

# Run Off update

April 2007

## 1. Whether the court should exercise its discretion to sanction an insurance business transfer scheme where policies are governed by foreign law.

### *In the Matter of Sompo Japan Insurance Company*

This case involved an application under section 109 of the Financial Services and Markets Act 2000 ("the FSMA") for the court to sanction a transfer of insurance and reinsurance business from the UK branch of Sompo Japan Insurance Inc ("Sompo") to an English transferee, Transfercom, a subsidiary of National Indemnity Company (itself a subsidiary of Berkshire Hathaway Inc.). The policies which were to be the subject of the transfer were originally written in Japan and then transferred to Sompo's UK branch in order to carry out the business transfer.

The policies were subject to different governing laws – the evidence was that approximately 27% (both in number and by the value of reserves) were subject to English law, 30% (in number) and 11% (by value) were subject to the law of another EEA country and 21% (by number) and 60% (by value) were subject to US law. The issue in this case was whether the court ought to exercise its discretion to make an order sanctioning the transfer of business in view of the fact that that order might not be recognised in all jurisdictions where Sompo has substantial assets.

Mr Justice Richards referred to the general principle that the court cannot act in vain when exercising a discretion – otherwise this would be "no more than a hollow act, of no merit or purpose, and should not be troubling the court and wasting everybody's time". He said that the same principle is relevant to applications under Part VII of the FSMA. Thus the court cannot make an order sanctioning a transfer if that order "serves no discernable purpose at all". However, the judge also noted that the fact that an order may not have effect throughout the world for all policies being transferred is not enough for the court to conclude that an order should not be made.

On the facts of this case, the court found that:

- a) An order sanctioning the transfer of those policies which were governed by English law would probably be recognised both in England and in other jurisdictions;
- b) An order sanctioning the transfer of those policies which were governed by the law of any other EEA country should be recognised as effective under the Judgments Regulation 44/2001 in all EEA countries, but the court did not express a final view on this point;
- c) An order sanctioning the transfer of those policies which were governed by the law of Japan, should, it appeared, be recognised in Japan (although the evidence on this point had not been definitive); and
- d) An order sanctioning the transfer of those policies which were governed by US law should be recognised by US state courts and there was some evidence that the federal courts would recognise the order, but again, the evidence on this was not definitive. (In any event though, it did not appear that Sompo had substantial assets located in the US against which any judgment could be enforced).

Accordingly, Mr Justice Richards was "less than convinced" that the scheme, once sanctioned, would definitely be effective as regards proceedings in foreign jurisdictions to enforce claims under policies which are governed by foreign law. However, given that the evidence established that over 27% of the policies are governed by English law, and it was reasonable to suppose that the transfer would be effective in any of the relevant jurisdictions



as regards those policies, the judge was satisfied that the proposed scheme would achieve a "substantial purpose". The fact that the scheme also covered a larger class of business not governed by English law was not in itself a ground for refusing to sanction the scheme. As a result, the court sanctioned the scheme.

## Comment:

This case is also of considerable importance because it establishes a precedent for the transfer of (re)insurance business written outside the UK to a UK branch, thus bringing it within the jurisdiction of the UK Courts to order a subsequent Part VII transfer to a third party. This is likely to prove to be a very useful mechanism for insurers and reinsurers, who have accepted London market business outside the UK and now wish to transfer it to an authorised entity in the UK. In view of the aspects of the judgement discussed above, a sufficient proportion of the business will need to be governed by English or other laws so that the English Court may be satisfied that its order will be sufficiently enforceable in the countries where policyholders are located to justify exercising its jurisdiction to approve the transfer. We expect to see many more of these two stage transfers.

## 2. Court gives reasons for rejecting objections to a scheme for the transfer of insurance business.

### *Equitable Life Assurance Society v Canada Life Ltd*

In this case, Mr Justice Evans-Lombe set out his reasons for his earlier order sanctioning a scheme for the transfer of part of the insurance business being conducted by Equitable to Canada Life. Section 111 of the FSMA requires that, after the prescribed substantive and procedural requirements have been met, the court "must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme". The court therefore has an overriding discretion whether to grant or refuse its sanction. In the recent case of *re Pearl Assurance (Unit Linked Pensions) Ltd* [2006], Mr Justice Briggs commented that the "discretion remains nonetheless one of real importance, not to be exercised in any sense by way of rubber stamp". (See our October 2006 update for more details of that decision).

Some of the objections raised by policyholders in this case included:

- a) Some policies which were not being transferred as part of the scheme might have performed better had they been transferred to Canada Life. The judge held that the court is not in a position to require the parties to vary the scheme so as to make it include provisions which the court may think might constitute a better or a fairer scheme. The court's judgment is whether the scheme as it stands is fair.
- b) Some policyholders had complained that Canada Life, although incorporated in England, was controlled from abroad by a Canadian parent company. The judge dismissed this objection, pointing to the fact that policyholders are protected by the supervision by the FSA of all companies authorised to carry on insurance business in this country.
- c) A number of policyholders had complained that they had not been consulted in the form of meetings before the promulgation of the scheme. It was suggested that had such meetings taken place, some of the provisions in the scheme which they objected to might have been dropped. The court rejected that argument too. There is no requirement for consultations under the FSMA and policyholders have adequate protection in the form of the FSA which has a supervisory role and which appoints an independent expert to report on the scheme.
- d) As in previous cases, objection was taken to the use by the independent expert of phrases such as "there is no material risk" of something happening, which, it was argued, do not constitute sufficiently definite assurances. However, the judge reiterated that the use of such phrases is commonplace and are construed by the courts as meaning that the expert, while not capable of giving an absolute assurance that a given event will not happen, is satisfied, as far as possible, that it will not.
- e) Finally, the past shortcomings of the management of the transferor are irrelevant to the court's decision on whether the scheme is fair in present circumstances.

This decision is a helpful indication of the courts' approach to some common objections which are raised in relation to schemes for the transfer of insurance business.

## 3. Sanctioning a scheme and over-capitalisation

### *Re First Alternative Insurance Co Ltd*

This was another recent case involving the exercise by the court of its discretion to sanction an insurance business transfer scheme. The transfer of policies from First Alternative Insurance to Esure had an overall economic effect which included the removal of some £65m from the combined businesses. That amount was to be returned to the shareholders of FAI and Esure. The court expressed concern that this suggested that either the businesses were substantially over-capitalised or that the necessary security for the combined policy obligations of Esure had been under-estimated. However, the judge concluded that those concerns had been allayed in the body of the independent expert's report. Furthermore, it was held that the extent of overcapitalisation was no reason to withhold sanction – instead, it provided a clearer rationalisation for the scheme.

## 4. Change of law to allow the second stage of the Equitas deal to go ahead.

A consultation period regarding proposed changes to the law on Part VII transfers closed in January (see our December 2006 update for details of the consultation paper). Parliamentary approval is expected for the changes, which include allowing all resigned Lloyd's names (and not just those names who resigned on or after 24 December 1996) to participate in Part VII transfers. This change in law is needed in order to allow the second phase of Berkshire Hathaway's takeover of Equitas to proceed (the first phase of the deal is expected to be completed by the end of this month).

Further information

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