Solvent schemes of arrangement – a class act

Solvent scheme of arrangement sanctioned for Great Lakes Reinsurance (UK) PLC

The issue of "class" of creditor is the most likely ground for objection by policyholders and/or cedants to a proposed solvent scheme of arrangement and a basis on which the court may conclude that it does not have jurisdiction to sanction the scheme. The question of what is a "class" of creditor goes back to the judgment of Bowen LJ in the 1892 case of *Sovereign Life Assurance Company v. Dodd.* In that case, the court concluded that the key test for determining whether or not one class of creditor was sufficient was that the meaning of the word "class":

> "...must be confined to those persons whose rights are not so dissimilar as to make it impossible for the creditors to consult together with a view to their common interest."

This issue was considered in a number of subsequent authorities, including the Court of Appeal decision in *Re Hawk Insurance Company Limited* in 2001 where Chadwick LJ stated as follows:-

> "The relevant question at the outset is: between whom is it proposed that a compromise or arrangement is to be made? Are the rights of those who are to be affected by the scheme proposed such that the scheme can be seen as a single arrangement; or is the scheme to be regarded, on a true analysis, as a number of linked arrangements? The question may be easy to state; but, as the cases show, it is not always easy to answer".

In simple terms, the issue is whether or not a group or groups of creditors can be constituted as one class or separate classes for the purposes of voting in favour of or against the proposed scheme.

The class issue was also addressed by the English court in the seminal case of *British Aviation Insurance Company* in 2005. This was the first occasion on which an English court refused to sanction a solvent scheme of arrangement in circumstances where BAIC convened a single meeting for a single class of creditors comprising (i) creditors with paid/outstanding loss claims and (ii) creditors with IBNR claims. Lewison J. concluded that such creditors did not have the same common interest. He concluded that in the context of a solvent run-off, policyholders with unsettled paid claims are entitled to have their claims paid in full and will have exactly the same right under the proposed scheme of arrangement. However, as far as policyholders with IBNR claims are concerned, their right in a solvent run-off is to wait and see whether a claim materialises and, if it does, to have a full indemnity in respect of that claim. Under the proposed scheme they will receive cash up-front which may be an amount greater or smaller than the liabilities which might eventually materialise. Inevitably the amount they receive will not, however, be the same under the scheme, so the effect of the scheme might well be to disadvantage them.

In subsequent decisions since BAIC,[1] the English courts have reiterated the importance of the class issue and have been at pains to point out that the BAIC decision on class is not of such general application as to mean that every

1 For example, Lindsay J. in NRG Victory Reinsurance Limited (March 2006).

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solvent scheme of arrangement going forward must have separate classes for (i) paid/outstanding loss creditors and (ii) IBNR creditors. Warren J in the *Willis Faber (Underwriting Management)* case in June 2006 also made it clear that the BAIC judgment should be seen in the light of its own specific facts and was not, therefore, binding on future schemes. Warren J. in WFUM gave two specific examples where a single class of creditor might be appropriate. The second example was where the scheme company is a pure reinsurer and the scheme creditors are, therefore, cedants rather than policyholders. As the cedants are in the risk business and able to assess their risk, IBNR claims do not present the same kind of uncertainty as for direct policyholders and there is no reason to say that in such cases the cedants cannot consult together and that there must be separate creditors' meetings on the basis of two different classes.

The solvent scheme of arrangement proposed by Great Lakes (a wholly-owned UK subsidiary of Munich Re) with its scheme creditors was in respect of its treaty reinsurance book of business written between 1 January 1988 and 1 October 2004. On the basis that the scheme business was exclusively reinsurance and short tail business, Great Lakes and its advisors concluded that one class of creditor was appropriate in the context of the scheme. This decision was supported by a substantial majority of scheme creditors (some 99% by value voted in favour of the one class scheme). It was also endorsed by the English court both at the convening stage and at the sanction stage before Lewison J on 3 July 2007. Lewison J stated as follows:-

> "The only question for me is whether the Registrar was right to direct a single meeting of a single class of creditors. I have considered the cases of Re British Aviation Insurance Company Limited... and Re NRG Victory Reinsurance Limited. I am satisfied that in this case the Registrar was right to summon a single meeting.
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> First, the class of creditors concerned are reinsurers only. They are, therefore, in the risk business and they will adopt the same actuarial methods both for their own reserves and for reinsuring risks. Secondly, the insurance risks underwritten in this case are short term insurance, they are a mature market and do not suffer from the same sort of uncertainties as the long tail asbestos claims which were considered in the earlier cases. Third, this is an unopposed sanction hearing so there is, in fact, no creditor who claims that his rights differ so significantly that he ought to have been accorded his own meeting.
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> It follows, therefore, that this is a case in which it was right to summon a single meeting of all creditors. The creditors summonsed to the meeting overwhelmingly voted in favour of the scheme. As a matter of discretion, therefore, there is no doubt that I should sanction if I have power to do so. I do have such power and I therefore sanction the scheme."

The judgment represents a significant development for solvent schemes of arrangement going forward as it shows that there are circumstances in which the court will determine that a single class of creditor is the appropriate way to proceed.

Mayer, Brown, Rowe & Maw LLP advised Great Lakes on the solvent scheme of arrangement.

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