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Client briefing
March 2006

Solvent Schemes of Arrangement: one class of insurance creditor or two?

The decision of Lindsay J. on 27th March in *Re NRG Victory Reinsurance Limited* [2006] EWHC 679 (Ch) deals with the vexed question of whether there should be one or two classes of insurance creditor for the purposes of convening creditor meetings in a solvent scheme of arrangement under section 425 of the Companies Act 1985. This issue has been the subject of much comment in the market after the decision of the High Court in the earlier case *Re British Aviation Insurance Co. Limited* [2005] EWHC 1621 (Ch).

Key Issues

Decision in Re British Aviation Insurance Co Limited considered

No invariable rule that accrued and IBNR creditors must have separate meetings

All relevant variables must be taken into account

Single creditor meeting for a scheme approved

Background

Most solvent schemes of arrangement implemented for London market risk carriers are designed to conclude the run-off of an insurer's business earlier than would be the case if the business was to continue until all claims had matured and been agreed by the relevant insurer in the normal course. For any scheme of arrangement the insurer's creditors must be organised into appropriate classes and meetings of each class of creditors must vote in favour of the scheme. Majorities in number in each class that represent at least three quarters in value of the claims of that class must vote in favour of the scheme for it to be eligible for sanction by the High Court. See our briefing *Working Towards Closure: The achievement of finality through a solvent scheme of arrangement* of March 2005 for a full explanation of how such schemes are normally constructed and the procedure that must be followed to make them effective.

One issue which arises is whether insurance creditors whose claims have 'accrued' form a separate class (for the purpose of voting on a scheme) from those insurance creditors whose claims have been incurred but not reported (IBNR).

BAIC decision

BAIC wrote insurance and reinsurance in the aviation sector. In seeking to implement a solvent scheme to bring finality to part of its business it convened a single meeting of creditors. It did not distinguish between those creditors whose claims had 'accrued' and those with IBNR claims. Some creditors voted against the scheme at the creditors meeting and later opposed the sanctioning of the scheme by the English Court. See our earlier briefing *Solvent Schemes of Arrangement: The M&G Re scheme and life beyond BAIC* of September 2005 for a full analysis of the decision and its implications.

Lewison J refused to sanction the BAIC scheme on the basis that a single creditors meeting to vote on the scheme had been insufficient and consequently he had no jurisdiction to sanction the scheme. The reason he held that IBNR claimants should be in a different class of creditors to those with 'accrued' claims was essentially that he felt that the IBNR claimants were subject to more uncertainty in the valuation of their claims than the accrued claimants. He also commented that the method of valuation for IBNR claims in the scheme seemed to be unsatisfactory in some respects.

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NRG Victory: the facts

NRG underwrote general insurance business from 1920 to 1993. It had been in run off since 1993 but is solvent. Some 99 per cent of claims against it are in relation to reinsurance in the marine, aviation, non-marine, pollution, asbestos and other health hazard markets. It proposed a solvent scheme of arrangement. The judge found that the NRG Victory scheme and the scheme proposed in BAIC had many similarities. However, NRG Victory intended to call one creditor meeting to consider the scheme, treating 'accrued' claims and IBNR claims the same for this purpose.

One direct insurance creditor had raised in correspondence an issue relating to the designation of creditor classes. Specifically, it had cited the BAIC decision as a reason why, in its view, NRG Victory should convene more than one class meeting. The direct insurance creditor did not, however, appear on the hearing to convene the meetings and had not indicated it would vote against the scheme at any meeting or appear later to oppose the sanctioning of the scheme.

The question for Lindsay J in the NRG Victory case was whether he should allow the company to convene a single creditor meeting, given the creditor issue raised by the direct insurance creditor, or whether in the light of the decision in *BAIC* the scheme was necessarily doomed to failure so that no meeting should be convened.

The decision

The way the judge approached the matter was to go back to basics.

He said that the test for assessing whether one or more class meeting is required set out in the case of *Sovereign Life Assurance Company v Dodd* [1892] 2QB 573 remains " the important touchstone". In that case it was decided that a "class" for the purposes of section 425:

> *"must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest."*

Lindsay J. held that nothing in the *BAIC* case changed the basic approach to this issue as set out above. The judge stated that where no one had attended the hearing to oppose the convening of a single creditor meeting or indicated that they intended to vote against the scheme on that basis, and given the nature of the evidence put before him by NRG Victory on the class issue, there was no compelling reason not to allow the scheme to proceed to the single meeting. He thought in such a case:

> "*To require a split into two or more meetings not only might, in such circumstances, introduce further delays and expense to no practical avail but might lead to small pockets of creditors - small either in number or value - having a veto which a more global regard to fairness would not have given them*."

Commenting directly on the *BAIC* decision he said that it should not be regarded as authority for the proposition that where there are both accrued and IBNR claimants they should invariably have to vote at separate class meetings. Whether separate classes were necessary depended upon a large number of variables and the circumstances prevailing in relation to each scheme. The factors to be taken into account might include;

- what classes of business had been written by the insurer and in what proportions;
- whether the business was direct insurance or reinsurance and in what proportions;
- where in the world the business was conducted and the claimants were to be found;
- the margin of solvency of the scheme company; and
- when the company stopped writing business and how long it had already been in run off at the time of the scheme.

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The judge made it clear this was not an exhaustive list of factors and that other variables might need to be taken into account. He added that care needs to be exercised in extrapolating principles founded on the particular evidence presented in one case and applying them without more to another case particularly where an opportunity to cross examine on that evidence was not available.

The judge alluded to the evidence put before him by NRG Victory in support of its contention that only one class meeting was necessary in this case. In particular, he referred to a witness statement proffered by Mr Mark Allen, an experienced non-life actuary with PricewaterhouseCoopers, in which Mr Allen:

- opined that the great majority of different types of latent claims can be sensibly and reasonably valued;
- stated that he was not aware of any type of claim to which NRG Victory might be subject which would not be susceptible to estimation under the proposed scheme;
- explained that it is often very difficult to distinguish between notified claims and IBNR claims in the reserving context, as they share many of the same characteristics;
- gave a number of practical examples to demonstrate that it is often easier to estimate the value of IBNR claims than of notified outstanding claims, even when they arise on the same policy; and
- opined that any notion that there is fundamentally greater uncertainty in estimating IBNR claims than in estimating notified outstanding claims is incorrect as a general proposition.

Based upon the facts before him Lindsay J held that there were powerful indicators that pointed towards a single creditor meeting being sufficient in the case of NRG Victory's scheme. These included, in addition to the factors outlined above, the extensive period of run off prior to the hearing and the fact that direct insurance accounted for only 1 per cent of NRG Victory's business.

Conclusion

The NRG Victory decision is a welcome reminder that each scheme must be considered on its own merits and in its own context. It also shows that no hard and fast rule was created by the *BAIC* case that separate creditor meetings had to be held for accrued and IBNR claimants in such schemes. The evidence in *NRG Victory* showed that the methodology for valuing IBNR claims was robust and would not result in significantly greater uncertainty for IBNR claimants over accrued claimants - a factor that had weighed heavily with the court in the *BAIC* case.

It is important to bear in mind the fact that the *NRG Victory* case was concerned with the convening of the meetings for a solvent scheme, not with the later stage of obtaining final court sanction for the scheme after the creditor meetings have been held and in the face of creditors who are represented at the hearing and argue vociferously against it as in *BAIC*. There is no doubt that *NRG Victory* will not be the final word on this issue.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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