

# Solvent Schemes of Arrangement

a roundtable discussion on recent developments

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# solvent schemes of arrangement

## A roundtable discussion held in London on 18 September 2009

This solvent schemes roundtable took place just a few days after the opinion issued by Lord Glennie on the Scottish Lion scheme. While the intention was to consider the changing nature of solvent schemes in general, this decision naturally gave a topical edge and dominated much of the discussion.

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## Solvent Schemes of Arrangement

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**Barbara Hadley** The agenda isn't set in stone, it never was and it particularly isn't now, following the Scottish Lion judgment last week. I think it would be good to start by asking everybody in turn what they feel personally about schemes of arrangement.

**Peter Payne** I personally feel they address an issue for a company in run-off and clearly, when you look at the history of commutations — which goes back 30, 35 years — the key problem will always be somebody who says 'I don't want to do it'. Ergo, if you want to run a company off you can't, and the scheme addresses the problem. So I think there is no doubt from a run-off perspective they are a very, very good idea. It's not an original thought but, whether they are perceived the same way from the client's side is, I think, an entirely different issue.

**Mark Allen** Well, I am an actuary who acts as an advisor to many solvent schemes, so you would expect me to say that I think they are a good thing. Commutations have been around in the market for many, many years and what the solvent scheme does is allow an arrangement to be reached by which the company can be wound up if the creditors want that to happen. And I think that is the key point. You would only want to propose a solvent scheme in a situation where the creditors want it to happen. And for me, when the creditors do, in a very significant majority, want it to happen, I think it must be a good thing. It gives everyone, or almost everyone, what they want.

**Peter Payne** Almost.

**Philip Hertz** I'm slightly coloured by the fact that, as a lawyer I've been drafting solvent schemes and schemes for insolvent companies most of my career. Solvent schemes were a natural progression from the use of schemes for insolvent companies. All I would say is, look at how many solvent schemes there have been. Look at how many objections there have been to those solvent schemes — not a huge amount actually, you only hear about the big news items. They have got to be a good thing as they are a tool. They are a tool to be used in the right place at the right time. Generally speaking, when you are an advisor, and you see someone saying 'shall I do a scheme?' and it's not right, you say to the client that it's not right. So where it is right in terms of fairness, I think it should be a good thing and I think most people are voting these things through.

**David Strasser** I represent policyholders so on a personal level I have torn feelings. I clearly feel the pain that policyholders feel if they are the unlucky few who have lots of policy limits and no claims history and who

don't want to give up their policy limits. Most of my clients, however, are in the situation where they have an established claim history and view schemes as providing them a benefit in their dealings with their insurers. Of course whether a scheme will be beneficial depends on the terms and facts surrounding the scheme. If you're talking about a company that's just going into run-off, I might be saying 'why are you doing that, what's your history of claims?' If you are talking about companies that have been in run-off for 20 years, that have a mature book of business, I think it's good. From a public policy perspective I think there is value in crystallising run-off claims and allowing the capital that is locked into these run-off companies to be removed and hopefully put to something more useful for society.

**Selinda Melnik** Having practised for all these years in the US bankruptcy system, what you see every day in Chapter 11 reorganisations is effectively a solvent scheme being filed with a plan just like the scheme being put forward to the creditors, and the plan is focused mostly on trying to crystallise and equitably distribute available funds to pay claims. There are many reasons that have been put forward by US policyholders for rejecting solvent schemes proposed outside of the US. Where scheme assets were located in the US or lawsuits impacting the scheme were pending in the US, relief in aid of the enforcement and effectiveness of the non-US scheme has been sought from US Bankruptcy Courts through Chapter 15 of the US Bankruptcy Code and its predecessor Bankruptcy Code section 304. In some instances, the inability to obtain such relief in the US could threaten or defeat the very viability of the scheme. Accordingly, there was a time when it was under discussion to attempt to defeat non-US solvent schemes, as it were 'through the back door', by attacking the request for relief in aid of the schemes made to the US Court. Such an attack on a US Chapter 15 petition in aid of a solvent scheme has not yet occurred. I suspect that is because the predicates for attack articulated to date do not appear to be sustainable under US Chapter 15. Among other reasons, they are counter to US public policy underpinning Chapter 15 as well as to the public policy effected through US reorganisation under US Chapter 11, the modern formulation of which in many respects mirrors UK solvent schemes. I realise that US Chapter 11 reorganisation doesn't apply to insurance company run-off and liquidation in the various states of the US, and indeed US insurers are not eligible for relief under the US bankruptcy code at this time. However, holding companies of such entities are eligible. And many state insurance insolvency proceedings are similar to Federal bankruptcy proceedings in numerous respects. But I think what is occurring, and what will occur more and more frequently, is a movement to support schemes

generally, and solvent schemes in particular, through an array of mechanisms including what was seen most recently in the Highlands case. Moving towards something almost in the nature of the cross-border protocol, as you are seeing in traditional international ‘insolvency’ cases.

**Barbara Hadley** Are we talking about a growth in supervised run-offs therefore in the US? Which is rather like a halfway house between an old fashioned run-off in the States and a scheme of arrangement?

**Selinda Melnik** I think that is a strong possibility. There is a lot of activity within the US generally in the insurance and solvency area, in the regulation of insurance and obviously in another quasi-civil war, so to speak, between federal oversight and state oversight of insurance regulation. All of that is focusing a spotlight on insurance and solvency regulation within states. And there are evolutionary attempts to bring things more in line with, effectively, US bankruptcy law. I think in the process of that, and through organisations like AIRROC and others who have attempted to put forward proposed harmonised law for dealing with run-off and schemes, there will be movement to exactly that, Barbara. And if not, there should be.

**Barbara Hadley** Dan would you like to comment on how you personally feel about schemes?

**Dan Schwarzmann** I think everybody knows my views on solvent schemes. The fact that I get called ‘Mr Scheme of Arrangement’ shows everyone knows where I stand on this. I think they are a great thing. One thing that I keep saying about schemes which keeps getting forgotten is that to get a scheme through requires a majority — 75 per cent by value and 50 per cent by number. And I have to tell you that is quite a significant hurdle. And they don’t get through by 75.1 per cent and 50.1 per cent, they get through by significant majorities. So, it’s not what I think about schemes it is actually what policyholders think about schemes. I fully accept that there are a handful of policyholders that don’t like schemes.

**Peter Payne** To tease that number out, perhaps to put it in a better perspective, and notwithstanding that you get a large percentage of acceptances, what kind of average — if there is such a thing — percentage of policyholders are actually voting?

**Dan Schwarzmann** I’m really glad you asked me that Peter. I fully accept that not everybody voted in the early days. By the way, I’m not talking about ‘no’ votes, I’m talking about ‘yes’ votes as well. However, a lot of work has been put into ensuring people understand what

schemes are about and the fact that their votes are important.

The solvent scheme document is normally distributed to thousands of policyholders because they may have a claim. In reality, the number who actually will have a claim is not normally thousands. Of those that actually do end up having claims, I don’t know the percentage, but I think it’s a significant percentage, that do vote.

**Peter Payne** Over 50 per cent?

**Mark Allen** By number there are obviously a fair number of creditors that may have very, very small amounts and they may not vote, because they may just decide not to. But by value, if we look at the big creditors on a recent scheme, the people who we might have expected to vote — whether they voted ‘yes’ or ‘no’ or whether indeed they abstained — then the great majority of those creditors by number would vote and that would mean by value that the majority of creditors able to vote would be voting.

**Philip Hertz** There is another factor, there is the apathy factor as well. If you send the scheme out to as many as you can, there will always be people who have claims and do claim, and there will be those people who do not participate.

**Dan Schwarzmann** The people who vote are different to people who then put claims in. There is a difference there as well.

**Barbara Hadley Forrest, what are your thoughts about schemes?**

**Forrest Krutter** As is well known, personally, on behalf of all of the Berkshire Hathaway entities we are very much opposed to schemes, except obviously we’re not talking about insolvent schemes. When we think, insolvent versus solvent, one should keep in mind that we believe every company should have an adequate loss adjustment expense reserve to cover their costs of run-off. And if there is insufficient to run it off, the company is insolvent. But with those caveats, our view is that when someone purchases reinsurance or insurance one is paying essentially three things. One is paying an expected loss cost, one is paying various intermediary costs including brokerage, premium taxes, VAT if applicable, and one is paying an extra amount for risk transfer. And to have an arrangement where the party that you do business with decides, because a majority of its creditors are perfectly happy with the deal, that they prefer now to walk away from the deal and leave the person who purchased risk transfer with no risk transfer despite their desires to

the contrary, is fundamentally wrong and inconsistent with the concepts of reinsurance.

**Barbara Hadley** Would anybody like to comment on that?

**Dan Schwarzmann** Forrest, your views are well known and I am glad to have this debate. I understand that viewpoint totally and I can understand why culturally schemes don't fit for certain parties. I understand it. But at the end of the day, and I'm sorry to come back to it, if you are proposing something that the significant majority buy into, it's because it's a good deal and there are benefits in doing that deal. You can only offer that type of deal if finality and certainty is achieved as a result. But I do understand why that may not work for some policyholders.

**Peter Payne** For me the issue is this, you're saying 'it's a good deal because a majority of people vote for it'. Well clearly it's a good deal for them as they voted for it. Ergo, it must be not a good deal for those who voted against it, in the minority I accept. But you can't say it's a good deal *per se* as people are voting against it. I still think you need to tease out the key issue. I'm not convinced it's a resolvable issue, in the sense that for the proposer of the scheme, it's clearly a good deal for them. It is their idea. They are looking to accelerate their run-off, shut down the operation, release their capital. I take your point about in the bigger picture you can say that's good from a public policy perspective. So there is no doubt that is a good deal for them. But it's not a good deal for those that don't want to accept the risk transfer back. And I don't see how you can resolve that point on its own by simply saying 'because the majority have said it's a good idea, ergo it must be a good idea'.

**Forrest Krutter** As I understand it — and I must admit my ignorance of English and Scottish law — the typical scheme situation until Dan's major advancements was where you have bondholders, and say I have a million dollars, you have ten million dollars of bonds but the bonds are identical. We each have the same terms. The problem here is that, unlike that situation, we have individual contracts, the contracts are different. No one is in the same situation. So I think that the analogy to traditional schemes, where all the parties are voting because they have the same contract other than the face value, is not applicable here. That's why you've never seen a standard scheme arrangement in arbitration provision, a mandatory arbitration provi-

sion. A traditional scheme, as I understand it, is in return for resolving the issues, the bondholders might take 99 cents on the dollar.

**Philip Hertz** I'm not sure that's right though. Because yes, you would use a scheme to restructure a company which has bondholder liabilities but you can use a scheme for almost anything.

**Forrest Krutter** That's the very issue of our debate isn't it?

**Philip Hertz** It's an important point because the question is 'what does the statute say'? The statute says that the compromise or arrangement is between the company and its creditors or shareholders — the statute doesn't prescribe which creditors or shareholders can be bound by a scheme. If you're dealing with people with different rights you put them into different classes. That's the protection. And the protection also comes from the sanction of the court.

**Forrest Krutter** But of course everyone has different rights because we all have different contracts.

**Philip Hertz** That's not quite right though, because at the end of the day, the issue of what class you should be put into has been well set out in the authorities now. The point is that schemes do not just deal with people with one type of contract. You can deal with

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**'Most of my clients have an established claim history and view schemes as providing them a benefit in their dealings with their insurers'**

David Strasser

all different types of contract through a scheme. Look at situations like Equitable Life, and I can quote you a number of other situations where you have financial creditors all in different situations, some with hedging contracts, some with subordinated debt, some with senior debt. That is why schemes are such a flexible tool and, frankly, that is why the Scottish Lion judgment is so dangerous.

**Forrest Krutter** I think it is one of the great achievements that will stand along with the Magna Carta.

**Peter Payne** The question, it seems to me, that came out in the Scottish Lion judgment is if you have an issue

such as an Equitable Life issue, and you use a scheme you are addressing a problem. Whereas a solvent scheme isn't a problem to be addressed. It's a desire by the company attempting to run itself off in an accelerated sense. But nobody else has a problem. I accept that the majority buys in.

**Philip Hertz** What about a company that's of marginal solvency?

**Barbara Hadley** Yes, it could become a problem.

**Forrest Krutter** Well the question is, is how do you measure solvency? Has it sufficient assets to cover the costs of run-off? Then my answer is that it's solvent and there's enough money to pay for the run-off. The shareholders would like to take the money that they were paid to run the company off and pocket it. I would have a very different feeling if in fact these schemes provided for the costs of acquiring reinsurance or insurance from someone else, in other words the costs of the risk transfer and a reasonable return of the intermediary costs.

**Dan Schwarzmann** Can I just come back to the point. Maybe this is one for Philip. Where does it say that a scheme of arrangement has got to deal with a problem?

**Philip Hertz** Well this is something that really worries me about the Scottish Lion judgment.

**Peter Payne** I agree, it doesn't. I'm just begging the question, is that a pertinent question to ask?

**Philip Hertz** Absolutely the right question.

**Dan Schwarzmann** There are a number of issues which you read about, which don't make sense. One of them is that solvent schemes are only done for the benefit of the shareholders. It can't be right. If this were the case then we would not be able to sell these, we would not be able to get schemes voted through by the policyholders. Policyholders have to ask themselves whether they find the deal, converting their policy into cash at a premium, acceptable.

**Peter Payne** But it begs a question, does it not? If you are arguing it's of mutual benefit, how many of those creditors who vote 'yes' would have themselves gone to that company and asked for a commutation? And I suggest not many.

**David Strasser** The reason policyholders wouldn't do that is, you can't get the kinds of deals when you go to an

insurance company and say 'I want to commute this coverage' that you get in a scheme. And that's the point that I think the courts miss completely. They just ignore that significant benefit. They just say 'well you could get that without a scheme'. But you can't, you don't have the mechanisms of being able to rely on an actuary and having the ability to go, if you don't like the number you're getting back, to an adjudicator who is an actuary and to have your claim evaluated on that basis.

**Peter Payne** I accept that if you've got no adjudication fall back that the only fall back you have is to walk away. I'm not sure about the deal. I think the deal is still there to be had.

**David Strasser** I can tell you from my experience, I go in and present all my claim history and the insurer will listen politely and yawn and then say 'I'll give you 50 per cent of what your demand is'. And then I'm stuck because I've made my offer based on what I can establish based on my claim history. So I have never been able to achieve the same results in commutations ...

**Forrest Krutter** If you came in to propose a commutation with us to a pure loss cost we would probably have a very negative view. But our attitude is, it's about the contract you agreed to, which says if you have losses we will pay them. So why do you expect a right by court order to amend a contract you agreed to?

**David Strasser** Because that's what the statute says and that's what I'm being offered by the insurer in the scheme.

**Philip Hertz** That's a different point.

**Forrest Krutter** Well maybe the statute says that in the United States we should disallow any reinsurance because after all you have a unilateral right to change the deal.

**Dan Schwarzmann** Forrest, I do think this is a different point. The point you were making earlier, the fact that you don't like schemes because they convert your policy into cash, I understand that. The point here is, could you get the sort of deal one on one with an insurer/reinsurer versus what can you get from a solvent scheme? And there is no question that schemes deliver more value because all parties, including the insurer/reinsurer, are getting total finality and certainty.

**Forrest Krutter** Well, if you're going to commute they deliver value, but if your desire is to keep the contract you negotiated 20 years ago and keep its

benefits then it delivers less value

**Dan Schwarzmann** The fact of the matter is, I think some policyholders do look at a solvent scheme and vote for the deal being offered knowing they would not accept an individual commutation. Mark, any views?

**Mark Allen** I spend a lot of time, obviously, looking at claims and schemes but also doing one on one commutations for insurance companies. I am absolutely sure that schemes give considerably better value. We are offering, or my clients are offering, significantly higher amounts.

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### ‘How many of those creditors who vote ‘yes’ would have themselves gone to that company and asked for a commutation?’ Peter Payne

Sure, in the scheme, the company is getting some benefit and in order for it to get that benefit it needs to give some of that money away in terms of a benefit to each of the individual creditors.

**Forrest Krutter** My point was about whether your client wants to commute or wants to keep the benefit of his original deal. As I understand what you just said, for a client that wants to commute, on average they will do better with a scheme than with individual commutations. But for the client who doesn’t want to commute but wants to keep the benefit of his original bargain, he’s worse off with the scheme because he’s lost the risk transfer.

**Philip Hertz** Then he would vote no.

**Dan Schwarzmann** I understand that point Forrest. I think it’s different to the type of deal that’s delivered by the scheme.

**Mark Allen** And the creditors look at the deal. The first thing they want to see is ‘so what’s the deal?’, ‘how much are we going to get?’, ‘how’s it going to be calculated?’, ‘can I use my own methods?’. And we’ve gone to great lengths to make the approach as flexible as possible. So the older schemes would mandate that the claims had to be valued in a certain way. More recent schemes have been very flexible. The creditor will use its own methodologies, its own valuations. They need to be robust and there’s an adjudication procedure behind it, but schemes are very different now to the way they were three, four, even a couple of years ago.

**Barbara Hadley** As I understand it, judges have been quite forward in saying they haven’t always been happy with how many creditors have been contacted, how keenly they have been contacted, how frequently ... and now that has changed. Would you say that the lengths taken to contact creditors are now observed and now sufficient?

**Dan Schwarzmann** Do you know I have never had a judge on one of our schemes comment about the contact we’ve made with policyholders other than in a complimentary way.

**Philip Hertz** The use of schemes to do what they’re doing now rolls out of insolvency practice. In insolvency practice the case law is clear. You have to use all reasonable efforts possible to contact your creditors. By writing to them or, if you can’t write to them because you don’t have their address, you advertise. In an

insurance case you go to the brokers as well. Throughout my whole career in doing schemes we have always done that. You always go over the top. You advertise in more jurisdictions because you really don’t want to be caught on a technicality like that. Also, from a reputational point of view, a client doesn’t want to be seen to be potentially trying for a bare minimum. I can’t think of any professional in the market that wouldn’t be saying to their client ‘you have to do more than is actually required’.

**Barbara Hadley** You can’t make people respond.

**Philip Hertz** That’s the point.

**Dan Schwarzmann** That’s what changed. More people are responding, because there is much more publicity about solvent schemes, which can only be a good thing. There’s always two sides of the coin. The more publicity about schemes, the more policyholders vote and, indeed, the more cases we get.

**Philip Hertz** I think what’s happened is that when schemes started, people experimented, the companies were much smaller. Some of them were of doubtful solvency and there was either a lot of apathy or there was a ‘no-brainer’ in doing the scheme. Then people tested the water and started doing bigger ones, like M&G and others.

**Dan Schwarzmann** There is a point here that I am concerned about in the market. The stats that are being put out on schemes are that the number of schemes are going up significantly. And the reason for that is because

there are a lot more pool schemes. But that's just statistics. When you do a pool scheme, and we've done lots of pool schemes, you impact a lot of pool members, so if you look at the number you think 'wow'.

That's a concern for me. It's distorting and concerning policyholders who think they may have missed a solvent scheme. The number of schemes has actually gone down. There are two reasons for this. For a significant period until September last year, clients were quite happy to sell their companies to acquirers such as Berkshire, because of the sale prices being achieved. They felt they should be going down the disposal route for finality and not the scheme route. However, I know from conversations we're having now that, as there is a problem getting leverage in the market and sales prices are being adversely impacted, insurers are now focusing a lot more on solvent schemes. However, the number that are available to be schemed has decreased because the low hanging fruit has been picked.

**Selinda Melnik** I really have a question more than a comment with respect to the decreasing number of schemes. That is that there has been a lot of talk about the expansion in Europe and Asia of scheming along the lines that have occurred in the UK, either in those other countries or through some kind of redomestication into the UK. And I was wondering what the status of that was and whether it's having any impact on the number of schemes?

**Dan Schwarzmann** That's a very good question. A couple of things on that. First of all let me address the point as to what happens where the policyholders are deeply divided. For some of the potential solvent schemes that Mark and I have looked at, we've said to the client, you shouldn't be doing this. It just doesn't work, it's not the right business to scheme. With others, we think it's the right business but when we talk to the policyholders it doesn't work, for whatever reason and we've moved on. We've spent a lot of time talking about schemes across the Atlantic and less time in Continental Europe. There is still a long way to go there. In some cases I'm sure it will work. In some cases it's inappropriate. Does that answer the question Selinda?

**Selinda Melnik** It does and the other question I had was about the comment that we are seeing more Part VII transfers chosen for finality rather than schemes. Is that in fact the case?

**Dan Schwarzmann** The internal Part VIIs, that's a company getting itself in a state where it can redeploy capital and potentially think about doing something with its book of business in some cases, are on the increase. The third party Part VIIs, that's an M&A deal, are on the decrease for reasons explained earlier. That's a change to what we were experiencing up to September last year.

**Mark Allen** Some of those Part VIIs will undoubtedly have been a precursor to a scheme.

**Forrest Krutter** I think that differs highly on whether they're internal or external. I don't think that's true of the external ones.

**Mark Allen** I think it would happen in both situations.

**Dan Schwarzmann** Philip, when a judge looks at a Part VII external do you think they would take into account whether or not it would go into a scheme afterwards?

**Philip Hertz** No, they shouldn't do because they are two separate procedures. If someone were to object

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**'I spend a lot of time doing one on one commutations for insurance companies. I am absolutely sure that schemes give considerably better value'** Mark Allen

to a Part VII on the basis that we were just going to do a scheme, the proper course for a judge to take is, 'well fine, when you do a scheme, the scheme will go to a vote of creditors and another judge will consider whether it's fair. That's not what I'm being asked. I'm being asked whether this Part VII should be sanctioned and whether there's a scheme or not is not part of my brief.'

**Forrest Krutter** The only place I'd disagree with that, and that might be due to my misunderstanding, is that in a Part VII you have to give some indication to the FSA what your plans are. And if you plan to do a scheme but tell the FSA you're not planning to, then I assume that's a problem.

**Philip Hertz** Well I think that would be a problem, but that's a regulatory problem.



**Barbara Hadley** Yes, that's not the court's problem.

**Forrest Krutter** No, but on the other hand where you go for a scheme after you told the FSA that you weren't...

**Dan Schwarzmann** If the FSA asks the question 'are you going to do a scheme after a Part VII' and somebody answers 'no' and then immediately says they are going to do it, that's appalling. Also, whilst we are on the subject of the FSA, there is a very relevant point to Scottish Lion, something that might be forgotten which is that the FSA now has a committee that reviews schemes. That wasn't the case for BAIC.

Scottish Lion was the first solvent scheme that went through the FSA committee, and what they looked at was the appropriateness and the fairness of the scheme. I've seen some commentators on Scottish Lion saying that it was the scheme or some of the scheme clauses that caused the issue. First of all, I will reiterate the point that the FSA reviewed the scheme. The second point that's really important here, is that the Scottish Court didn't look at the Scottish Lion scheme. It's a different process to the English Court. In Scotland, what you can do — which you can't do in England — is take a fundamental point before the sanction hearing. And that is what happened in Scottish Lion.

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**'What you see every day in Chapter 11 reorganisations is effectively a solvent scheme with a plan just like the scheme being put forward to the creditors'** Selinda Melnik

The judge was asked to consider whether it was fair to scheme a solvent company and he did not consider the Scottish Lion scheme specifically. He was looking at solvent schemes generally.

**Barbara Hadley** Can we look at Lord Glennie's judgment. My question is 'what does it actually mean?' And the second part of that is 'what does it mean for Scottish Lion which is due to go back to court in January?' Does it affect it, does it not affect it?

**Philip Hertz** I think the most important question is 'what does it mean?' as opposed to what it means for Scottish Lion. Because actually this is a judgment that is made in the context of a solvent scheme which could have huge ramifications in other areas. What the judge is basically saying here is, unless you have a problem — whatever that means, we can come back to that — then effectively

you need unanimous consent to do anything for creditors or members. Remember schemes are a very flexible tool that can be used for anything where you have to deal with shareholder rights or creditor rights. So, that means that potentially, in a non-insurance restructuring situation there is a problem because some people may disagree it needs to be restructured. Some people may say — as junior creditors may say in a corporate situation where business hasn't gone so well, albeit it may be business is returning but the director wishes to do something now — well, you don't need to do anything now and we object to this, and if we object to it you can't do anything under the scheme. To my mind, the judgment, with all due respect to his lordship, is wrong headed. It just doesn't make sense to an English lawyer looking at the statute which says that you can do a compromise or arrangement if you get the right voting majorities and the sanction of the court. To say that if a couple of people object therefore that weighs very heavily against implementing a scheme for any situation, that's got to be a bad thing and a bad thing for the use of schemes.

**Barbara Hadley** In other industries?

**Philip Hertz** Everywhere.

**Peter Payne** The argument about 'what is a problem?' is potentially circular, in the sense that you take an M&A problem and say 'sort this problem within the format of the scheme', whereas a solvent scheme isn't a problem because it's simply a proposition by a company going into run-off, I suggest you could say that the minute somebody puts his hand

up and says 'actually I'd rather not do or be part of a solvent scheme please' that becomes a problem. Ergo, you can do a scheme.

**Philip Hertz** You can look at it in insurance terms. Forget all the other reasons that schemes have been used, it's not just the insolvency context. Everyone would agree that if you have a company of doubtful solvency, marginal solvency that's a problem. But if you've got a company that's very solvent that wants to do a scheme, Lord Glennie is saying that's not a problem — so where do you draw the line? I'm struggling to look at the statute which has a couple of paragraphs which tells me where you draw that line. To limit the jurisdiction in that way is, to quote David Bennett on Mercantile & General, to 'drive a coach and horses through the statute'. When I was growing up I was told that there something called the sovereignty of parliament and judges had to follow

statute made law. But here it seems to be the other way around. The judges seem to be saying ‘very interesting what parliament have done, but we’re going to make up our own law’.

**Dan Schwarzmann** What’s your interpretation of the Scottish Lion case David?

**David Strasser** I’m probably not qualified to give an interpretation as I’m not an English lawyer. But the way I read what the Court is saying is that if someone objects and the company is not impaired in some way, the scheme will not be sanctioned. The way I read the opinion is that the Court is only protecting objectors, it is not protecting creditors who voted ‘no’. Moreover, you can still have a scheme go through if you buy off the objectors. That’s giving the objectors a huge club to come in and say ‘okay I want four times what everybody else is getting’. The opinion therefore does exactly what other courts have worried about and what the objectors themselves have insinuated — that there is hanky-panky going on in connection with the whole voting process and claim valuation. That the company is buying ‘yes’ votes or overvaluing ‘yes’ votes as compared to ‘no’ votes. But now you’re handing the objector a club to come in and do just that.

**Forrest Krutter** You don’t think that probably existed before?

**David Strasser** I think it’s been doubled in size. If you read the objectors’ press release from WFUM they talk about favourable settlements they got from WFUM. It happens in the US all the time too. In my very limited experience, in bankruptcy court, if there’s nobody standing up objecting, a court’s going to approve whatever is in front of them.

**Philip Hertz** David, you made a very good point in the sense that Lord Glennie’s looking one way at the objectors, and indeed the court’s job is to look after the interests of the dissenting creditors, but also they have to look after the interests of all creditors. And what about the 80 per cent or 90 per cent of creditors who voted for this scheme?

**Selinda Melnik** I have a question. I think there is something in Scottish law that might have changed the landscape. My question is what might there be in Scottish law that essentially gives the Scottish Court jurisdiction to ignore statute or to rewrite it by requiring the 100 per cent approval?

**Philip Hertz** There is nothing to my knowledge.

**Peter Payne** On that point, why does his lordship feel that he has the ability to do what he has done? Why doesn’t he feel that he is overriding parliament? How does he square that in his mind?

**Philip Hertz** He’s saying that ‘I’m exercising my discre-

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**‘[The Scottish Lion judgment] is one of the great achievements that will stand along with the Magna Carta’** Forrest Krutter

tion’. I keep coming back to this point, it’s very important. This is not a sanction hearing, he’s not looking at a scheme. He’s being asked a question in isolation and therefore ... in truth, maybe he should have said ‘I’m sorry I can’t answer that question — when is it ever fair not to do a solvent scheme?’ But I suppose that was asked by the dissenters, and I suppose he had to try and entertain it. But it’s a very odd question as it’s almost like saying ‘the statute says you can do X but when is it fair not to do X?’ A court also has the discretion but trying to pinpoint when that discretion should be exercised or not is like pinning jelly to a wall.

**Dan Schwarzmann** But that’s what he did, Philip. He was asked the question. The exam question was ‘Forget Scottish Lion, forget any scheme that’s come through — can the minority be bound by schemes?’ And his response to that was ‘not unless the company proposing the scheme is impaired’. The good thing about this judgment, unlike BAIC, is that the judgment is in respect of a specific point of law. This judge is saying, ‘in my view, you cannot bind a minority to a solvent scheme if the company is not impaired’. That is a clear point that can be discussed in the Court of Appeal and by other judges.

**Philip Hertz** What might happen here is exactly what happened with BAIC. The famous paragraph 143 at the end of the judgment, Lewison’s judgment and everyone saying ‘it’s the end of the world’ but all of a sudden M&G goes through, DAP goes through. A number of cases go through and almost ignore it, as it’s a first instance decision.

**Dan Schwarzmann** What I’m hearing is that this now needs to be dealt with. Scottish Lion have two calls here. Either they appeal it, or they don’t and the scheme fails. ➔

So it's a point of law until it gets appealed.

**Philip Hertz** It's certainly the law in Scotland, which is persuasive in England.

**Dan Schwarzmann** If you had another company, that was solvent, not impaired, whatever that means, how much weight would be given to that judgment in an English Court?

**Philip Hertz** I suppose the advice might be, 'look if you get objections to this and the judge takes cognisance of this decision, then you might have a harder time persuading him that the scheme is fair. If you think the scheme is

*the interest of the creditors ... as a body that a solution should be found and implemented; and that, to this end, the creditors must act as one and, in identifying the appropriate solution, must agree to be governed by the wishes of the majority... That is the situation in which, in my opinion, the principle of creditor democracy applies. But I do not see why it need apply in all cases where a scheme of arrangement is proposed.'*

And the killer is, 'a solvent scheme is an instance of a case where subject to other considerations, creditor democracy should not carry the day'. So he is saying that a solvent scheme is an instance of a case, which by implication means there might be other schemes in a similar situation.

**David Strasser** So the Appeals Court will look at the language not at the issue the way he framed it?

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**'What the judge is basically saying here is unless you have a problem, whatever that means, then effectively you need unanimous consent to do anything for creditors or members'** Philip Hertz

fair then it should be able to be pushed through.' People say it hasn't changed because that's always been the case, but this changes everything because actually this has an impact and a ripple effect. Not just for solvent schemes and insurers. Throughout all the use of schemes.

**Peter Payne** Is that actually a good thing, in the sense it has such a major effect on a broader issue than simple run-off schemes that it's more likely to be addressed?

**Philip Hertz** Yes, it should be. And it's a point of appeal. I wouldn't be surprised if someone said 'if it's the wrong decision in the Court of Appeal it goes to the Supreme Court'. It's essential. Effectively, if it never gets appealed and gets left you might as well take it off the statute books if Lord Glennie has his way, because if anyone objects you might as well need 100 per cent consent.

**David Strasser** I did not read [Lord Glennie's] opinion to have that broad an application because the way he phrased his issue, he limited it to situations where an insured was having its insurance cover taken away.

**Philip Hertz** It's Paragraph 56 though. He talks about creditor democracy, he talks about Equitable Life UK. Then he says, 'The examples are many and various but it seems to me that the common thread is that the scheme is put forward in a situation where ... there is a problem requiring a solution; that it is in

**Philip Hertz** Anyone taking this case to appeal will then need to go broader and say, 'How have schemes been used?'. Anyone that's been in the restructuring market or in another other field, M&A, will say 'schemes can be used for anything' that's the beauty of schemes. They are a wide and flexible tool and to

limit them in this way I think is anathema to what the statute actually says. I think it's completely wrong.

**Dan Schwarzmann** I keep looking at the good consequences of the judgment. The good part is that this broad issue is in play. We want to know the answer to this. I can also see alternative solutions. Something we have been talking about for a while is 'opt-out schemes'. Where a policyholder within a scheme has the ability to say 'actually I don't want to be forced to do this commutation'. In certain circumstances we talk to clients about it, and in many circumstances we haven't. The fact of the matter is, if you do an opt-out scheme, the deal being proposed changes and policyholders may find it less attractive. I would see opt-out schemes as a legal solution, not necessarily as a commercial solution to the Scottish Lion issue.

**Peter Payne** Just to clarify a point Dan, the crude assumption is that companies that propose solvent schemes are looking to accelerate their run-off to the point where they can wind the company up, take the capital out and go down the pub with it. If you introduce an opt-out scheme it implies there's a 'fag-end' they still have to service. Why would they bother?

**Dan Schwarzmann** Every deal is different. I can see in certain circumstances that can be of some benefit. It depends on the company. It's case by case. I was

talking about the legal solutions and the commercial solutions. The other thing we have to understand is that there have been some schemes proposed in the

mately there were still 'no' votes in that scheme when the court went ahead and sanctioned it.

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**'The judge was asked to consider whether it was fair to scheme a solvent company and he did not consider the Scottish Lion scheme specifically'**

Dan Schwarzmann

market, where, in order to remove no-votes, hefty deals have been done. That is causing an issue. A company like Scottish Lion is not a big company. It can't afford to do that. Therefore it is good that we are now debating this legal issue as it is important for companies that are solvent but who do not have a huge balance sheet.

**Philip Hertz** I don't see any solution other than the court should simply be looking at schemes on a scheme by scheme basis. To make a general deal, and say if there is a problem then therefore creditor democracy can't carry the day. He's run a coach and horses through the statute.

**Mark Allen** If creditor democracy doesn't apply the only other thing can be creditor veto. So if there is any 'no' vote on a scheme then a scheme can't be effective. It isn't just when somebody turns up in court with an objection, it's effectively if there's any 'no' vote.

**Philip Hertz** That's an interesting way of looking at it. That may well be right. On a non-insurance, people may just want to change lending facility terms for the benefit of all the lenders and for the benefit of the company. You get one who holds out (and if Scottish Lion is right), you can't do it. Whereas the beauty of the scheme was that even though maybe the facility document said you needed unanimous consent, with a scheme you could do it with 75 per cent, and now perhaps you're back to a hundred.

**Mark Allen** So you can have 100,000 creditors and just one hold out and that could potentially stop everything?

**Philip Hertz** Yes — if Scottish Lion is right.

**David Strasser** That's contrary to WFUM. I mean, even though the objectors withdrew their objections, ulti-

**Mark Allen** That's why this is so fundamentally different because it's so wide ranging, it's across so many industries and it's talking about creditor veto, the way I see it.

**Barbara Hadley** Moving away from Scotland, just for a while. The Highlands scheme, with its implications for the US market and the growth of supervised run-offs. Selinda maybe you'd like to talk about that and what you feel could happen in the light of the Highlands scheme judgment.

**Selinda Melnik** I'm not familiar enough with the inner workings of everything in the case, only official case documents, press coverage and published analyses, so I'm at a bit of a disadvantage. But from the bits that I have read it appears that, and correct me if I'm wrong, that an agreement has been reached between a US state insurance insolvency proceeding and the UK proceeding, an agreement that we might refer to as a protocol similar to those agreed in cross-border insolvency cases. Is that what happened?

**Dan Schwarzmann** That's fair Selinda. There was a question mark over whether a transfer of liabilities had occurred. There was a settlement by the US company to the UK company for that transfer and both parties wanted certainty and finality over that transfer.

**Philip Hertz** There wasn't so much a question mark over whether the transfer occurred, I think people have said it had occurred as a matter of English law. The question was should it be recognised as a matter of US law.

**Dan Schwarzmann** That's fair. And all of that was crystallised within a deal and then a scheme which then gave finality to both the UK and US insurers because the UK scheme was recognised by the English Court and the US Court then provided Chapter 15 relief.

**Philip Hertz** It was effectively a scheme of direct creditors and it was a solvent scheme within an insolvency. One of the novel features of it was Highland US had said that, to pay the settlement sum to Highland UK *quid pro quo*, for that they wanted to ensure they got in some way, shape or form a release from those creditors who might have had a claim against them had the transfer not been recognised in the US. And that scheme gave that release. ➔

One way of looking at that was almost to say that the scheme through the Chapter 15 effectively gave recognition to the Part VII transfer.

**Selinda Melnik** And why was that?

**Philip Hertz** Because the original policy had been transferred from the UK branch to the US company to Highlands UK the English subsidiary. There was a dispute later between the two companies as to whether that transfer would be recognised in the US and Highlands US said ‘we’re not getting into it with you but we will pay you a sum’ and there was a number of settlement terms, but one of them was ‘those policyholders who might be able to claim in the US that the transfer wasn’t effective should no longer be able to claim against the US company but only claim against the UK company’, i.e. that they too should recognise that the transfer had happened and receive money under the solvent scheme. So the effect of the scheme of arrangement and the recognition of it under Chapter 15 effectively recognised what had happened quite a few years before in terms of the transfer between the US and the UK company.

**Barbara Hadley** Does this signal some feeling of compromise regarding the US not being keen on schemes and is there some way forward in the easing of relations?

**Forrest Krutter** There are two separate questions I believe. One is a question of how will the US courts, and specifically the US bankruptcy courts, deal with solvent schemes approved by European courts. I’m not an expert on bankruptcy but I am certainly aware of the same cases and I believe our bankruptcy courts will honour them in this country. I will be the first to admit my limited expertise in this area. With respect to the second question, I do not see the US allowing solvent schemes. Just like the US doesn’t allow insolvent schemes run by accountancy firms. And I’m not convinced that not allowing insolvent schemes to be run by an accountancy firm is a good thing, don’t misunderstand me. But fundamentally, as all of you are aware, in the US, where you have an insolvent situation it’s overseen by the state regulator and the regulator may sub-contract to an accountancy firm but ultimately the regulator maintains control. It’s a regulator dominated process. I do not see the solvent scheme being adopted by US courts to US entities. As all of you are aware there is a statute in Rhode Island that provides for solvent schemes. It’s never been used and I’m not aware of any proposal put forward for it to be used.

**Selinda Melnik** I think the formulation that currently exists of what a solvent scheme might look like, from experience to date from the UK, may not be the formu-

lation that ends up being adopted and actually gets into use in the US. But I think maybe some other incarnation of that concept will move forward, as will the pressure to centralise regulation of insurance or at least move to some joint federal/state sharing of regulation. I can’t imagine what that will look like. But I think that portends a change in the landscape.

**Forrest Krutter** Maybe, but even at the federal level it’s going to be fought over inch by inch. Something as controversial as solvent schemes... I mean we will certainly devote every effort to prevent them from leaking into federal legislation.

**Selinda Melnik** I think that there is a movement to try to find some way in the US to deal with restructuring situations so that they don’t end up as an insolvency. And solvent schemes I think, of some form, are something that will probably be looked at by more states for that reason.

**Forrest Krutter** I think that under those situations, and this will obviously be the subject of intense lobbying by multiple interests, the states will realise that this simply means to allow reinsurance contracts to be rewritten and put in jeopardy cedants. That’s why we have an interesting political system. It will be fought state by state.

**Barbara Hadley** I did have a final point which was Lloyd’s and its attitude to schemes, but thankfully that’s actually very easily answered as it’s still ‘no’. I shall ask Dan to pick the key points that have been made here. One of them could be that we all agree to disagree.

**Dan Schwarzmann** Key points we can take away today? These aren’t points that I’ve necessarily made but points I’ve been listening to. I fully understand and fully respect the view that Forrest has made about why schemes are objectionable to certain policyholders. They have bought a policy and they want to keep it. I genuinely respect that view and I know Forrest passionately believes it. There are, however, some policyholders who object to solvent schemes because they want a better deal. That has had an impact in that certain companies just can’t afford to do that, like Scottish Lion, and we end up in Court. What I’ve been hearing is that Scottish Lion has created a new law which has got to be looked at. I don’t think I’ve heard anyone round the table say ‘this is the death of schemes’. But it’s a fundamental point which needs to be addressed. The other thing I have heard about is Highlands. I’ve heard about innovation. One thing that schemes have done in the market is that they’ve brought innovation and brought debate, and that can only be a good thing for us all. And I hope everybody around the table would agree with that.