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**"What, Never? Well, hardly ever!"**

15 September 2009



### **The Court of Session judgment in *Re Scottish Lion Insurance Company Limited* ("SL") [2009] CSOH 217**

#### **Has it really changed the solvent scheme landscape?**

##### **Key Points:**

- When considering whether the statutory majority in value of claims (75%) has been achieved the Court's inquiry is not limited to whether the valuation is perverse or irrational and is a matter of both jurisdiction and discretion
- the principle of "creditor democracy" would apply when a scheme is proposed in a situation where there is a problem requiring solution
- a solvent scheme is an instance where "subject to other considerations" creditor democracy would not carry the day
- it is incumbent on the company proposing the scheme to adduce in evidence reasons which might justify why the majority of creditors is attempting to coerce the minority

##### **Background**

On 10 September, the Scottish Court of Session (through Lord Glennie), gave an Opinion that some commentators have suggested could sound the death knell for so called "solvent schemes of arrangement" as used to estimate and settle the liabilities of insurance and reinsurance companies.

Lord Glennie gave his Opinion in an application by SL for the sanction of a scheme of arrangement proposed under Part 26 Companies Act 2006 ("CA 2006"). The purpose of the scheme was to quantify and settle SL's liabilities to all its policyholders under or in relation to policies of direct insurance. The hearing was held to determine two key issues of principle which, if decided in a particular way, were considered likely to limit considerably the scope of the full sanction hearing. That hearing (if still necessary following resolution of these matters) will take place in January 2010.

There are two classes of scheme creditor in the scheme. These are scheme creditors with non-IBNR claims and scheme creditors in respect of IBNR claims. The scheme contains an estimation methodology with extensive provisions for the valuation of IBNR claims. Like many other such schemes, the SL scheme contains provisions prohibiting scheme creditors from taking proceedings to enforce their claims unless SL consents to their doing so. There is also a provision entitling SL to terminate the scheme and revert to run-off. SL can only exercise the reversion to run-off provision before it has made any payments under the scheme.

The sanction petition listed a number of alleged advantages and disadvantages of the proposed scheme. The advantages included the fact that some creditors' claims would be determined and paid sooner than would be the case without a scheme. There is also no discount for early payment. The disadvantages include the usual disadvantages to a solvent scheme, such as the fact that scheme creditors will be paid on the basis of an estimate of their claim, with the result that some creditors may end up being paid too much, while others may end up receiving too little. Another disadvantage, as is usual with estimation schemes, is that after the bar date under the scheme, policyholders lose any right to bring claims against SL. This is one of the



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factors leading to the challenge, since many of the policies written by SL are occurrence based policies providing long-tail coverages that are no longer readily available in the market at any reasonable level of premium.

The FSA did not object to the scheme in court; indeed we understand that the FSA provided SL with a letter of non objection to the scheme. The FSA has of course issued its own guidelines for whether it will object to a scheme by a "substantially solvent" entity. SL presumably passed those regulatory hurdles.

The scheme also provided for the appointment of an independent vote assessor ("IVA") to assist in the quantification of claims for voting purposes.

## **The challenges**

Five creditors of SL, all based in the United States, challenged the scheme's sanction. They did so, at this hearing, on two bases. First, they questioned the IVA's determination of the quantum of creditors' claims for voting purposes. They suggested that the IVA had applied a flawed, and/or less rigorous approach to the evaluation of creditors' votes in favour of the scheme than had been applied to the claims of those creditors who voted against the scheme.

Secondly, and more significantly for the viability of solvent schemes as a general principle, the opposing creditors questioned whether it would ever be fair for the court to sanction a "solvent" scheme of arrangement in the face of continuing creditor opposition to the compulsory termination of their "occurrence" cover.

## **Can the chairman's decision that the statutory majorities were achieved be challenged?**

Lord Glennie, rejected a submission that the chairman's or the IVA's decision on the level of votes for or against a scheme could only be challenged on the basis that his decision was either perverse or irrational. Lord Glennie agreed with Warren, J in *Re Sovereign Marine & General Insurance Company* that this was a matter for case by case determination.

Lord Glennie recognised there was a distinction between making a challenge to the quantification of the vote and opposing the scheme itself at the sanction hearing. He said that a challenge to the size of the vote in favour of a scheme went to the court's jurisdiction. The court would only have jurisdiction to sanction a scheme if the majorities set out above were met.

By contrast, a challenge to the votes at sanction stage on the basis that the chairman or IVA had acted unfairly was not a matter of jurisdiction. Instead it was a matter for the discretion of the judge at sanction. In Lord Glennie's view, there was no material difference between these bases of challenge.

## **Would it ever be fair to sanction a "solvent" scheme of arrangement in the face of creditor opposition?**

In Lord Glennie's view, the "real question" for the court to determine was in what circumstances it might sanction a solvent scheme in the face of opposition from dissenting creditors. The judge accepted that the court's power to sanction a scheme of arrangement was unfettered. However, there was a distinction to be made between schemes which were proposed to resolve a "problem" in the company and schemes, such as that for SL, which appeared (to the judge) ultimately to be for the benefit of the company's shareholders and the detriment of some of its creditors.

The schemes of arrangement proposed by the Equitable Life Assurance Society and Cape Industries were examples of schemes proposed to address particular "problems". In Cape, the issue was the management of liabilities for asbestos personal injuries. In Equitable Life, the scheme was proposed to mitigate the adverse financial effect of guaranteed annuity policies. The judge also had to consider whether the valuation process in a solvent scheme amounted to "confiscation" of assets that fell outside the scheme of arrangement. Lord Glennie expressly held that the term "arrangement" within Part 26 CA 2006 had a wide meaning. He therefore held a "solvent scheme" giving creditors a limited period of time to submit claims could still amount to an "arrangement" as that term was used in Part 26 CA 2006.

The estimation process did not therefore amount to an act of expropriation that was incapable of sanction by the court.

By contrast it was difficult for the court to see any justification for the removal of a company's liability to occurrence-based policyholders. This was because such a scheme was beneficial to a company's shareholders, rather than to its creditors.

Lord Glennie considered, at paragraph 56, that the principle of creditor democracy applied where the scheme is put forward in a situation where there is a problem requiring solution, that it was in the interests of the creditors (or classes of creditors) as a body that a solution should be found and implemented and that, to this end, the creditors had to act as one and, in identifying the appropriate solution, must "agree" to be governed by the wishes of the majority, because if they did not then their failure to agree would ruin it for all. (We do not consider that Lord Glennie meant to refer to an "agreement" in any formal sense but rather one which could be imputed to the creditors -

otherwise to require this would go beyond the language of Part 26.)

Lord Glennie considered that a solvent scheme was an instance of a case where, subject to other considerations, creditor democracy should not carry the day. The judge does not, however, go on to state what these other considerations are. Lord Glennie also considered that the line need not necessarily be drawn between "solvent" and "insolvent" schemes (paragraph 57). Lord Glennie also considered that the line need not necessarily be drawn between "solvent" and "insolvent" schemes (paragraph 57).

## Commentary and Conclusions

Lord Glennie acknowledges the importance of the majorities in favour of a scheme of arrangement (paragraph 53 of the judgment). He also recognises the breadth of the court's discretion at sanction – paragraphs 38 and 39 of the judgment. Where the judge appears at first blush to go further than the express requirements of Part 26 CA 2006 is in saying that creditor democracy "should not carry the day" if the company proposing the scheme is solvent.

A close examination of the judgment nevertheless indicates that Lord Glennie did not completely rule out sanctioning a scheme of arrangement proposed by a solvent insurance (or reinsurance) company. His emphasis is on the need for "other" considerations (paragraph 56) and for "supporting material justifying the [scheme]"; paragraph 57. Although Lord Glennie does not elaborate on these observations, they are arguably merely another illustration of - and consistent with - the fact based, "case-by-case" approach to solvent schemes taken by Lewison, J in *Sovereign Marine and General Insurance and British Aviation Insurance Company*.

Just as importantly, Lord Glennie's comments also reflect the FSA's guidance on solvent schemes promulgated in July 2007. In that guidance, the FSA said that a scheme proposed by a "substantially solvent company" should not treat policyholders any worse than the treatment they would receive from such a company in solvent run-off. This, as with the judgment in SL, suggests that a scheme of arrangement giving, for example, policyholders the choice as to whether or not to "opt out" of the scheme's regime altogether might receive more favourable response from the sanctioning court under the approach taken by Lord Glennie than has been the case here.

Seen against that background, Lord Glennie's insistence upon a scheme by scheme approach at the sanction stage, founded on the court's broad discretion, does not appear to break new ground. Nor does it rule that 100% unanimity of voting creditors is required for a solvent insurance scheme to be sanctioned. It merely stresses the importance of ensuring that where policyholders are asked to give up claims in a scheme proposed by a solvent company, they are treated in a manner that is equivalent to the treatment they would receive from an insurer or reinsurer in a solvent run off.

It is now for SL to bring forward to the adjourned second phase of the sanction hearing evidence of those elements which will be required to persuade the judge that their scheme does indeed, as they protest, contain other considerations and advantages for creditors which justify bending the will of the minority to the vote of the majority.

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