutation since the deadline was announced is meritless. *See* Policyholders' Br. at 14, n.1.

"windfall" if AFIA claims are not submitted and reinsurance is not recovered. Apx. Vol. II at 69, ¶4.7.

Second, the only amount of future AFIA-specific liabilities in the record is cited by the Liquidator: a maximum of ***$63 million***. Liq. Br. at 26. That is a significant amount for which the estate should clearly stay open to collect reinsurance and pay creditors.

Third, as cited above, the Liquidator collected significant reinsurance recoveries in 2018 and 2019. All of that – and not just what is associated with AFIA Cedents – will come to an end if the deadline is set.

D. The *Ambassador* Decision Is Relevant

The Liquidator claims the *Ambassador* opinion by the Vermont Supreme Court is irrelevant because the only critical factor there was that all policyholder claims could be paid in full. Liq. Br. at 19-23.[3] As an initial matter, if there were only one relevant factor, the Vermont Supreme Court would not have laid out a four-factor test. *In re Ambassador Ins. Co.,* 114 A.3d at 492, 500 (Vt. 2015).

Without regard as to whether all policyholders claims could be paid or not, the Vermont Supreme Court looked at the same statutory language that exists here and set forth four factors that should be examined. Two of them: the estate's remaining liabilities and assets could not even be considered here by the Superior Court because the record lacks evidence as to their amount.

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[3] Notably, the Liquidator does not claim, as the Superior Court did, that *Ambassador* is irrelevant because *Ambassador* involved a different type of requested relief than that sought here. Appellant's Br. at 26. That was clear error.

The Liquidator contends that because Zurich cannot calculate IBNR, the Superior Court reasonably concluded no one could. Liq. Br. at 21. This is incorrect. The operative estimate here is the IBNR of the entire estate, which is obviously something Zurich cannot do on its own, and which the Liquidator should do in a manner that can be cross-examined by interested parties. With regard to Zurich's share of that IBNR, as described in its opening brief, Zurich's claims are the responsibility of Home, which Home has delegated to a Chubb entity as its agent. Just as Home reinsured 100% of Zurich's claims, the solvent reinsurer Chubb reinsures 100% of those same liabilities. *See* Appellant's Br. at 40.[4]

The remaining two factors also weigh in favor of reversing the Superior Court here. First, the estate's administrative costs are declining and are outweighed by investment income and reinsurance recoveries. *See* p. 7-9, *supra*. Second, with regard to a delay in final payments, this lag was already predicted by this Court when it approved the AFIA Agreement (*Home I*, 154 N.H. at 490 ("it is reasonable to assume that collection proceedings would be lengthy, complex, and difficult")) and interim payments can be made in a way that protects the interests of all creditors.

Finally, as set forth in Zurich's opening brief, even if the exact factors applied by the Vermont Supreme Court are not adopted here, New Hampshire law requires a reasonable balance. Logically, that must incorporate an analysis of the estate's assets and liabilities, including IBNR. *See* Appellant's Br. at 34-36.

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[4] Chubb, as Home's agent, has no economic incentive to estimate IBNR that it reinsures and could be subject to a commutation, unless the Liquidator, or this Court, requires the estimate to be performed.

E. The Liquidator's Agreements Are Relevant and Probative

Despite its efforts, the Liquidator also cannot ignore agreements it entered on Home's behalf. *See* Liq. Br. at 28-34. According to the Scheme of Arrangement, the Liquidator is to use "all reasonable endeavors" to collect amounts owed by reinsurers. *Id.* at 109, ¶2.2.1. The Scheme is designed to last until all claims are crystallized (*i.e.,* the reporting of all claims) and liabilities are "discharged in full." *Id.* at 84, ¶15.1, and at 136, ¶7.1.1. Meanwhile, the Zurich settlement provides that Home shall be "liable to indemnify [Zurich]" for Zurich's policy liabilities. Apx. Vol. I at 295, ¶5.1.

The deadline the Superior Court unreasonably approved ignores those obligations and ignores this Court's 2006 approval of the AFIA Agreement that was to serve the interests of Class II creditors and AFIA Cedents alike. The Liquidator should not be allowed to evade its responsibilities.

II. The Effect of the Liquidator's Requested Relief

This Court should also consider the chilling precedential effect on policyholders' rights in future insolvencies if liquidators are given the broad leeway granted by the Superior Court here. Liquidators could close proceedings without ever having to demonstrate to a court the estimated value of claims that will go unreimbursed or assets never collected. Policyholders who faithfully paid premium would find themselves liable for 100% of their claims just because those claims took decades to develop.

The Superior Court also endorsed an end run around New Hampshire law that could set an unfortunate precedent. As addressed in Zurich's opening brief (and not responded to by the Liquidator), the Liquidator has designed a *fait accompli* that dodges RSA 402-C:48, which

requires the collection of economically justifiable assets prior to a liquidation's termination. Now is the time to estimate reinsurance assets and determine the feasibility of collection, because if the deadline is imposed, those assets will disappear. Once that happens, calculation pursuant to RSA 402-C:48 is pointless when the assets are already lost forever.

Finally, contrary to the Liquidator's repeated statements, Zurich is not seeking to keep the estate open indefinitely or exercise some "veto" over its close. Zurich's request is far more modest than the Liquidator's. It is also more modest than Policyholders-Appellees' suggestion that Zurich could reopen the liquidation at a later date despite the obvious logistical and practical difficulties with such an action. Policyholders' Br. at 33-34. Zurich simply contends that New Hampshire law requires a reasonable balance that must weigh estimated outstanding assets and liabilities against the estate's completion. The Superior Court's order here in the absence of such necessary information was unreasonable and unsustainable.

Respectfully submitted,

ZURICH INSURANCE PLC, GERMAN BRANCH

By its attorney,

Dated: November 15, 2021

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CERTIFICATE OF COMPLIANCE

This brief complies with the word limitation set out in Supreme Court Rule 16(11), as the body of the brief contains 2,988 words.

CERTIFICATE OF SERVICE

I hereby certify that a copy of Zurich's reply brief shall be served on all counsel of record through the New Hampshire Supreme Court's electronic filing system.

/s/ Mark C. Rouvalis
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