NEWSSTAND

Solvent Schemes of Arrangement: The Scottish Lion Mauled

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Scottish Lion Insurance Company is attempting for the second time to promote a solvent scheme of arrangement to bring its insurance business to an early close. The first attempt was abandoned in 2005 when the company was ordered by the Scottish Court to disclose to one objecting creditor a list of all its scheme creditors, whereupon the proposed scheme was withdrawn.

Earlier this year meetings of scheme creditors were convened (there was a separate meeting of IBNR creditors) to approve the second scheme put forward by the company, now under new ownership. This second scheme has been described by some as being particularly aggressive and, in spite of an apparent vote by the requisite majority in favour of this scheme at each of the creditors' meetings, it was opposed at the sanction stage by a group of US creditors. The principal grounds of objection were that the valuation of votes by the Chairman and the Independent Vote Valuer was flawed, so that in reality the requisite majority was not obtained at each meeting; that the estimation methodology was improper and, in particular, was seeking to impose an "all sums net of contribution" methodology on policyholders whereas the policies were governed by US law and under the law of some or all of the relevant states a pure all sums basis was to be applied; and finally that it was unfair for the company to seek to transfer the risk back to the policyholders by terminating the cover and paying to the policyholders a sum which might in the end not prove adequate.

Lord Glennie dismissed the petition at a Case Management Conference in October 2009, after having delivered an Opinion in September 2009 which did not purport to be final but contained two very significant rulings. On the valuation issue, he ruled that the Court was entitled to examine the valuation of votes both in favour of and against the scheme, because if the requisite majority has not in fact been obtained, there is no jurisdiction to sanction the scheme. This ruling is no surprise. There are no express rules for the conduct of meetings to approve schemes under Part 26 of the Companies Act 2006, and in particular for the acceptance and valuation of disputed claims for voting purposes, but an analogy may be found in the Insolvency Rules relating to meetings convened to approve voluntary arrangements, another case where a 75% majority in value is required. These rules expressly provide that if there is a dispute as to the validity or amount of a claim for voting purposes, the Chairman of the meeting should admit the vote but mark it as objected to and, if it is material, the Court will decide the matter, after hearing all the evidence, and is not restricted to whatever evidence might have been presented to the Chairman of the meeting at or before the time of the meeting.

In this case the basis for valuation affects both the valuation of claims for payment purposes in the scheme if it becomes effective, and also the question of whether the 75% majority in value was achieved.

On the question of fairness, Lord Glennie echoed the remarks of Mr Justice Lewison in the *British Aviation Insurance Company* (BAIC) case ([2006] 1 BCLC 665), who considered that it was unfair for insurance companies, which are in the risk business, to terminate cover and retransfer the risk back to dissenting policyholders who are not in the risk business. Lord Glennie also expressed the view that where a company is solvent, "creditor democracy" should not be allowed to prevail and a scheme could not be forced upon dissenting creditors unless there was a particular problem to be solved or the scheme had benefits for the creditors. He followed the view taken by Lewison J that what were described in the scheme document as advantages of the scheme were in reality advantages for the company, not for the scheme creditors.

Different considerations apply where a particular issue needs to be addressed, such as the guaranteed annuity rate issue in the Equitable Life case, and pools have problems of their own, which can mean that any solvent scheme will have benefits for the policyholders.

Lord Glennie in his Opinion formally left it open to the company to come back to Court to demonstrate some benefits for the creditors, whilst making it clear that in the absence of any such benefits he would not sanction the scheme. The decision is under appeal and the appeal is due to be heard on 1 to 4 December. It seems that the company considered that there was no point in taking this issue further at first instance and that it would be better to proceed straight to appeal on this issue. He has still to rule on the valuation issues. These will have to be addressed if the appeal on the general fairness issue succeeds.

This is a Scottish case, and so not binding on an English judge, although it would be persuasive and, if the appeal process goes all the way to the new Supreme Court, its judgment would be binding in England. Lord Glennie's view about creditor democracy would seem eminently appealable, as it appears to fly directly in the face of the express provisions of Part 26 of the Companies Act 2006 which provide that if a compromise or arrangement is agreed by the requisite majority, in both number and value, and the Court sanctions the scheme, it becomes binding on dissenting creditors.

That, of course, presupposes that the Court does sanction the scheme. It is accepted law that the Court will not merely rubber stamp the view of the majority, but if a scheme is one that an intelligent and honest man, acting in the interest of the group which he purports to represent, could reasonably approve, the Court would not normally withhold sanction. This all goes to the issue of fairness, which was one of Lewison J's principal objections to the BAIC scheme. In the final analysis it may boil down to whether it is fair to estimate unmatured liabilities. On this actuaries have differing views. It would not be expected that an insurance company would promote a solvent scheme to bring its insurance business to a close unless the remaining liabilities could, in the view of its actuaries, be fairly estimated. Such schemes have been approved by significant majorities of creditors in other cases, suggesting that there are many policyholders who do consider them fair. The issue on the appeal will be whether objecting creditors, who do not wish to have the risk compulsorily transferred back to them, can successfully block any solvent scheme in the absence of demonstrable advantages for the creditors or an issue that is causing problems.

The FSA's process guide for insurance schemes requires that policyholders should be no worse off under the scheme, and it is noteworthy that the FSA did not object to this scheme, preferring to leave it to the commercial judgement of the scheme creditors.

Prophets of doom are already heralding this decision as the death of solvent schemes. That view is almost certainly premature. Quite apart from the question of an appeal in this case, the pessimists said the same about BAIC in 2005, and yet the same Lewison J sanctioned a scheme drafted by the current author just two months after his BAIC judgment. Schemes which are restricted to reinsurance claims may be less exposed to this criticism. Since (re)insurer creditors are also in the risk business it is not obvious that they are unable to assess for themselves whether a scheme is fair.

Note:

Peter Fidler contributed the chapter on Schemes of Arrangement in the 2nd Edition (2004) of *Fletcher Higham and Trower on Corporate Administrations and Rescue Procedures*.