

DOCKET NO. CV-02-814173-S	:	SUPERIOR COURT
	:	
THE CONNECTICUT SURETY COMPANY,	:	
CONNECTICUT SURETY CORPORATION,	:	JUDICIAL DISTRICT OF
CONNECTICUT SURETY INSURANCE	:	
AGENCY, INC., FUNDS MANAGEMENT INC.,	:	HARTFORD
CONNECTICUT SURETY INSURANCE	:	
AGENCY OF ARIZONA, INC., BONDS II	:	AT HARTFORD
SURETY GROUP, INC., AND CONNECTICUT	:	
SURETY INSURANCE AGENCY OF NEVADA,	:	
INC., IN LIQUIDATION	:	SEPTEMBER 3, 2003

MOTION TO TRANSFER COLLATERAL

Susan F. Cogswell, Insurance Commissioner of the State of Connecticut, as Liquidator of Connecticut Surety Corporation, Connecticut Surety Insurance Agency, Inc. (“CSIA”), Funds Management, Inc., Connecticut Surety Insurance Agency of Arizona, Inc., Bonds II Surety Group, Inc., Connecticut Surety Insurance Agency of Nevada, Inc. (collectively, the “Affiliates”) and The Connecticut Surety Company (“CSC”), hereby moves the court for the entry of an order authorizing the transfer of collateral securing bonds underwritten by CSC or other insurers from CSIA to Capitol Indemnity Corporation (“CIC”). In support of her motion, the Liquidator avers as follows:

I. Background

1. These proceedings commenced on February 6, 2002, when a consensual Order of Rehabilitation was entered which placed CSC into rehabilitation proceedings pursuant to Conn. Gen Stat. §§38a-903 – 38a-961, inclusive, and appointed the Insurance Commissioner of the State of Connecticut as rehabilitator.

2. Following the entry of the rehabilitation order, the rehabilitator determined that it was in the best interests of policyholders, creditors and the CSC estate to commence a liquidation proceeding for CSC. The Court entered an Order of Liquidation on May 17, 2002.

3. During the course of the liquidation proceedings, the Liquidator determined that the affairs of the Affiliates should be wound up as part of the receivership proceedings of CSC. The Court entered an Order of Substantive Consolidation (the "Substantive Consolidation Order") on May 29, 2003. The Substantive Consolidation Order provided for the authority of the Liquidator to take possession of the assets of CSIA and the other Affiliates and to administer them under the general supervision of the Court. Additionally, the Substantive Consolidation Order provided that the collateral security for surety bonds underwritten by CSC and other insurers which is beneficially held by CSIA as collateral for third parties, would not be available to satisfy the claims of creditors of CSC and the Affiliates.

4. CSIA was an insurance agent that issued and administered surety bonds on behalf of CSC, Star Insurance Company, Redlands Insurance Company and others (the "Sureties"). As part of underwriting bonds, CSIA frequently required the bond principal (the party on behalf of whom the bond was issued) to provide collateral security for its obligation to reimburse the surety in the event of a loss. In connection with the issuance and administration of surety bonds for the Sureties, CSIA obtained and held the collateral security (the "Security") provided by the principals for the benefit of the Sureties.

5. Pursuant to a certain Renewal Rights Agreement dated as of January 31, 2002, CIC purchased from CSIA all of its rights to renew surety bonds (the “Old Bonds”) that had previously been issued through CSIA on behalf of the Sureties. CIC and its affiliates (collectively, the “CIC Sureties”) have issued approximately seven hundred bonds (the “Replacement Bonds”) that have replaced certain of the Old Bonds. The Replacement Bonds continue to cover the identical risk of the Old Bonds being replaced. It was the intention of the CIC Sureties to obtain the benefit of the Security (the “Replaced Bond Security”) that had been issued for the Old Bonds that were being replaced. However, CIC did not obtain documentation from most of the principals authorizing the transfer of the Replaced Bond Security from CSIA to CIC or pledging the Replaced Bond Security to secure the Replacement Bonds. As a result, the Replaced Bond Security remains under the control of CSIA.

II. Legal Basis for Transfer of Collateral

6. The Liquidator maintains that an interest in the Replaced Bond Security has been equitably assigned to the CIC Sureties. Connecticut courts have recognized the doctrine of equitable assignment in transactions where a debt was assigned and, although the parties intended the assignment of the security for that debt, the assignment of the security was not documented. *Lemmon v. Strong*, 59 Conn. 448 (1890) (applying equitable assignment doctrine to permit purchaser of note to sue guarantor, despite the fact the guaranty had not been assigned to the purchaser); *Roth v. Stein*, 100 Conn. 668, 677-78 (1924) (holding that the transfer of a note carried with it “full benefit of the security” supporting the note, because, “[n] such a case in

equity regard is to be had to the whole transaction and its purpose”); *see also Dysart Corp. v. Seaboard Surety Co.*, 240 Conn. 10, 17 (1997). In such cases, courts have examined the facts and circumstances surrounding the transaction to determine whether all of the parties intended to transfer the security for the obligation in addition to the obligation itself. *Lemmon*, 59 Conn. at 454. In *Lemmon*, the court found that a note separated from a guaranty securing the note had little value and that “[t]he transfer of a debt or obligation usually carries with it as an incident all the securities for its payment, although such securities are not in terms transferred with principal obligations.” *Id.* The *Lemmon* court examined the circumstances surrounding the assignment of the note and found that all parties intended the assignment of the guaranty securing the note as well as the assignment of the note. *Id.*

7. The Liquidator maintains that issuance of a Replacement Bond by the CIC Sureties in effect transferred the reimbursement obligation for the Old Bond being replaced, and that this transaction is closely analogous to the transfer of the notes involved in the *Lemmons* and *Roth* cases. Following the logic of those cases, the transfer of the reimbursement obligation should carry with it a transfer of an interest in the Replaced Bond Security because it was the security for those reimbursement obligation.

8. The Liquidator further maintains that the bond principals, the Sureties and the CIC Sureties all intended that the Replaced Bond Security would secure the obligations of the principals under the Replacement Bonds to reimburse the CIC Sureties with respect to losses under the Replacement Bonds.

III. Transfer of Collateral

9. The Liquidator contends that the following facts support the contention that the principals under the Replacement Bonds intended that the Replaced Bond Security would secure their obligations to reimburse the CIC Sureties for any losses in connection with the Replacement Bonds. First, the Replacement Bonds provide exactly the same coverage as the Old Bonds. Second, the Replacement Bonds were issued through the same agents as the Old Bonds. Third, none of the principals under the Replacement Bonds was requested or required to provide new security for the Replacement Bonds. Fourth, none of the principals under the Replacement Bonds have requested the return of the Replaced Bond Security on the basis that the Old Bonds have been released. Fifth, the CIC Sureties would not have issued the Replacement Bonds without the benefit of the Replacement Security.

10. Each principal under a Replacement Bond and each agent for such principal will be notified of this Motion and will have an opportunity to object to the relief sought herein.

11. Each of the Sureties has agreed to the transfer of the Security to the CIC Sureties for administration and have further agreed that the Replaced Bond Security may be used as collateral security for the Replacement Bonds.

12. The Liquidator is willing to enter into an agreement with the CIC Sureties that provides for the transfer of possession of all of the Security to the CIC Sureties so that it can be

administered as to the Old Bonds and the Replacement Bonds. The Liquidator's willingness to enter into such an agreement is conditioned on obtaining an order of this Court that (a) authorizes the CIC Sureties to assume the obligations of CSIA with respect to the administration of the Security and (b) determines that the CIC Sureties are entitled to the benefit of the Replaced Bond Security.

13. The Liquidator believes that the relief sought in this Motion is in the best interest of CSIA, its creditors and its estate because it will relieve the estate of the substantial burden of administering the Security and will eliminate any controversy over the rights of various parties in the Replaced Bond Security.

IV. Notice of this Motion

14. The Liquidator proposes to provide notice of the Motion in the form attached hereto by sending a copy of the notice first class United States Mail to the last known address of each principal or owner of Replaced Bond Security and each agent that produced bonds for CSIA. The Liquidator proposes to deposit such notice in the mail not less than 20 days prior to the hearing scheduled by the Court on the Motion.

15. The Liquidator believes that notice provided in the manner set forth in the preceding paragraph will be adequate to provide reasonable notice of the Motion to principals

and other parties who have provided Security to CSIA for the benefit of the Sureties. Because the Liquidator will be required to serve nearly 2000 notices in connection with the Motion, the Liquidator seeks approval by the Court of the form and manner of notice prior to serving it.

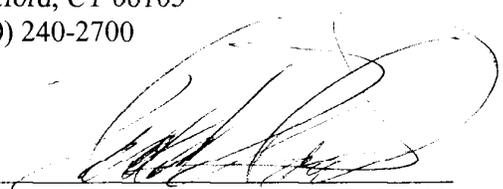
V. Conclusion

WHEREFORE, the Liquidator prays for the entry of an order determining that an interest in the Replaced Bond Security has been equitably assigned to the CIC Sureties to secure the obligations of the principals under the Replacement Bonds to reimburse the CIC Sureties with respect to losses under the Replacement Bonds; authorizing the Liquidator to transfer possession of the Security to CIC and to enter into an agreement with CIC providing for the assumption by CIC of CSIA's obligations to administer the Security for the benefit of the Sureties; approving the form and manner of notice proposed by the Liquidator; and granting such other and further relief as to the Court shall seem just and equitable.

Dated at Hartford, Connecticut, this 2nd day of September, 2003.

Respectfully submitted,

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