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OUTER HOUSE, COURT OF SESSION

[2009] CSOH 127

P1981/08

OPINION OF LORD GLENNIE
in the Petition
THE SCOTTISH LION INSURANCE COMPANY LIMITED
Petitioner;
For
an order under Section 896 of the Companies Act 2006 and for sanction of a Scheme of Arrangement under Section 899 of the Companies Act 2006

Petitioners: Howie QC, Howlin; Morton Fraser LLP
Respondents: McNeill QC, Munro; Simpson & Marwick

10 September 2009

Introduction

[1] This is a petition by The Scottish Lion Insurance Company Limited ("the Company") for sanction of a scheme of arrangement ("the scheme") under s.899 of the Companies Act 2006 ("the 2006 Act"). Sanction of the scheme is opposed by five creditors of the Company, all of whom are based in the United States, of whom the first named in the answers to the petition is Goodrich Corporation. I shall refer to the opposing creditors collectively as "the respondents".

The background

[2] I take the background substantially from the averments in the petition, most of which are admitted. The Company began underwriting in 1948, initially underwriting marine business in relation to vessels belonging to the Clan Line Steamers Group and later more generally. In 1962 it began writing aviation business. As was the case with many insurance companies in the London Market, some incidental non-marine business was written as part of the marine account. In late 1982 it began writing a specific non-marine account. In 1983, it ceased writing a general aviation account. The business comprised a mixture of direct insurance and reinsurance, including excess of loss reinsurance. A significant part of the business was occurrence insurance, covering liabilities arising out of events occurring during the lifetime of the policy but in respect of which claims might be made after the policy had expired. The

Company at no time underwrote life business or was authorised to do so.

[3] The Company underwrote business through brokers in London. At various times from 1962 onwards, it also wrote business through the Institute of London Underwriters ("the ILU"), which signed and issued policies on behalf of the Company alone or on behalf of the Company and other members of the ILU ("the ILU Policies"). The Company was a member of the subscription market in London and generally participated as an insurer or re-insurer on risks subscribed by a number of other insurance companies through the London Market Broking System.

[4] The Company ceased writing new business on 9 December 1994. Since then it has been in run off. Its remaining portfolios contain both short-tail and long-tail business. Whilst it is thought that its short-tail business, such as property insurance, is unlikely to give rise to any future claims, its long-tail business will include exposure to Asbestos, Pollution and Health Hazard ("APH") losses.

[5] In October 1988 the Company was required by the ILU to provide a guarantee ("the ILU Guarantee") in relation to liabilities under the ILU Policies. The ILU Guarantee was provided by the Company's then owners on 12 October 1988. They were released from the ILU Guarantee in May 2008. On 21 May 2008 Barclays Bank Plc ("Barclays") opened an irrevocable stand by letter of credit ("the LOC") in favour of the ILU by order and for account of SLI Holdings Limited. The LOC can be drawn on by the ILU in the event of a default in payment by the Company in relation to any policy written through the ILU on or after 12 October 1988.

The reasons put forward for the scheme

[6] The reasons for the scheme are explained in the petition. In the ordinary course of run off, claims are adjusted and settled as and when they are received and once their validity and quantum have been agreed. In addition, the Company terminates its liability to individual creditors once and for all by means of agreed commutation payments. Liabilities terminated by such payments include liabilities in respect of claims incurred but not yet reported ("IBNR"). Unless a mechanism for terminating the run off is implemented, the run off may continue for many years or even decades. In the absence of such a mechanism, the Company will never know with certainty whether all of its liabilities have been extinguished. In the meantime, both the Company and its creditors will incur substantial ongoing costs in connection with the processing and quantifying of claims and in connection with the termination of the Company's liabilities by means of a series of individual commutations. The proposed scheme of arrangement with all of its creditors who are creditors in relation to its underwriting business ("scheme creditors") will, if sanctioned and fully implemented, bringing the run off and its associated uncertainties to an end.

[7] I should emphasise that the Company avers in the petition that it is solvent and there is no reason to doubt that this is so. There is no suggestion of any threatened or imminent insolvency or of any circumstances likely to bring about insolvency if the court does not sanction the scheme.

[8] This is not the first time that the Company has presented a petition for sanction of a scheme of arrangement. It did so in 2005. The 2005 scheme was intended to take effect between the company and certain of its creditors. Sometime after the notices convening a meeting of scheme creditors had been

despatched, the 2005 scheme was withdrawn. This is not relevant to the present petition but, for those who are interested, the history of that petition is narrated at paras. [2]-[5] of the Opinion of Lord Drummond Young in *Re. Scottish Lion Insurance Co.* 2006 SLT 606.

The proposed scheme

[9] The details of the scheme are complex but are summarised, sufficiently for present purposes, in the petition in a series of numbered sub-paragraphs:

> "(1) The Scheme will extend to all of the Company's 'Scheme Liabilities', which include all liabilities of the Company under or in relation to an insurance contract. That definition includes IBNR Claims but excludes unpaid agreed claims and all liabilities and obligations which are barred by statute or otherwise unenforceable.
>
> (2) Scheme Liabilities will be valued at the 'Valuation Date', which is defined as 31 December 2007, although the Company may take account of events occurring after that date in appropriate circumstances.
>
> (3) There will be two classes of Scheme Creditors, namely (i) Scheme Creditors in respect of non-IBNR Claims and (ii) Scheme Creditors in respect of IBNR Claims. ...
>
> (4) Scheme Creditors will be invited to submit claims in respect of Scheme Liabilities. The claims will require to be substantiated by supporting documentation. There will be a long-stop date ('the Bar Date') by which the claims and supporting documentation must be submitted.
>
> (5) The submission of claims by Scheme Creditors will lead to the claims being determined either by agreement between the Scheme Creditors and the Company or, in the absence of such agreement, by a Scheme Adjudicator by the application of a specified 'Dispute Resolution Procedure'.
>
> (6) The Scheme Adjudicator will be a qualified actuary with considerable experience in the insurance industry and particular experience in the adjudication of claims in schemes of arrangement proposed by solvent insurance companies. ...
>
> (7) Whether they are determined by agreement or by the Scheme Adjudicator, all claims in the Scheme will require to be determined by reference to a set of 'Estimation Guidelines' which are set out in an appendix to the Scheme itself. The Estimation Guidelines are flexible. They contain particularly extensive provisions in respect of IBNR claims.
>
> (8) Once a Scheme Creditor's claims have been determined, there will be set off against them any sums owed by the Scheme Creditor to the Company and the balance (if it is a positive amount) will be paid by the Company to the Scheme Creditor in full and final settlement of all of the Company's liabilities to that Scheme Creditor in respect of the Company's insurance business.
>
> (9) If and when the Scheme comes into effect, Scheme Creditors will be prohibited from enforcing their claims against the Company by way of proceedings ... unless the Company consents to their doing so. Scheme Creditors who hold security for their claims will be entitled to have recourse to their security but will be obliged to give credit to the Company for sums realised on enforcement.

(10) The Scheme contains a provision which will entitle the Company to terminate the Scheme and revert to run off in certain circumstances. In general, however, the Company will be precluded from reverting to run-off once it has made the first payment under the Scheme."

If and when the Scheme is fully implemented, so that the Company has no further liabilities under it, the proprietors of the Company intend to put the Company into members' voluntary liquidation.

[11] The Scheme Adjudicator appointed by the company is Mr George Maher of Towers Perrin LLP. He is described in the petition as an actuary with extensive experience of the insurance and reinsurance market who has, in the past, acted as an independent scheme adjudicator or an independent vote assessor in relation to numerous insurance company schemes of arrangement and, further, has acted as chairman of creditors' meetings in relation to such schemes.

[12] In statement 6 of the petition, the Company summarises what it perceives to be the advantages or disadvantages of the scheme to scheme creditors. Advantages of the scheme include: (i) early payment, i.e. the fact that scheme creditors will have their scheme liabilities determined and paid sooner than if there were no scheme; (ii) that there will be no discount for early payment, so that in most cases scheme creditors will receive, in effect, a premium over the present value of their claims; (iii) that the scheme offers a practical, straightforward and cost effective means of determining the value of present and future claims, including IBNR claims, with a dispute resolution procedure under which the Scheme Adjudicator will determine claims in respect of which agreement cannot be reached; and that the scheme will bring finality and certainty in respect of the claims of scheme creditors, thereby achieving savings in costs which the company will apply towards making the undiscounted payments. Disadvantages include: (i) the fact that the scheme creditors will be paid on the basis of an estimate of the value of their claims, so that, although some may receive more than they would otherwise have been entitled to, others may receive less; (ii) that if the scheme comes into force, scheme creditors will be barred from bringing court proceedings to obtain payment of their claims; and (iii) that the company's insurance liabilities to scheme creditors in respect of scheme liabilities will cease and any subsequent losses which might otherwise have resulted in a claim against the company under the contracts of insurance will not thereafter be covered.

The relevant statutory provisions

[13] The petition is presented under Part 26 of the 2006 Act which deals with arrangements and reconstructions. I set out below the relevant provisions

"**PART 26** ARRANGEMENTS AND RECONSTRUCTIONS

Application of this Part

895 Application of this Part

(1) The provisions of this Part apply where a compromise or arrangement is proposed between a company and-

(a) its creditors, or any class of them, or

(b) its members, or any class of them.

(2) In this Part-

- "arrangement" includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods; and ...

Meeting of creditors or members

896 Court order for holding of meeting

(1) The court may, on an application under this section, order a meeting of the creditors or class of creditors, or of the members of the company or class of members (as the case may be), to be summoned in such manner as the court directs.

(2) An application under this section may be made by-

(a) the company,

(b) any creditor or member of the company, or

(c) if the company is being wound up or an administration order is in force in relation to it, the liquidator or administrator.

Court sanction for compromise or arrangement

899 Court sanction for compromise or arrangement

(1) If a majority in number representing 75% in value of the creditors or class of creditors or members or class of members (as the case may be), present and voting either in person or by proxy at the meeting summoned under section 896, agree a compromise or arrangement, the court may, on an application under this section, sanction the compromise or arrangement.

(2) An application under this section may be made by-

(a) the company,

(b) any creditor or member of the company, or

(c) if the company is being wound up or an administration order is in force in relation it, the liquidator or administrator.

(3) A compromise or agreement sanctioned by the court is binding on-

(a) all creditors or the class of creditors or on the members or class of members (as the case may be), and

(b) the company or, in the case of a company in the course of being wound up, the liquidator and contributories of the company.

(4) The court's order has no effect until a copy of it has been delivered to the registrar."

Procedure

[14] It is well established that approval of a scheme of arrangement is a three-stage process. The stages, and the purpose served by each, were explained by Chadwick LJ in *Re BTR plc* [2000] 1 BCLC 740, 742 and again in *Re Hawk Insurance Company Limited* [2001] 2 BCLC 480 at paras.11-12 (his remarks were made under reference to the equivalent provisions in the 1985 Act, but they apply equally to those now in force):

> "
>
> [11] There are ... three stages in the process by which a compromise or arrangement becomes binding on the company and all its creditors (or all those creditors within the class of creditors with which the compromise or arrangement is made). First, there must be an application to the court ... for an order that a meeting or meetings be summoned. It is at that stage that a decision needs to be taken as to whether or not to summon more than one meeting; and, if so, who should be summoned to which meeting. Secondly, the scheme proposals are put to the meeting or meetings held in accordance with the order that has been made; and are approved (or not) by the requisite majority in number and value of those present and voting in person or by proxy. Thirdly, if approved at the meeting or meetings, there must be a further application to the court ... to obtain the court's sanction to the compromise or arrangement.
>
> [12] It can be seen that each of those stages serves a distinct purpose. At the first stage the court directs how the meeting or meetings are to be summoned. It is concerned, at that stage, to ensure that those who are to be affected by the compromise or arrangement proposed have a proper opportunity of being present (in person or by proxy) at the meeting or meetings at which the proposals are to be considered and voted upon. The second stage ensures that the proposals are acceptable to at least a majority in number, representing three-fourths in value, of those who take the opportunity of being present (in person or by proxy) at the meeting or meetings. At the third stage the court is concerned (i) to ensure that the meeting or meetings have been summoned and held in accordance with its previous order, (ii) to ensure that the proposals have been approved by the requisite majority of those present at the meeting or meetings and (iii) to ensure that the views and interests of those who have not approved the proposals at the meeting or meetings (either because they were not present or, being present, did not vote in favour of the proposals) receive impartial consideration. ..."

[15] Under Scottish procedure, the application for sanction of a scheme of arrangement is made by petition. The relief sought in the petition also reflects the three stage procedure described in *Re Hawk Insurance Company Limited*.

The first stage - the order that a meeting or meetings be summoned

[16] In para.1 of the prayer of the petition, the Company sought an order under s.896 of the 2006 Act that creditors' meetings be convened and that detailed provision be made for the composition and

mechanics of the meetings, the method of voting and counting of votes, etc.. It was proposed in the petition that there be separate meetings of the two classes of scheme creditors, i.e. (i) scheme creditors in respect of non-IBNR claims and (ii) scheme creditors in respect of IBNR claims. The application for an order was heard on 15 December 2008. In accordance with current practice, all known policyholders (as potential creditors) had been notified in advance of the hearing of the application and given the opportunity to attend and be heard. Two separately represented groups of creditors, including the respondents, attended and made representations.

[17] The court's interlocutor of 15 December 2008 ordered that two separate meetings be held, the First Meeting being a meeting of the non-IBNR creditors and the Second Meeting being a meeting of the IBNR creditors. It was recognised, of course, that some creditors might fall into both categories, and it was accepted that they could participate in each meeting to the extent that their claims fell into the relevant category. No issue is taken by the respondents in these proceedings with the identification of the appropriate classes of creditors or the number of meetings. The chairman of the meetings was ordained to report to the court the outcome of each of the meetings within 14 days after he received the report of the Independent Vote Assessor, to whom I shall refer below.

The second stage - the creditors' meetings

[18] The meetings were duly held on 2 March 2009 under the chairmanship, in each case, of Daniel Schwarzman of PricewaterhouseCoopers LLP ("PwC"). The Company had appointed PwC as Scheme Adviser and Scheme Actuarial Adviser in relation to the scheme. In his report dated 23 April 2009, the chairman reported that the statutory majorities, i.e. a majority in number representing 75% in value of each class of creditors present and voting either in person or by proxy at the meetings, had been achieved in favour of the scheme. The respondents, who are some of the creditors who opposed the scheme, challenge the results of the meetings. I shall have to come back to this aspect in some detail.

Further procedure and answers lodged by the respondents

[19] In para.2 of the prayer of the petition, the court was asked, upon receiving the report of the chairman of the meetings, to make an order for advertisement of the petition and the lodging of answers by anyone claiming an interest. That is sometimes referred to as a "first order". That order was made on 29 April 2009. The order allowed interested parties to lodge answers by 18 June 2009.

[20] The respondents, though not the other group of creditors who had attended court at the hearing in December 2008, duly lodged answers to the petition. Their "overarching objection" to the scheme is that it amounts to a "confiscation of their valuable rights, for which they have paid substantial premiums, for no or wholly inadequate compensation": para.8.3. They elaborate on this in para.6.3 of their answers:

> "... the respondents regard the Scheme as amounting to a confiscation of their rights. ... further explained and averred that, first, even assuming the attribution of a fair value to Scheme Liabilities (for the purposes both of voting on the Scheme and, if the Scheme is sanctioned, of determining amounts payable) 'early payment' of Scheme Liabilities is in no intelligible sense an advantage, other than to the Company and its ultimate owners. Many Scheme Creditors, including the respondents, are major industrial organisations which have been engaged in diverse

> manufacturing processes over many decades. The extensive 'occurrence-based' coverage purchased by such organisations through the London market, for substantial premiums, represents to them a valuable, and irreplaceable, business asset. The respondents, in common with other Scheme Creditors who voted against the Scheme, would prefer to retain the benefit of the contracts of insurance entered into by them with the Company, not least since replacement occurrence-based coverage is no longer available on any insurance market at any price. Secondly, even if no discount specifically attributable to early payment is applied, the value of Scheme Liabilities is likely to be (and for voting purposes, has already been) heavily discounted in other ways. ... thirdly, whatever may be the merits of the process chosen by the Company for the determination of claims, the benefits of that process will enure very largely to the Company itself and to its ultimate owners. Fourthly, however advantageous 'finality and certainty' may be for the Company and its ultimate owners, neither represents an advantage of any kind for the respondents and other Scheme Creditors who voted against the Scheme. If the Scheme is sanctioned, it will have the effect of compulsorily transferring the risks assumed by the Company (in return for the payment by Scheme Creditors of substantial premiums) back to policyholders, thereby depriving them, for little if any compensation, of the measure of finality and certainty their purchase of occurrence-based coverage had given them."

These are powerful arguments which cannot lightly be brushed aside.

[21] In their answers, the respondents also raise questions as to the validity of the way in which values were attributed to creditors' claims for voting purposes. I shall return to this aspect later.

The third stage - the application for sanction of the scheme

[22] Para.3 of the prayer asks the court to sanction the scheme. At the time of ordering that the meetings be held, the court was made aware that there might be opposition to the motion for sanction and pencilled in 7 July 2009 and the ensuing three days for the hearing of a contested application for sanction. The case was put out By Order on 22 June 2009 so that parties could inform the court of their state of readiness for the hearing. It became clear, for reasons which will become apparent, that a full contested hearing could not take place on the reserved days in July. Nonetheless, parties had in their notes of argument identified certain issues of principle which, if decided in a particular way, might considerably limit the scope of the hearing. Accordingly, it was decided to use the reserved dates in July for the hearing of argument on these issues, and long-stop dates for a full contested hearing (if one was still necessary) were fixed for January 2010.

[23] This Opinion arises out of the argument on the two discrete issue of law argued in July. In case the point should matter, that hearing is, in my opinion, properly to be considered as a preliminary part of the third stage, i.e. as a part of the hearing of the application for sanction of the scheme.

The valuation of the votes cast at the meetings

[24] There is no difficulty in determining that at the meetings of each class of creditors there was a majority in number of the creditors who supported the scheme. The difficulty lies in ascertaining whether the majority in number represents 75% in value of the creditors of the relevant class. This is so

particularly in the field of occurrence-based insurance and IBNR claims where, by definition, the insured party will not be able to anticipate with any confidence what claims may be made against it in the future by third parties (for example, former employees), and therefore will not know either the extent of its potential liabilities to such third parties or of its claims against the petitioners for indemnity under the relevant policy of insurance. If the exercise is to be carried out at all, the likelihood of future claims has to be estimated (or guesstimated, as critics of the exercise might suggest).

[25] In summarising the proposed scheme, I have already referred to Estimation Guidelines which it is proposed should be used to determine claims in the event that they cannot be agreed. The Estimation Guidelines are set out in Schedule 2(a) to the scheme and are annexed to the petition. They run to over 20 pages. I need not refer to them in detail. Schedule 2(b) provides "Supporting Information to Scheme Liabilities submitted using the Estimation Guidelines". It runs to a further 19 pages. It sets out the level of supporting evidence to be supplied by a scheme creditor in support of the different approaches used for estimating scheme liabilities for different insurance contract types and claim loss types described in Schedule 2(a). But it is recognised in Schedules 2(a) and 2(b) that other projection techniques may be adopted by a scheme creditor. The Company, the Scheme Adjudicator and the Scheme Actuarial Adviser are required to apply the principles, policies and assumptions comprised within the Estimation Guidelines for the purpose of agreeing and, if necessary, adjudicating on claims submitted by scheme creditors.

[26] This, of course, is for valuing claims once the scheme has been sanctioned. It does not directly address the valuation of claims for the purpose of determining at the meeting of creditors whether 75% of the creditors by value support the scheme. It was proposed in the petition that a similar exercise should be carried out for that purpose and that, in addition, there should be an Independent Vote Assessor ("IVA") appointed to oversee the process. In Statement 8.3 of the petition the petitioners describe the role of the IVA in these terms:

> "8.3 ... for the purpose of providing a cross-check on the votes cast at each of the proposed Scheme Creditors' meetings, the Company has appointed Mr Colin Jan William Czapiewski to act as an Independent Vote Assessor. The appointment of independent vote assessors is becoming more common in solvent insurance company schemes of arrangement which fall under the jurisdiction of the High Court of Justice in London. Mr Czapiewski's task will be to assess the estimated value of the votes cast by any Scheme Creditor which votes against the Scheme at either or both of the Scheme Creditors' meetings and of a significant sample of the votes case by those Scheme Creditors which vote in favour of the Scheme. The sample will be sufficient to determine whether the majority mentioned in section 899(1) of the Act has been achieved. In addition, Mr Czapiewski will be entitled to review further votes should he so request. Having conducted his assessment, Mr Czapiewski will report to the Company on his findings. UnlessYour Lordships otherwise order, it is intended that the chairman of the Scheme Creditors' meetings should have regard *inter alia* to Mr Czapiewski's report when determining the number and value of the votes cat at those meetings. The report will be lodged in Court before the

Company seeks an order sanctioning the Scheme under section 899 of the Act."

[27] In making provision for the mechanics of voting at the meetings and the counting of votes, the interlocutor of 15 December 2008, in accordance with the relief sought in the petition, made the following order:

"9 ... the chairman of the Meetings shall have power, at his discretion:

...

(iv) failing agreement between the Company and a Scheme Creditor as to the value to be placed upon that Scheme creditor's claims against the Company for the purpose of voting at the Meetings or either of them, to fix that amount in such manner as shall appear to the chairman to be fair and reasonable having regard to (a) any supporting documentation produced by the Scheme Creditor, (b) the information available to the Company from its own records, (c) any advice received from the Scheme Actuarial Adviser mentioned in the Scheme, who shall apply the principles mentioned in the Estimation Guidelines mentioned in the Scheme and (d) the report of the Independent Vote Assessor mentioned in the petition; provided that the amount so agreed or fixed shall be binding solely for the purpose of determining the number of votes which may be cast at the Meeting in question by that Scheme Creditor."

[28] In his report, the chairman of the meetings reported that he had assessed the value of the creditors' claims in accordance with the court's interlocutor and had deferred to the opinion of the IVA where their valuations differed. He reported the outcomes of the meetings as follows:

First Meeting - Notified Outstanding Claims (i.e. non-IBNR claims)

Votes Cast	For	For (%)	Against	Against (%)
By Number	61	78	17	22
By Value	£10,218,370.90	89	£1,293,132.96	11

Second Meeting - IBNR Claims

Votes Cast	For	For (%)	Against	Against (%)
By Number	49	61	31	39
By Value	£21,121,462.55	97	£671,479.25	3

In each case, therefore, the statutory majority was achieved at both meetings.

[29] In Appendix 5 to his report, the chairman sets out the figures as they would have been had he accepted, at face value and without undertaking the exercise which he was directed to carry out in para.9 (iv) of the interlocutor, all the voting values proposed by scheme creditors

First Meeting - Notified Outstanding Claims (i.e. non-IBNR claims)

Votes Cast	For	For (%)	Against	Against (%)
By Number	70	71	27	29
By Value	£29,051,005.48	72	£11,399,958.47	28

Second Meeting - IBNR Claims

Votes Cast	For	For (%)	Against	Against (%)
By Number	61	56	47	44

By Value	£27,855,461.55	35	£50,826,061.66	65

Had these figures been taken, the scheme would have failed to obtain the statutory majority at either meeting.

[30] The report by the IVA dated 22 April 2009 was also lodged in process. It is of interest to note his general comment about the scheme in para.2.7:

> "The Scheme inevitably involves the estimation of claims amounts that have not yet been settles and the valuations of such claims, whether in the voting process or in the SCHEME itself, are therefore subject to a degree of uncertainty. The amounts that I have suggested are consistent with the Estimation Guidelines of the SCHEME and are based upon a best estimate approach to valuation ..., without any allowance for the time value of money except as set out in the Scheme. I recognise that estimates established for voting purposes are not binding upon the creditor or the COMPANY. Should the SCHEME proceed, all claims will be subject to the process of agreement and, where necessary, independent adjudication as described in the SCHEME. This process may result in different valuations from those contained within this Report."

The IVA was provided with files in respect of 62 scheme creditors of those who voted. Of those, he accepted in their entirety the values as submitted of 20 scheme creditors; he rejected entirely the claims submitted by a further 18 scheme creditors; and he amended the value of the claims submitted by the other 24 scheme creditors. Reasons for rejection and amendment are given in the report. He summarises the position in respect of the 44 claims not rejected in their entirety in a table at the end of his report. Adding back in the figures for those rejected in their entirety, the position is as follows:

	Outstanding Claims (non-IBNR)		IBNR Claims	
	Submitted	Accepted	Submitted	Accepted
Total accepted	£ 4,058,524	£ 4,058,524	£17,780,353	£17,780,353
Total amended	£20,305,515	£ 5,549,943	£58,288,001	£ 2,849,155
Total rejected	£13,830,067	£ 0	£ 1,322,521	£ 0
Totals	£38,194,106	£ 9,608,466	£77,390,875	£20,629,508

The respondents' criticisms of the evaluation process

[31] In para.8.3 of their answers to the petition, the respondents make these averments in respect of the process of evaluating for voting purposes claims submitted by scheme creditors:

> "... so far as the respondents have been able to ascertain on the basis of limited information provided to them by solicitors acting for the Company, the IVA accepted uncritically the recommendations of PwC as Scheme Advisers and the assumptions, many of which are misconceived if not simply erroneous, upon which those recommendations were based. Expert reports speaking to these matters have been instructed and will be produced, although, unless and until the data (including voting packages and supporting materials submitted by Scheme Creditors, and the materials - including legal and actuarial advice - relied upon by the IVA in producing his report) are made available, there is a limited amount that the respondents' experts can say by way of specific criticism of the methodology employed by the Scheme Advisers and endorsed by the IVA. Reference is made to the averments below which particularise the respondents' criticisms of and objections to the methodology adopted in the evaluation of claims

> and weighting of votes in the present case. ... the voting methodology adopted by the Scheme Adviser and Scheme Actuarial Adviser, and endorsed by the IVA, involved a fully unilateral and extensive devaluation of the votes of Scheme Creditors, including the votes of the respondents, who voted against the Scheme. While those Scheme Creditors voting in favour of the Scheme whose files were passed to the IVA for an assessment also typically experienced a devaluation of their claims for voting purposes, the extent of the devaluation was significantly less. In any event, as previously stated, only an unknown 'sample' of the files of Scheme Creditors voting in favour of the Scheme were submitted for assessment by the IVA. Beyond that, those Scheme Creditors' own valuation of their claims was unchallenged. The process was accordingly inherently biased against Scheme Creditors voting against the Scheme."

[32] In answer 8.3(b) the respondents refer to the adjustments made in the values attributed to creditors' claims for voting purposes:

> "(b) ... it is apparent that votes cast against the Scheme were devalued to a much greater extent than votes cast in favour of the Scheme on average, votes cast against the Scheme in the IBNR class were devalued by 99% and those in the non-IBNR class by 89%. Conversely, votes cast in favour of the Scheme were devalued only by 24% in the IBNR class and I 65% in the non-IBNR class. The consequence of this devaluation was that the Company was able to claim that the statutory 75% majority by value has been achieved in both cases."

In his submissions for the respondents, Mr McNeill QC, borrowing from the remarks of Warren J in para.19 of his (I think, second) judgement in *Re Sovereign Marine & General Insurance Company Ltd.* ([2007] EWHC 1331 (Ch), unreported, 16 May 2007), said that the disproportionate reductions in the values given to supporting and opposing creditors' claims for voting purposes were startling and cried out for an explanation. (I should note that that judgement of Warren J in *Re Sovereign Marine & General Insurance Company Ltd.*, which is the one to which I shall make reference in this Opinion, is one of a number of *extempore* judgments which he delivered following on from his principal judgement in that case, reported at [2006] BCC 774.) Mr Howie QC, for the petitioners, retorted that the report from the IVA was full of explanations, albeit only in respect of the claims that he was asked to look at. The adequacy of the explanations given and the consistency of approach in valuing creditors' claims will no doubt form a significant part of the argument in due course.

[33] Answer 8.3 then goes on to give more details of the process of valuing claims for voting purposes. Amongst the specific points made are these:

> (c) The devaluation exercise proceeded upon the basis of a number of unfounded or erroneous assumptions (which were not, in any event, applied even-handedly). In the first place, it was assumed that absence of any developed claims profile (for example, in aviation asbestos claims) denoted an unlikelihood that such a claims profile would develop in the future. This assumption was then used to justify devaluations of voting values, in some cases to nil. The assumption is

without any actuarial foundation, and wholly ignores the reality of mass tort litigation in the United States.

(d) The exclamatory statement produced in connection with the Scheme stated that vote valuations should reflect 'the mean of the distribution of possible outcomes', and assumption uncritically accepted by the IVA. This application of a 50% 'confidence level' is actuarially unsound. A 90% confidence level is typically used in the context of insurance business transfer schemes under Part VII of the Financial Services and Markets Act 2000, as providing more robust valuations. Had a 98% confidence level being applied in the present case, the devaluations of voting values would have been significantly less. In any event, although the IVA states that he considered a mean distribution between an 'all sums' allocation and a 'pro rata' allocation, it is apparent that in fact he considered a mean distribution between a 'pro rata' allocation and the 'all sums net of contribution' approach (which, as more fully explained below is merely a variant on 'pro rata' allocation, and lacking any foundation in US state law).

(e) In estimating the future value of their claims, Scheme Creditors such as the respondents applied to the majority approach in the United States to the allocation of liabilities to insurance policies. This 'all sums' approach means that, where a policy is triggered by the emergence of an insured risk, it responds up to the limit of the underlying claim, even if other policies in respect of the same risk are simultaneously triggered. The insurer pays may then seek to obtain contribution from other insurers. However, the Scheme Advises and the IVA have proceeded on the basis that the 'all sums' rule is 'generally accepted as not being appropriate'. This is simply wrong. The legal advice taken by the Scheme Advisers and the IVA, if any, has not been disclosed and it is, accordingly, in possible to discern how such a view was arrived at. Nevertheless, having discarded the majority 'all sums' rule, the Scheme Advisers and the IVA go on to apply to the valuation of future claims and amalgam of the 'pro rata' approach which has been rejected by the majority of United States courts and an approach described as 'all sums net of contribution'. This latter approach has no foundation in the law of any state of the United States. It fails to notice that the burden of seeking contribution rests with insurers, not with policyholders, and that the right to seek contribution is subject to an antecedent requirement to meet the insured's liability in full. It subtracts from the amount theoretically payable, under the 'all sums' approach, to a policyholder all amounts that might theoretically be recovered by the insurer (having paid the policyholder in full) by way of contribution, notwithstanding the fact that not all such amounts will be recoverable (and you, for example, to insolvencies and gaps in cover). The overall result is that the 'all sums' regime is replaced with a variant on 'pro rata' allocation, even though the 'pro rata' approach has been rejected by courts applying the US state law governing the Scheme Creditors' policies, and that, accordingly, the future value of claims is substantially and significantly diminished."

A number of other points are made in the various sub-paragraphs under answer 8.3. I will not quote them in full. They include a complaint that different estimation methods have been employed in respect

of different Scheme Creditors; that the Scheme Advisers and the IVA have been inconsistent in their treatment of the supporting documentation (or lack of it) supplied by different Scheme Creditors; and that certain specific errors have been made in the valuation of the respondents' IBNR claims based on assertions which, the respondents say, are impossible to understand.

The issues

[34] The two issues of principle identified by the parties and argued at the hearing in July were these:

(1) Are the respondents entitled to challenge the decision by the chairman of the creditors' meetings that the statutory majorities, both by number and value, were attained at the meetings of both classes of creditors? and

(2) Can it ever be fair to sanction a "solvent" scheme of arrangement in the face of continuing creditor opposition to having their occurrence cover compulsorily terminated?

During the course of the discussion, the formulation of the issues inevitably underwent some change, but in their original form they provide a convenient label for the argument. I shall deal with each in turn.

Issue (1) - can the decision by the chairman that the statutory majorities were achieved be challenged?

[35] At the beginning of his argument for the petitioners on this point, Mr Howie QC argued that the chairman of the meetings did precisely what he was required to do in terms of the court's interlocutor of 15 December 2008. The terms of that interlocutor were fixed after a hearing at which the respondents were represented. A procedure was laid down in para.9(iv) of the interlocutor for attaching a value to claims for voting purposes in order to decide whether the statutory majorities were achieved. He acted in accordance with that procedure and the contrary is not suggested. It was open to the respondents to submit such supporting material as they thought fit to demonstrate the true worth of their claims, including evidence of the law in various parts of the United States. There is no suggestion that such evidence as was submitted was not considered. Accordingly there is no basis for seeking to go behind the chairman's determination of the results of the meetings. The court could look behind what was done by the chairman in cases of dishonesty or perversity (of the type sometimes called "irrationality"): see *Re The British Aviation Insurance Co. Ltd.* [2006] BCC 14 at paras.66-67; *Re Sovereign Marine & General Insurance Company Ltd.* at para.43. Mr Howie submitted that that was the limit of the court's power to intervene. The test was similar to that applicable in cases of judicial review. It was not enough for the respondents to say that he made mistakes or got it wrong.

[36] For the respondents, Mr McNeill QC emphasised that the court, in performing its functions under Part 26 of the 2006 Act, had to proceed upon a basis that there should be fairness in the underlying procedure, in the sense that proper weight would be given to the position of individuals and companies entitled to participate. If that were not the case, there would have been no true vote at all. There might be cases where people had contracted into a process whereby there would be a meeting and everything, including valuation of claims, would be left to an expert without any right of review. That was not the case here. Further, the petitioners' argument proceeds upon the basis of the petitioners' scheme, and

seeks to impose upon the court and the creditors the petitioners' system for evaluating claims. Not only is a dissentient creditor forced, if the scheme is sanctioned, to give up his rights but he is forced to do so by a procedure which is entirely at the hand of the petitioner. The consequence of the petitioners' argument, if correct, would be that the court would be disabled from identifying and dealing with inequality at the meeting. The court should allow a challenge to the chairman's decision as to the outcome of the vote not only on the basis of perversity but also because that decision can be shown to be wrong or because the vote can be shown to be unrepresentative of the wishes of the body of creditors as a whole. He referred me to *Re Sovereign Marine & General Insurance Company Ltd.* at paras.54-61.

[37] As the argument proceeded it became clear that it was important to identify the stage at which, and the purpose for which, a challenge to the chairman's decision as to the result of the vote might be permitted. A statutory majority, both by numbers and by value, in favour of the scheme at the meeting(s) convened pursuant to an order of the court under s.896 of the 2006 Act is a prerequisite to the court sanctioning the scheme under s.899. It is a jurisdictional hurdle to be surmounted by the petitioner. If no statutory majority in favour of the scheme is achieved, the court has no jurisdiction to sanction the scheme. A challenge to the chairman's decision that a statutory majority in favour of the scheme was achieved accordingly brings into play the question of the jurisdiction of the court under s.899. In such circumstances, where the question is whether or not a majority in number representing 75% in value of the creditors voting at the meeting were in favour of the scheme, the court may understandably find itself drawn to the view that there should only be a restricted right of challenge to the chairman's decision. That accords, so it seems to me, with the remarks of Warren J in his judgement on 16 May 2007 in *Re Sovereign Marine & General Insurance Company Ltd.*. At paras.54-57 he sets out his understanding of the rights of opposing creditors to challenge the result of the vote:

> "54. First, the opposing creditors are allowed to challenge the vote as a stage 2 challenge on grounds of perversity. Secondly, the opposing creditors are allowed to challenge the scheme, probably at stage 3, on the grounds of the special interest or unrepresentative nature of the vote. Thirdly, the opposing creditors are allowed by the voting protocol to object to the vote at stage 3.
>
> 55. The parameters of permitted objections are not clear but it seems to me that they may go beyond perversity, dishonesty, special interest and unrepresentative votes. For instance, and I do not say that this would be established on the facts, but an example might be that the estimation for the purposes of the vote is not in accordance with a simplified version of the estimation methodology as is required by the voting protocol.
>
> 56. Fourthly, the extent of the court's discretion at stage 3 is, in a normal case, to be exercised in accordance with the National Bank case" - a reference to *Re National Bank Ltd* [1966] 1 WLR 819, approving the approach set out in *Buckley on the Companies Act*, as to which see below - "but the extent of that discretion in normal circumstances is a matter for case-by-case man development. The valuation of IBNR claims is one large area of controversy.

> 57. Fifthly, it follows, I think, that there is a good arguable case that the vote itself is open to challenge for the purposes of stage 2 if the opposing creditors had a substantial objection under the voting protocol and that this is not just a matter for the exercise of the stage 3 discretion."

In that passage, Warren J draws a distinction between a stage 2 challenge and a stage 3 consideration of the matter. By a stage 2 challenge, he clearly means the challenge to the chairman's report of the voting at the meeting, the meeting being stage 2 of the three stage process described by Chadwick LJ in *Re Hawk Insurance Company Limited.* Stage 3 is the final stage, the stage at which the court is asked to sanction the scheme which has *ex hypothesi* been approved by the statutory majority at the meetings convened pursuant to the order of the court under s.896. As I read his decision, Warren J is drawing a distinction between a challenge to the vote as such, a stage 2 challenge which goes directly to the question of the court's jurisdiction to sanction the scheme, and opposition to the scheme itself at stage 3, where the court is asked to exercise its discretion. At that latter stage the grounds upon which an opposing creditor may seek to oppose the scheme are clearly wider than perversity, dishonesty and irrationality. The opposing creditor is entitled to seek to prove that the voting was unfair, unrepresentative or affected by special interests, or that the counting of the vote, and in particular the valuation given to the various claims put forward by the creditors, was flawed, either as a matter of methodology or because of one or more significant errors of whatever nature. I did not ultimately understand Mr Howie to contend that, even at stage 3, the respondent was limited in his arguments to complaints of perversity or irrationality.

[38] While the distinction is, as a matter of principle, tolerably clear, there is considerable scope for overlap, as Warren J identified in para.57. In those circumstances, whilst the argument that a stage 2 challenge, which seeks to impugn the declaration of the result of the vote, should be limited to traditional judicial review type grounds, such as perversity or irrationality, might be well founded in principle, in practice a wide range of grounds of challenge will be available to the objecting creditor at the discretionary stage (stage 3) when the court is asked to sanction the scheme. Accordingly, it seems to me that it will rarely be important to draw a clear line between the two situations.

[39] It is, of course, well established that the court is not bound to sanction a scheme which has achieved the statutory majorities at the creditors' meetings. The role of the court in sanctioning the scheme is set out in the well-known passage from *Buckley on the Companies Act* (14th Ed.) at pp.473-474, which has been approved in a large number of cases:

> "In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bone fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and

> thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.
>
> The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme."

In *Re BTR plc* [2000] 1 BCLC 740 at 747g-h, repeated in *Re Hawk Insurance Company Limited* at para. [12], Chadwick LJ said this:

> "... the court is not bound by the decision of the meeting. A favourable resolution of the meeting represents a threshold which must be surmounted before the sanction of the court can be sought. But if the court is satisfied that the meeting is unrepresentative, or that those voting at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote in favour of the resolution is not to be given effect by the sanction of the court."

Those issues being open to parties at stage 3, it is difficult to see what purpose would be served by holding that a challenge to the decision of the chairman of the meeting that the statutory majorities had been achieved could only be advanced on perversity or irrationality grounds.

[40] As to where a line is to be drawn, if at all, between what can and cannot be taken into account at the stage where the court is required to exercise its discretion, I take the view, as did Warren J in *Re Sovereign Marine & General Insurance Company Ltd.* at para.56, that this is a matter for case-by-case development. I am, however, satisfied that the grounds advanced by the respondents in the present case are grounds which they are entitled to advance in opposition to the application that sanction be granted to the scheme under s.899 of the 2006 Act. Should it turn out, after the evidence has been adduced, that the challenge to the system of valuing the votes at the meetings is of such substance that it calls into question the jurisdiction of the court to make any order under that section, that is a problem which, if it is of any practical significance, can be dealt with at that time.

[41] I therefore reject the submission for the petitioners on this issue, in so far as that submission was directed to excluding a criticism of the valuation of claims for voting purposes even at the stage 3 sanction hearing. Insofar as the submission was directed only at the exclusion of such a challenge, other than on grounds of perversity or irrationality, at the stage 2 jurisdictional threshold, I prefer to leave the point open. It is unlikely to be of any materiality in the present case.

Issue (2) - Can it ever be fair to sanction a "solvent" scheme of arrangement in the face of continuing creditor opposition to having their occurrence cover compulsorily terminated?

[42] The discretion conferred by s.899 of the 2006 Act to sanction a scheme which has been approved by the requisite majorities at creditors' meetings is, on the face of it, unfettered. The cases, however,

show that, subject to being satisfied on certain matters, the court "will be slow to differ from the meeting": *Re Telewest Communications plc (No.2)* [2005] BCC 36 at para.22, though some disquiet about how this ties in with the court having an unfettered discretion has been voiced in *Re The British Aviation Insurance Co. Ltd.* at para.75 and *Re Sovereign Marine & General Insurance Company Ltd.* at para.41. For these reasons, either because the discretion is indeed unfettered or because the court will be slow to differ from the majority, a submission that it can never be fair to sanction a solvent insurance scheme which has achieved the statutory majorities at the meeting(s) of creditors is likely to run into difficulties. However, Mr Howie's: "What never?" was met by Mr McNeill's: "well, hardly ever!" That, so it seems to me, identifies the real question in issue here, which is this: in what circumstances might the court sanction a solvent scheme such as this in face of opposition from dissenting creditors? Or, to put it another way, what does a petitioner seeking sanction of such a scheme in the face of such opposition have to show? Is it sufficient for him simply to say that "the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve" (applying the test stated in *Buckley*) and rely on creditor democracy to carry the day? Or must he go further?

Submissions

[43] In developing his submissions, Mr McNeill emphasised that, when he referred to a solvent scheme, he was contrasting it with a scheme of arrangement for which sanction was sought at a time when the company was insolvent or was at risk of becoming insolvent should it fail to make a compromise or arrangement with its creditors. For the purpose of the discussion that follows, I propose to use those expressions in that wider sense. The Company here was financially sound. Statements 1.5 and 1.6 of the petition read as follows:

> "1.5 That the Company has not granted any charge or other right in security over any of its assets. It is not in administration. No receiver has been appointed over the whole or any part of its assets. No resolution has been passed and so far as the Company is aware no petition has been presented for the Company to be wound up.
>
> 1.6 That the Company is solvent. Reference is made to the Company's audited financial statements as at 31 December 2007 (the "2007 Accounts"), which are the most recent accounts of the Company to have been audited as at the date of presentation of this petition. There has been no material adverse change in the Company's financial position since 31 December 2007. The Company has access to further funds of £19,009,383 if necessary."

The importance of the Company being financially sound was that each of its creditors could confidently expect to be paid as and when it made a valid claim on its policy of insurance. There was no perceived risk that claims made would not be met. Unlike the case where a company was facing financial difficulties, and it might therefore be in the interest of its creditors to seek to make some compromise or arrangement with it, in the case of a company which was financially sound there was no similar reason for its creditors to give up or compromise their rights. It was open to the Company to make a composition with such of its creditors as were willing to enter into one with it. But absent any factor of

the type indicated, which might put pressure on the creditors to compromise their rights (and there might be circumstances other than financial difficulties which could put pressure on creditors to agree a compromise), there was no reason why creditors should be forced to give up their rights against their will. Nor, absent any pending financial difficulties and the threat to the interests of creditors if something was not done to put matters back on a sound footing, was there any reason why the creditors should have to act together and submit to the will of the majority, or any reason why those who wanted to make a composition with the company should be entitled to force others to participate. Creditor democracy should not prevail in circumstances where there was no need for it.

[44] Mr McNeill accepted that the statutory provision applied whether or not a company was insolvent or threatened with insolvency. The statutory predecessors of Part 26 of the 2006 Act originally applied only to companies about to be or in the course of being wound up: see *In Re Savoy Hotel Ltd.* [1981] 1 Ch 351, 358, per Nourse J. That restriction has disappeared, and the position since 1925 has been that the court's power to sanction a scheme of arrangement is unfettered by any such consideration. The question was, nonetheless, relevant to the exercise of discretion under what is now s.899 of the 2006 Act. If there was no reason for the company to propose a scheme other than in the interests of its shareholders, and no reason for the creditors to have to act as a body in relation to such a proposal, how could it be fair, or just and equitable, to force a dissentient creditor to accept the scheme and give up his contractual rights into which he and the company had both freely entered. The effect of forcing the respondents to accept the scheme against their will would be to deprive them of the benefit of the occurrence-based insurance for which they had paid, a replacement for which was now unobtainable, and to require them to take back for themselves the risks which they had been entitled to assume were covered by their insurers. It was obvious that any payments made under the scheme could be no more than estimates of the respondents' future liabilities. As the petitioners acknowledged, some creditors would be paid more than was ultimately necessary and some would be paid less. What reason was there to justify forcing a creditor to accept the cancellation of a policy of insurance in return for a payment which, as the company accepted, might not be adequate to meet the risks handed back to him?

[45] In the course of his submissions, Mr McNeill referred to a number of well-known authorities. The first group of authorities were relied on to show that the circumstances in which schemes of arrangement have typically been proposed and sanctioned. The cases were *In re English, Scottish and Australian Chartered Bank* [1893] 3 Ch. 385, *The Philadelphia Securities Company v. The Realisation and Debenture Corporation of Scotland Ltd* (1903) 22 SLT 217, *Re Equitable Life Assurance Society* [2002] BCLC 510 and *Re Cape plc* ([2006] EWHC 1446 (Ch), unreported, David Richards J). Those cases illustrated the need for there to be a problem (for the creditors as well as the company) which needed to be solved. Only then might a scheme properly be forced through against the opposition of unwilling creditors. A potential benefit to shareholders of the company was not a sufficient reason to justify imposing a scheme which might be to the detriment of some of the creditors.

[46] Mr McNeill next referred to in *In re NFU Development Trust Ltd* [1972] 1 WLR 1548 and *In re Savoy Hotel Ltd* for the proposition that the scheme and the circumstances in which it arose must involve "some element of give and take". In the former case, the judge had described the scheme in harsh terms and had commented: "Confiscation is not my idea of an arrangement". That was an extreme case, but some element of give and take was essential. That was absent in a case such as the present where the creditors were being asked to give up their rights under insurance contracts with the Company for an amount which was uncertain, would only be determined after the scheme was accepted, and might not adequately reflect the value of the liabilities which they might incur in the future; and all this in circumstances where, but for the scheme, the real value of their entitlement to rely upon the contracts of insurance was not in doubt. The scheme was one-sided in that it was designed to free the Company from its obligations under insurance contracts so that it could be wound up for the benefit of its shareholders.

[47] Finally, Mr McNeill referred to the two recent authorities in which solvent insurance companies had sought sanction for cut-off schemes in relation, in particular, to IBNR creditors. These were *Re The British Aviation Insurance Co. Ltd.* (Lewison J) and *Re Sovereign Marine & General Insurance Company Ltd.* (Warren J) to which I have already referred. It was clear from the reported decisions that both judges were concerned about the fairness of sanctioning the scheme against the opposition of dissenting creditors, particularly in light of the difficulties in putting a proper value on their claims, both for voting purposes and if calculating payments under the scheme should it go ahead, and the risk of prejudice to them arising from that. In *Re The British Aviation Insurance Co. Ltd.* sanction was refused on jurisdictional grounds, the judge finding that the creditors' meetings were not properly constituted. However, at the end of his judgement he made it clear that, even if he had had jurisdiction to do so, he would not have sanctioned the scheme. There were a number of reasons for this, including the following: (i) he thought that the votes allowed to be cast at the scheme meeting did not fairly represent the creditors with substantial IBNR claims; (ii) he considered that the estimation methodology did not provide a clear basis for treating all creditors alike and resulted in uncertainty; and, in his numbering, (iv) the supposed benefits of the scheme were largely benefits to the company and its shareholders or were brought into existence by the exigencies of the scheme itself. He concluded his judgement with this observation in para.143:

> "In the end, though, the most powerful consideration is that it seems to me to be unfair to require the manufacturers who have bought insurance policies designed to cast the risk of exposure to asbestos claims on insurers to have that risk compulsorily retransferred to them. The Company is in the risk business; and they are not. This is not a case of an insolvent company to which quite different considerations apply. On the evidence presented to me the Company is able to meet its liabilities under such policies as and when they fall due. The purpose of the scheme is to allow surplus funds to be returned to shareholders in preference to satisfying the legitimate claims of creditors. No matter how usable and reasonable an estimate may be, the very fact that it is an

> estimate is likely to make in an inaccurate forecast of the actual liabilities of policyholders. If individual policyholders wish to compound the Company's contingent liabilities to them, and to accept payment in full of an estimate of their claims, there is nothing to stop them doing so. But to compel dissentients to do so would, in the words of Bowen LJ, require them to do that which it is unreasonable to require them to do."

[48] Mr Howie, for the petitioners, emphasised that the point raised was of great importance for the market. At its most extreme, the argument for the respondents was apt to suggest that a solvent scheme did not fall within Part 26 of the 2006 Act at all. The argument for the respondents at one point appeared to be that in the absence of any financial difficulties on the part of the company there could not be a compromise or arrangement at all, since there would not be any give and take. This was plainly wrong. The scheme put forward by the Company was a scheme of arrangement, properly so-called, falling within the terms of Part 26. As a matter of ordinary English, the word "arrangement" was of wide import and should not be restricted: *Re Savoy Hotel Ltd* at p.359D-F and see also per Lord President Clyde in *Singer Manufacturing Co* v *Robinow* 1971 SC 11 at pp.13-14. It was wide enough to apply to any form of transaction affecting rights. There was no requirement in the concept of arrangement for there to have been a problem requiring a solution. The creditor need not be given some advantage compared with his prior position, though no doubt he would need a reason to vote in favour of a scheme under which no such advantage was apparent. It would be a misuse of language in a solvent cut-off scheme to describe the process of valuation of claims as "confiscation". The cases of *In re NFU Development Trust Ltd* and, on this point, *In re Savoy Hotel Ltd* were of no application here. There would, of course, be cases where IBNR creditors get more than their real entitlement, and cases where they get less. But provided there was a mechanism for a reasonable valuation, that was sufficient to categorise the scheme as an arrangement for the purposes of the Act. No equivalence was required or implied. There could be an arrangement if the company offered x for y, regardless of whether there were any underlying circumstances either to justify that offer or to make the creditor regard it as sufficient. The present scheme offered certainty. Payment was to be made straight away on the basis of an assessment of the value of the potential future claims. That was a straightforward offer which had attractions to some but not to others. But it was certainly an arrangement which could be approved by the creditors and sanctioned by the court.

[49] Mr Howie referred to the approach summarised in *Buckley*, which built upon what was said in *In re English, Scottish and Australian Chartered Bank*. Lindley LJ at p.408, quoting from the judgement of Fry LJ in *In re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 at 247, said that the court

> "must be satisfied that the proposal was at least so far fair and reasonable, as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might approve of it."

Further, the scheme proposed need not be the only fair scheme or even, in the court's view, the best

scheme. There may be reasonable differences of opinion about such matters: see e.g. *Re Telewest Communications plc (No.2)* at para.21. Thus understood, the test was a high one for an objector to surmount. If an intelligent and honest businessman acting in his own interest (not concerning himself with the interests of the class as a whole) could vote for it, the scheme should be sanctioned. Commutation of liabilities happened every day; the present scheme was simply a compulsory commutation scheme. Further, it was clear that intelligent and honest men can and do approve of solvent cut-off schemes. In an uncertain world, many creditors may prefer "jam today" rather than run the risk of a failure of their insurers at some point in the future. Mr Howie told me, on instructions, that there had been a number of solvent cut-off schemes which had been sanctioned by the court, though he accepted that none had been sanctioned after a contested hearing. Sanction had been refused in *Re The British Aviation Insurance Co. Ltd.* on jurisdictional grounds concerning the composition of the creditors' meetings. In *Re Sovereign Marine & General Insurance Company Ltd.*, however, the main opposition to the scheme was withdrawn after several hearings and sanction was eventually granted, even though there remained before the court a letter of objection from a dissentient creditor. In at least two other cases in London solvent cut-off schemes had been sanctioned despite written objections.

[50] Mr Howie submitted that the respondents' argument, if correct, would give any dissentient creditor a veto over a scheme of arrangement which might be attractive to the vast majority of creditors. Once it was established that the scheme fell within ss.895-899, that argument was not tenable. It would render the whole purpose of those sections nugatory. As was pointed out in a number of cases, the purpose of the sections is to allow things which could have been done with consent to be done in the teeth of opposition. The respondents' submission was not improved by changing "Never" to "hardly ever". That would simply mean that a solvent cut-off scheme was *prima facie* inadmissible - the answer would still always be "No", whenever there was a dissentient.

[51] To redress the balance on the merits, Mr Howie was at pains to emphasise that IBNR claims could be assessed on an actuarial basis with reasonable accuracy. Although it was accepted that the valuation given to creditors' claims would not necessarily be precisely accurate, the court should not assume that it was not possible to arrive at a reasonable and fair valuation of such claims. Nor should the court assume that if the scheme went ahead the respondents, and other creditors, would be wholly uninsured. The petitioners might have written only a small part of a line, or there might be excess of loss insurance which would have the effect of making the difference between the claimed amount and the valuation less stark.

Discussion

[52] In considering the submissions put to me, the starting point must be to consider the terms of the statute and the approach to the exercise of discretion which has been established in the case law dating back to the 19th century. The statute is silent as to whether the scheme is a solvent scheme or an

insolvent scheme. The statute applies in all cases. On an application by the company, or indeed by the creditors, the court orders that a meeting or meetings be convened. It will do so whether the scheme is a solvent or an insolvent scheme. At the meeting or meetings the matter is put to the vote. Unless a majority in number representing 75% in value of the creditors or class of creditors present and voting at the meeting either in person or by proxy agree to the scheme of arrangement, the court has no jurisdiction to sanction it. The meetings, and the voting at them, are crucial. A failure properly to identify different classes of creditors and to hold different meetings for each class will invalidate the meetings and the court will have no power on the strength of those meetings to sanction the scheme.

[53] Conversely, however, if the meetings are properly constituted and the statutory majority both in number and by value is achieved, the court may sanction the scheme. S.899 of the 2006 Act sets out no guidelines for the exercise of that discretion. The discretion is at large.
[54] The approach of the courts to the exercise of that discretion is summarised in the passage from *Buckley* which I have already quoted. The court will look to see that the provisions of the statute have been complied with. It will look to see that the class was fairly represented by those who attended the meeting and that the statutory majority are acting *bona fide* and not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent. And it will wish to be satisfied that the arrangement "is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve". Furthermore, it is accepted that there may be a number of different schemes, all of which can be categorised as fair. By parity of reasoning, opposition to a scheme might also be regarded as a fair and reasonable option. But amongst the various options, it is for the proponents of a scheme to put it forward and for the creditors to vote on it. When they have voted on it the court will be slow to differ from the decision of the majority.
[55] Mr Howie was correct to describe this as a high test for the objector to satisfy. And, subject to the qualifications which have already been identified, it is in general right that this should be so. In the typical case, as Mr McNeill submitted, the compromise or scheme of arrangement arises out of some difficulty or problem that needs to be addressed. A simple case is where the company is faced with financial difficulties. If it goes into liquidation, the creditors may get a very small dividend on their claims. If, on the other hand, they are willing to enter into a compromise or scheme of arrangement with the company, the company may get back on an even footing and they may recover more, albeit not their full claims. In such circumstances it is easy to see why the creditors must be required to act together and be bound by the majority. A dissenting minority should not be allowed to prevent a scheme coming into effect which is obviously for the benefit of the body of creditors as a whole. In such circumstances it is easy to see that the principle of "creditor democracy", as it is often called, should normally prevail. The situations in *Re Equitable Life Assurance Society* and *Re Cape plc* were more complex, but they provide other illustrations of situations where creditor democracy is needed and will normally be respected.
[56] 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, as Mr McNeill submitted, there is a problem requiring a solution;

that it is 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 must 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. 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. A solvent scheme is an instance of a case where, subject to other considerations, creditor democracy should not carry the day.

[57] In the present case, there is no reason, apart from the wishes of its shareholders, why the Company should not continue with run-off. It is solvent and appears to have made provision to meet its potential liabilities in the future. From the point of view of the shareholders, the scheme appears to be put forward so that the period of run-off can be brought to an end and the Company wound up. Unless the scheme is sanctioned, the creditors, for their part, can reasonably anticipate that as and when claims are made against them they will be able to seek an indemnity from the Company under their policies of insurance with it. If any of them wish to enter into a commutation agreement with the Company, they can do so without the participation of any of the other creditors. But if they do not wish to do so, why should they not be left in a position in which they presently find themselves? In other words, in a situation where the Company is sound financially, why should one group of creditors who might wish to enter into a commutation agreement with the Company be entitled to force other creditors to participate against their will? There may, of course, be reasons apart from financial uncertainty which might justify the majority of the creditors in attempting to coerce the minority in this way. I do not suggest that the line is necessarily to be drawn between a solvent and an insolvent scheme of arrangement, using the terms solvent and insolvent in the wider sense described in para.[43] above. But in a solvent scheme, I would expect petitioners, applying for a scheme to be sanctioned, to be able to place before the court averments and supporting material justifying the proposition that in the particular case, notwithstanding that it is a solvent scheme, the minority should be bound by the decision of the majority.

[58] The distinction between a solvent and an insolvent scheme is referred to by Lewison J in para.143 of his judgement in *Re The British Aviation Insurance Co. Ltd.*. I have quoted the relevant passage. He does not in terms to spell out the "quite different considerations" which apply to the case of an insolvent company as opposed to the case of a solvent company. He approaches the matter on the basis that in the case of a solvent company, the matters relied upon by the dissenting creditors are entitled to great weight. He emphasises that

> "If individual policyholders wish to compound the company's contingent liabilities to them, and to accept payment in full of an estimate of their claims, there is nothing to stop them doing so. But to compel dissentients to do so would ... require them to do that which it is unreasonable to require them to do."

That unreasonableness seems to me to stem from the fact that where the company is solvent it is unnecessary for the body of creditors or class of creditors to as a whole that there should be any scheme, still less a scheme forced upon unwilling participants. I respectfully agree with that reasoning.

[59] I was invited by Mr McNeill, if I were in his favour, to dismiss the petition. It is true that there are no averments in the petition of the type which I have suggested would be necessary if, despite the solvency of the Company, it is sought to be argued that the scheme should be imposed upon the objecting creditors against their will. It seems to me, however, that the better course would be to put the case out By Order to allow parties to consider their positions in light of my Opinion, and I shall do this.
[60] I should add that I was not persuaded that I should dismiss the petition on the ground that the scheme lacks the required element of give and take to which Mr McNeill referred in his submissions. The case of *In re NFU Development Trust Ltd.* was clearly an extreme case. I am satisfied that the word "arrangement" has a wide meaning and should not unnaturally be confined by judicial decision. It is possible to see the scheme in the present case, despite the solvency of the Company proposing it, as containing elements of give and take. It certainly, in my opinion, falls within the meaning of "arrangement" as used in Part 26 of the 2006 Act.

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