

Decision rejecting Solvent Scheme due to lack of 'problem' overturned

The Scottish Lion Insurance Company Limited

First Division, Inner House, Court of Session – 29 January 2010

The Scottish Court of Appeal has overturned a decision by Lord Glennie on 10 September 2009 in which he refused to sanction a solvent scheme of arrangement put forward by Scottish Lion. It was held that he was wrong to have added a requirement that in the case of solvent schemes there had to be a 'problem'. British insurers breathe a sigh of relief.

The Scheme

Scottish Lion applied to the court for sanction of their proposed Scheme of Arrangement. The company had ceased writing new business in December 1994 and had been in run-off ever since. It sought to enter into a Scheme of Arrangement to finalise its liabilities given the long tail nature of the business it underwrote.

The Scheme was challenged by five US creditors – Goodrich Corp., ExxonMobil Corp., Textron Inc., ITT Corp. and Zapata Corp. All five creditors had either general liability or general aviation insurance policies that provided cover on an occurrence basis.

The dissenting creditors argued that the cover that they had was irreplaceable in the current market and therefore the estimation of future liabilities that they would receive

under the Scottish Lion scheme would not amount to adequate compensation for them giving up their contractual right to an indemnity for future claims.

Lord Glennie's decision

Lord Glennie held that it would be unreasonable to force opposing creditors into accepting the scheme of arrangement regime and refused to sanction the proposed Scheme.

Where an insurance company is solvent, a policyholder can expect to rely on an indemnity from their insurance company if a claim is made against them. Unless there exists circumstances which jeopardise or threaten to jeopardise this indemnity, why should a policyholder be forced to enter into a commutation against its will?

Lord Glennie examined the idea of Creditor Democracy, an idea that is given credence by the statutory provisions. His view was that this idea only operates where there is a 'problem' requiring a solution and it is in the creditors' interest as a whole to find a solution to that problem. If the majority are in favour of that solution then it should not be open for a minority to block it for the rest. There is such a problem in insolvent schemes but not in this case where the company is solvent.

The Appeal

The Court focussed on whether Lord Glennie was right to dismiss Scottish Lion's petition on the preliminary point of whether, this being a solvent scheme, it should not be sanctioned in the absence of being able to show that there was a "problem requiring a solution".

The starting point was that there was nothing in the relevant statutory provisions that suggested that a solvent scheme was to be treated differently from those where a company was insolvent or on the verge of insolvency. Solvency was relevant for the Court's discretion when sanctioning a scheme but it was not the only factor.

Similarly, the existence of a 'problem' was also a factor to consider in deciding whether to grant a scheme. However, it was not a precondition to the sanctioning of a scheme, solvent or otherwise. The Court referred to other examples where schemes had been sanctioned in the absence of a 'problem'.

Turning to the creditors' objections to the scheme proposal, the Court held that the loss of their contractual rights was not something that would disable it from sanctioning a scheme. It is at the heart of the statutory provision that, provided the statutory majorities were obtained and the necessary sanction granted, contractual rights will be varied or extinguished even when there was opposition to this.

The Court distinguished the case of *British Aviation Insurance Co Ltd* where a solvent scheme was not sanctioned as, in that case, only part of the company's business was to be subject to the Scheme of Arrangement and not, as in this case, the whole of the business.

All this meant that the 'Buckley' test of whether the proposed arrangement was one that "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve" should still be considered in the light of all relevant factual evidence. Scottish Lion were entitled to have the opportunity of establishing the benefits of the scheme and the validity of their approach to the valuation of claims.

Comment

The initial decision by Lord Glennie was held by some to have sounded the death knell for solvent schemes of arrangement. The effect of the decision was that where

there were dissenting creditors to a scheme proposal, those creditors would be able to block that proposal. This decision goes a long way to addressing this concern and leaves the solvent scheme process very much alive and kicking.

The Court has pointed out that the variation or extinguishing of contractual rights is no reason to prevent a scheme going ahead and is part and parcel of the statutory regime. It is hard to argue against this. Further, the Court correctly identified that there is no distinction in the authorities between solvent and insolvent schemes. This does not mean that there never will be but, for the time being, it is not for the Courts to introduce such a distinction.

Scottish Lion now have the opportunity to prove to the Court that their scheme is reasonable but it is still not certain whether the scheme will be sanctioned. The Court was tight-lipped when it came to commenting on the merits of this particular scheme but did not discount the possibility that the fact that the opposing creditors were being forced to accept estimated values in lieu of their contingent claims may, along with other arguments, still win out.

The Court also referred to an amendment to the opposing creditors' pleading that some of the creditors who voted to accept the scheme had a special interest by reason of negotiated settlements prior to the vote which increased the value of their claims. This pleading was not made at first instance and the final word of the Court was that, if established, this may be a 'blot' in the scheme.

Therefore, while the future of the solvent scheme regime looks a lot more certain than it did two months ago, the same cannot be said for the Scottish Lion scheme. This judgment hints at the obstacles that they still need to overcome before the sanction will be granted.

If you require any further information in relation to the way in which these developments impact upon your business please contact Nicholas Bradley, David Breslin or Viran Ram on 020 7379 0000 at Lawrence Graham LLP.

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