For the last decade many insolvent U.K. insurance companies have proposed “schemes of arrangement” under section 425 of the U.K. Companies Act, 1985. Section 425 provides an expeditious means by which companies organized under the laws of England may reach binding agreements with their shareholders or creditors to restructure their affairs, if the necessary majority of creditors vote in favor of the schemes and the English High Court approves them.

Solvent insurance companies have seized on section 425 as a device by which they can terminate their long-term, incurred but not yet reported (IBNR) obligations to owners of occurrence insurance policies, enabling them to release reserves previously maintained for the benefit of their policyholders to their equity holders. Although the solvent scheme documents promise payment in full of allowed claims, in practice once the schemes are approved in the U.K. the scheme proponents typically challenge the IBNR claims for lack of evidentiary support. Because the schemes deny policyholders judicial review of adverse decisions on their claims, the policyholders are without recourse if the scheme proponents reduce the claims to unacceptable levels.

The majority of occurrence policyholders affected by these schemes are U.S. entities, and to be effective the schemes require U.S. enforcement under the U.S. Bankruptcy Code, enjoining policyholders' suits against the insurers based on the contractual rights extinguished by the schemes. Enforcement of a scheme against a U.S. debtor, who may rely heavily on such insurance assets to satisfy creditors, may have serious consequences for the debtor's possibility of rehabilitation.

This article contends that, because solvent schemes are not by definition foreign proceedings under section 101(23) of the Bankruptcy Code, because solvent schemes violate the fundamental U.S. policies of sanctity of contract and due process, and because of the extreme prejudice to U.S. policyholders caused by these schemes, U.S. courts ought to refuse to recognize solvent schemes under Chapter 15 of the Bankruptcy Code. If inclined to grant recognition, the courts ought to condition recognition on substantial protection for U.S. policyholders.

Background

The Nature of Occurrence Policies and IBNR Claims. The insurance policies procured by U.S. companies from the London insurance market that are targeted by solvent insurance schemes are “occurrence” policies. Coverage under occurrence policies is triggered when certain defined events occur during the policy period, even though the actual claims may not arise until many years in the future. These policies differ from more restrictive “claims-made” policies, which only provide coverage if claims are actually asserted during the coverage period.

The purpose of occurrence-based coverage is to protect the insured against latent injury claims that may take years, or even decades, to become manifest. The policies provide unlimited prospective coverage against IBNR claims, as long as the underlying occurrence happened during the relevant policy period. Such coverage, which is not available in today's insurance market, is particularly valuable for products liability, asbestos, chemical exposure, and environmental pollution risks, because claims for exposures to such risks may arise for many years and because large numbers of claims
of varying magnitudes can and do arise very suddenly with little or no claims history. Because policyholders could not predict what liabilities they would face in the future, they historically were willing to pay substantially higher premiums to secure this type of coverage than the more restrictive claims-made policies.

Section 425 and Solvent Schemes. From time to time, insurance companies elect to stop writing certain types of coverage, and go into “run off,” meaning that the company ceases to provide the type of coverage, but it continues to remain bound by its preexisting contractual commitments under the policies it issued, and as long as claims continue to be presented and the company remains solvent, the claims will continued to be met in full. Notably, run-off does not mean the company is insolvent, merely that it declines to write new business.

Run-off of occurrence policies can take a long time to administer because claims may be presented for many years. If a company wants to expedite the process, it may offer to commute its obligations to its insureds, exchanging early payout for cancellation of the insurer's future obligation to pay claims as they arise in the ordinary course of business. Commutations are frequently based on actuarial calculations of the present value of future claims, determined in accordance with historical claims experience. An insured may be willing to accept a commutation of its policy rights if the amount of the early payout is sufficient, but only if the insurer is in a formal statutory winding up or liquidation procedure can it compel the policyholder to enter into a commutation.

A policy holder with IBNR claims might refuse to commute its policy because of the extraordinary difficulty it would face in reaching agreement with the issuer about the value of its claim. The estimation of potential future toxic tort and environmental claims is difficult at best, particularly when there is no historical claims experience. 6

To expedite the run off process and terminate their longstanding contractual commitments to their policyholders without entering into a formal insolvency or liquidation proceeding, and without paying their policyholders for the fair value of their policy rights, as they would have to do in commutation, a number of solvent U.K. insurance companies have proposed schemes of arrangement under section 425 of the Companies Act, 1985. These schemes amount to forced commutations with no judicial review.

Section 425 proceedings are markedly different from insolvency or reorganization proceedings in the U.S. and the European community, which typically involve an entity in financial distress that places its business and its assets under the jurisdiction of a court or administrator, which is then responsible for supervising the marshalling of assets, the maximization of value, and the equitable distribution of that value to creditors. 7 In contrast, section 425 does not involve judicial or administrative supervision or jurisdiction over the businesses or assets of the debtor, nor over the distribution of value to creditors. Instead, in a section 425 proceeding, the scheme proponent devises its scheme without any statutorily required input from creditors and then requests the U.K. High Court to permit it to convene a meeting at which its creditors will vote on the scheme. At that initial stage the court considers whether the scheme proponent has correctly designed the class structure. If so, the court permits the scheme proponent to send the scheme out for vote. If the creditors vote in favor of the scheme, the court holds a second hearing to consider whether the scheme should be sanctioned, considering among other issues whether the scheme is fair to creditors. If the court sanctions the scheme, the court's role is then complete. It plays no role in the subsequent adjudication of claims or the distribution of value to creditors. Absent manifest fraud, the creditors have no right of recourse to the court on any issues following scheme sanction, including no right of appeal to the judicial system from adverse claims determination.

As PricewaterhouseCoopers has stated in promotional materials directed to solvent insurers that want to extinguish their contractual asbestos liabilities without paying the costs that commutation would entail, solvent schemes are able to “deal[] with long tail liabilities emanating from North American policyholders” and to “achieve certainty, finality and the possible release of capital otherwise tied-up that could be better employed elsewhere.” 8
Common Issues of Concern Regarding Solvent Insurance Schemes

Most solvent schemes share certain common objectionable elements, a number of which appeared in the only two solvent schemes to which IBNR policyholders have objected in the U.K., the 2005 scheme proposed by BAIC and the scheme proposed in 2006 by the WFUM Pools. The BAIC and WFUM schemes illustrate the problems that solvent schemes pose.

Solvency and Cherry-Picking. Frequently the scheme proponents are solvent companies who place only some of their lines of business in the schemes, while continuing solvent run-off for other lines, or, in some cases, continuing to operate more profitable lines of business going forward. For example, at the time BAIC proposed its solvent scheme in early 2005 it had been engaged in a solvent run-off for a number of years and was paying its obligations in the ordinary course as they came due. Its scheme documents represented that it was capable of meeting its liabilities under all issued and outstanding policies in full. According to the December 2003 financial statements accompanying the scheme documents, BAIC had net assets above its liability reserves of at least 104 million (about $190 million).

Similarly, all but one of the companies included in the 2006 WFUM scheme were solvent. In the course of this argument in the U.K. proceedings that the U.K. court had jurisdiction over three non-U.K. scheme companies, WFUM's counsel repeatedly asserted, unequivocally and emphatically, that solvent schemes in general, and the solvent WFUM schemes in particular, had nothing to do with financial rehabilitation:
[S]chemes in the majority of cases are solvent and nothing to do with reconstruction or anything of that sort. They are to do with all sorts of other types of things, often to do with shareholders.

[T]he sanction of a scheme is not an intervention in the companies' affairs by the court. It is simply a necessary step in giving statutory force to a creditor's composition or agreement or re-arrangement....

[T]here is no [judicial] intervention simply by sanctioning a Scheme. But even if there were any doubt about that, we do respectfully stress that in the case of a solvent scheme such as this, it is absolutely clear that it does not meet the words “an intention to preserve or restore the financial situation.” That is plainly not what a solvent scheme of this sort is about....

There is no conceivable basis, we would respectfully submit, that on the facts of this case it could be said that the scheme has anything to do with an intention to preserve or restore the financial position. There is absolutely nothing wrong with the financial position of these companies.

[C]an your Lordship imagine that a solvent company with published accounts would enter into a proceeding that is listed insolvency proceeding....

It is just inconceivable that as a practical matter that a large profitable company is going to enter into a [Company voluntary arrangement, or CVA] even for a part of its business.

Inadequate Notice. Experience suggests that scheme proponents are not successful in providing adequate notice to their many thousands of policyholders. For example, in BAIC there were only 72 allowed votes, out of 17,500 policyholders. In WFUM, with 17 scheme companies, and 13,806 identified policyholders, only 604 scheme creditors actually voted.

Policyholders may also find it difficult to determine exactly which policies are included in the schemes, which would make it impossible to cast an accurate vote or to file an accurate claim. For example, WFUM involved a complex series
of interlocking schemes proposed by 16 original insurers (who because of name changes over the years have been known by 46 different names), who included some but not all of the occurrence policies they had issued and who employed cryptic and often illegible “stamps” as a key factor in determining whether the policies were in or out of the scheme. The last 122 pages of the 500 page scheme document represent WFUM's attempt to explain which policies were included. The document is dense, and the 247 stamps to which it refers are often illegible. Images of 12 of the stamps are missing entirely. 18

Class Issues. A creditor class under section 425 is improperly constituted where there is not a sufficient commonality of rights among the class members to enable them to decide what is in their collective best interest. 19 The solvent schemes typically propose to lump all policyholders, whether they are also reinsurers of the scheme proponent, direct insureds, affiliates of the scheme proponents, holders of liquidated claims, or holders of IBNR claims, into one voting class, regardless of their divergent rights.

For example, the BAIC scheme proposed a single voting class to include affiliates, policyholders with mature claims (including those who had reached commutation agreements with the scheme proponents), IBNR claims, and reinsurance claims. 20 Similarly, the WFUM scheme proposed a single voting class for IBNR, reinsurance, and current creditors. In both cases the courts refused to approve a single voting class. 21 In BAIC, Mr. Justice Lewison noted that the reinsurers who were also policyholders accounted for only 8% of the company's estimated scheme liabilities, their economic interests were completely different from the interests of the direct insureds, and two of the votes cast were cast by subsidiaries of BAIC's parent company. He concluded that the votes cast did not adequately represent the views of the creditors. 22

Similarly, in WFUM, after a six-day hearing, Mr. Justice Warren ruled that the scheme must be amended to provide for two classes to enable the IBNR creditors to vote separately from those creditors whose claims were actual or outstanding. 23

Questionable Vote Devaluation. In both BAIC and WFUM, the scheme proponents devalued the votes cast by certain IBNR policyholders, usually those who voted against the schemes, transforming defeat of the schemes into victory for the proponents. In BAIC, in which there was only one voting class, the 72 allowed votes were comprised of 38 insureds and 34 reinsureds. Eleven of the 38 direct insureds voted in favor of the scheme. One of the largest had no IBNR claims. Two others did not allocate their claims between accrued and IBNR claims but were allowed to vote their claims in full. All but two of the holders of IBNR claims who voted against the scheme had their claims substantially reduced for voting purposes and in six cases their claims were disallowed completely. Of the 34 reinsureds, 33 voted in favor, one against. Sixteen of the reinsureds were also reinsurers of the company, and the majority of the reinsureds had no or only modest IBNR claims. 24

Mr. Justice Lewison was skeptical about the validity of the devaluation of the IBNR claims:

[Counsel for the scheme proponents] also submitted that the valuation of an unliquidated or uncertain claim at a nominal amount [as was done by the scheme companies following the vote] is common practice in schemes of this kind.... In the context of a scheme of arrangement this practice is beneficial to a creditor because it allows his vote to be counted in assessing whether the numerical majority of creditors has been reached, even though his vote may count for little in assessing the majority of creditors by value. In many cases, this may well be true. But in the context of the present scheme it is common ground that the “big numbers” relate to IBNR claims. These “big numbers” do not seem to me to have been reflected in the amounts for which opposing creditors were admitted to vote. The company's own estimates of its liabilities include amounts allocated on account of IBNR claims. They appear to have been used in agreeing the claims of Honeywell and Viacom, who supported the scheme. If an actual claim by a disease-ridden mechanic materializes against any of the policyholders who claim to have IBNR claims, it is inconceivable that such a claim would only be worth $1.
The attribution of $1 to IBNR claims effectively means that the Company has treated the probability of an actual claim arising as being virtually nil. I have a very uneasy feeling that these IBNR claims were simply brushed aside.

... The real problem is that the votes of the policyholders with IBNR claims have to be estimated using sophisticated and controversial actuarial techniques. In such a case it seems to me that the court must be especially wary of simply waving through a vote in which so many of the dissentients have had a nominal value placed on their claims. 25

In WFUM, 10 of the 11 solvent schemes lost the vote based on the 75% by value test for the IBNR classes--the dollar vote in the solvent IBNR classes was $67 million in favor of the schemes and $158 million opposed. After the scheme proponents and the vote adjudicator “adjusted” the votes, the vote value was $50 million in favor of the solvent schemes and $3.2 million opposed. 26

The WFUM objectors sought discovery regarding the methodology used to adjust the votes and requested additional time to submit their opposition to the scheme, to permit them to incorporate the information learned through discovery in their opposition. In his decision granting additional time, Mr. Justice Warren expressed concern about how the votes were adjusted:
Following the class meetings, from the end of October to mid-March 2007, the chairman assisted by the adjudicator and PRO and their solicitors reviewed the votes. The result was a substantial change. Mr. Sheldon sets out a table at a paragraph of his skeleton argument. The percentage votes in favour are transformed into votes all of over 90 per cent in favour of the scheme, save for one company where it is 89.9 per cent. In relation to the one company where a majority in number had not been achieved, the debts of those voting against and one of the debts of those voting for the scheme seem to have been reduced to zero, leaving only one creditor who voted in favour.

These changes are startling. They cry out, to my mind, for an explanation. It may be that the explanation is that the creditors put in unreasonably high estimates and/or insufficient supporting information. On the other hand, it may be that the change results from an inadmissible methodology being applied. There is a possibility of a straightforward error, but that is not prima facie a plausible explanation across the board in this way. 27

Faulty Claim Adjudication Processes. The schemes typically require policyholders to provide substantial evidence of their claims, without which the claims will be disallowed. Policyholders with liquidated or mature claims, or even policyholders who have merely received notice of claims, are generally able to generate reliable claims estimates not readily susceptible to challenge. In contrast, policyholders with IBNR claims have little or no information with which to generate a claim other than their contractual rights to coverage up to the policy limits. Instead, they must rely on complex actuarial calculations provided by experts, which take considerable and expense time to prepare.

The schemes do not provide for judicial review of claims adjudication, nor do they typically provide for neutral claims adjudicators. Instead, the scheme proponents select, retain, and commonly pay the claims adjudicators, who are U.K. actuaries or insurance professionals and have neither legal training nor any expertise in the U.S. state laws governing the insurance contracts at issue. Policyholders can not challenge his impartiality or appeal his rulings. 28 In the vast majority of schemes both solvent and insolvent the same claims adjudicator has been selected by the scheme proponents to decide disputes between the policyholders and the scheme administrators. 29

Extraordinarily short timetables are commonly provided, including truncated claims bar dates, which do not provide IBNR policyholders with adequate time to develop values for those exposures with sound actuarial analyses. 30
The WFUM Scheme proposed an estimation methodology which would be binding on scheme creditors, who can challenge its application to their claim but not the methodology itself. The methodology applies exclusively to the IBNR claims, as it is not necessary to estimate accrued but unpaid claims nor is any methodology required to reach agreement on outstanding claims. The methodology section covers some 42 pages but ultimately fails to provide clear guidance to creditors as to how IBNR claims will be treated. On its face it demonstrates the extreme difficulty of estimating IBNR claims.

No Judicial Scrutiny of Scheme Companies' Businesses. The scheme managers typically have no obligation to report to creditors on the size of the schemes' estates, the progress of the claims adjudication, settlements or commutations reached with other policyholders or creditors, the compensation for the scheme administrators, or the disposition of estate property once all claims were paid. The policyholders, moreover, have no right to discovery to obtain any of this information.

Throughout the scheme process the scheme proponents are not constrained in any way with respect to asset transfers or the manner in which they conduct their businesses, and the courts have no jurisdiction over the scheme companies' assets and business. The WFUM scheme companies' barrister admitted in the English proceedings that WFUM's scheme is not a judicial proceeding and that the English court's sanction of the scheme does not constitute “judicial intervention”:

[T]he sanction of a scheme is not an intervention in the companies' affairs by the court. It is simply a necessary step in giving statutory force to a creditor's composition or agreement or re-arrangement, whatever the particular scheme happens to be about.

Ultimately the High Court of Justice refused to sanction the BAIC scheme on the ground that it was fundamentally unfair to the policyholders facing unknown IBNR claims:

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 it an inaccurate forecast of the actual liabilities of policyholders. If individual policyholders wish to compound the Company's contingent claims 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 that which it is unreasonable to require them to do.

In the WFUM matter, after the U.K. court supported the policyholders' objection to a single class, and issued an order calling into question the devaluation of the IBNR votes on the scheme, WFUM settled with the objectors. The WFUM scheme was sanctioned in the U.K. on September 17, 2007. At the date of this writing the hearing on approval of its Chapter 15 petition is scheduled for October 23, 2007, in the U.S. Bankruptcy Court for the Southern District of New York.

Potential Grounds for Objection to Solvent Schemes Under Chapter 15
Because so many of the policyholders are U.S. companies, and because of the explosion of tort claims in the U.S., the U.S. is the “one jurisdiction which really matters usually,” as counsel for the WFUM Solvent Scheme Companies admitted in the English WFUM proceedings. 34 The scheme proponents must obtain relief from the U.S. bankruptcy courts under Chapter 15 if the schemes are to be effective. 35 No IBNR policyholders have opposed section 425 solvent schemes in the U.S., and the U.S. courts have routinely approved the uncontested schemes, both solvent and insolvent, under section 304 and now under Chapter 15. 36

Many compelling bases for opposition to recognition of solvent schemes under Chapter 15 nonetheless exist.

Solvent Schemes Are Not “Foreign Proceedings.” Section 101(23) of the Bankruptcy Code defines “foreign proceeding” as “a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.” Solvent schemes are not foreign proceedings because: (a) they are not a collective judicial or administrative proceeding, (b) because the assets and affairs of the scheme companies are not at any time subject to control or supervision by a foreign court, and (c) because the solvent schemes do not relate to reorganization or liquidation.

Section 1501 states that its purpose “is to incorporate the Model Law on Cross-Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of,” among other things, “cooperation between... the courts and other competent authorities of foreign countries involved in cross-border insolvency cases,” “fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor;” and “facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.” 37 Although the House Report stated that “the scope of the Model Law and chapter 15 are not limited to proceedings involving only debtors who are technically insolvent,” it also observed that the scope “broadly includes all proceedings involving debtors in severe financial distress, so long as those proceedings also meet the other criteria of section 101(24).” 38 This language demonstrates unequivocally that Chapter 15 is intended to address entities in financial distress involved in insolvency cases. Solvent companies that are neither in nor anticipate financial distress, and that do not file insolvency cases, which seek Chapter 15 relief solely to terminate contractual obligations are not included.

The legislative history of Chapter 15 contains no suggestion that Congress intended for financially healthy foreign entities to use this nation's bankruptcy courts to extinguish their contractual liabilities to U.S. citizens for their own benefit and the benefit of their equity holders. Chapter 15 is thus consistent both with the purpose of the Model Law discussed supra, and with its predecessor, section 304, which constituted an explicit Congressional recognition of “the importance of the principles of international comity in transnational insolvency situations.” 39

The UNCITRAL “Guide to Enactment” of the Model Law on Cross-Border Insolvency, on which Chapter 15 is predicated, also supports the exclusion of solvent schemes from Chapter 15 protection. The Guide, in explaining the scope of the Model Law, states that a “foreign proceeding” must:

   i. have a “basis in insolvency-related law” of the foreign country;
   ii. require the “involvement of the creditors collectively;”
   iii. involve the “control or supervision of the assets and affairs of the debtor by a court or another official body;” and
   iv. have as its purpose the “reorganization or liquidation of the debtor.”

The UNCITRAL Guide explains that the term “insolvency” as used in the Model Law “refers to various types of collective proceedings against insolvent debtors,” and includes among those “proceedings aimed at reorganizing the debtor and proceedings leading to a liquidation of the debtor as a commercial entity.” 40 This includes “a variety of
collective proceedings... be they compulsory or voluntary, corporate or individual, winding-up or reorganization. It also includes those in which the debtor retains some measure of control over its assets, albeit under court supervision (e.g., suspension of payments, ‘debtor in possession’).”

Three of these four factors are missing in solvent schemes. Section 425 is not an insolvency-related law, neither a court nor any other official body has control or supervision of the assets and affairs of the debtor, and solvent schemes do not have as their purpose the financial reorganization or liquidation of the scheme proponents.

Scheme proponents may contend that these schemes nevertheless constitute “reorganizations” within the meaning of section 101(23). The reasoning set out in an analogous case, In re Petition of Rose, makes such a contention untenable. There, the representatives of U.K. insurers argued that section 101(23) and section 304 were sufficiently broad to encompass a transfer scheme under Part VII of the U.K. Financial Services and Markets Act 2000, whereby the assets and liabilities of twelve insurance companies were to be transferred to a thirteenth, all of them solvent. The Court held that the former definition of a “foreign proceeding,” read as a whole, meant a foreign bankruptcy case:

Because the term “reorganization” is not specifically defined in the Code, Mr. Rose argues that the term has only one meaning and that any type of corporate restructuring within any type of foreign proceeding falls within the parameters of Code § 304....[emphasis in original].

This court disagrees with Mr. Rose's characterization of the meaning to be ascribed to the term “reorganization.” It is true that the code does not specifically define that word. When interpreting a statute, however, the court must first look to the plain meaning of the particular statutory language at issue, as well as the language and design of the statute as a whole. Kmart Corp. v. Cartier, Inc, 486 U.S. 281, 291, 108 S.Ct. 1811, 100 L.Ed.2d 313 (1988). The meaning of a particular section in a statute should be understood in context with and by reference to the whole statute, by appreciating how sections relate to one another. In other words, the preferred meaning of a statutory provision is one that is consonant with the rest of the statute. Robinson v. Shell Oil Co., 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 809 (1997) (“The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.”). The Court must also review the statute pursuant to the reasonable interpretation “mandated by its grammatical structure.” United States v. Ron Pair Enterprises, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed. 290 (1989).

The Court observed that the Bankruptcy Code is concerned with the restructuring or liquidation of companies in financial distress:

In this instance, the court finds that Mr. Rose's attempt to isolate the words “reorganization” from the words liquidation,” “adjusting debts” and “discharge” does not reflect the statute's intent, which indicates that a "reorganization under this section should have characteristics of proceedings of the type that the adjectives immediately preceding that word have, as well as have characteristics of proceedings of the type described elsewhere in the Code, such as a Chapter 11 reorganization.

... The reorganization of a corporation in bankruptcy, however, is a different concept. As “commonly understood, [it] is distinguishable from a consolidation or a merger. It is not ordinarily the combination of existing corporations, but is simply the completion by proper agreements and legal proceedings, of a business plan or scheme for winding up the affairs of, or foreclosing mortgages upon the property of insolvent corporations, and the organization of a new corporation to take over the property and business of the distressed one.” [citation omitted].
The Court dismissed the petition:

The court understands that this is the only court with the authority to issue a United States nationwide injunction. It is unfortunate that Mr. Rose is uncertain of the effect of the UK Final Order in the United States. However when all is said and done, Mr. Rose is asking the court to do what it cannot - to enter an order allowing him to use the bankruptcy law to enjoin potential lawsuits in the United States so he can effect a corporate financial restructuring of a group of foreign insurance companies unrelated to any foreign insolvency proceeding. This court does not have the authority to enter any order, no matter what the ramifications to the Corporations, which exceeds the scope and jurisdiction of the statute that it is interpreting. 46

Rose's reasoning is equally applicable to Chapter 15 petitions for recognition of section 425 solvent schemes, in which solvent foreign insurance companies, unrelated to any foreign insolvency proceeding, attempt to invoke U.S. bankruptcy court jurisdiction to ensure the enforceability against U.S. policyholders of solvent schemes that are unrelated to foreign insolvency proceedings. Their purpose is not to ensure equitable distribution of limited assets of a debtor among its creditors, as is generally contemplated by insolvency laws, but rather to terminate unprofitable or potentially unprofitable lines of business, while continuing solvent run off of other lines, or, indeed, continuing in business in other profitable lines. As Rose held, the use of U.S. cross-border insolvency proceedings is inappropriate where the requisite connection to a foreign insolvency proceeding is absent. 47

The definition of foreign proceeding was amended in significant ways when Chapter 15 was enacted in 2005, 48 but many of the section 304 cases that analyze the criteria for a foreign proceeding remain instructive. Under section 304, courts typically focused on the critical characteristics of appropriate procedural safeguards and judicial oversight. For example, in Petition of Tam, 49 the court held that the liquidation of a Cayman Islands corporation pursuant to a “winding up” proceeding was not a foreign proceeding. Although creditors were permitted to petition the court for review of the liquidators' actions and the Cayman Registrar of Companies was required to review those actions, the liquidators essentially operated free from supervision and control of the Cayman courts. “Under the Companies Law, creditors have no right to be heard on matters relating to the conduct of the winding up and are not entitled to discovery respecting the actions undertaken by the liquidators in connection therewith. The liquidators are under no obligation to report to creditors unless the proceeding continues for more than one year.” The Court also observed that the “winding up” was conducted “without oversight from the Registrar, or any other Cayman governmental agency, instrumentality or authority. As such, the Cayman Liquidation is distinguishable from those cases involving nonjudicial liquidations in which § 304 relief, or its equivalent has been granted” and the Court held it was not a “foreign proceeding” for purposes of section 304. 50

Chapter 15 Petitions Filed by Solvent Companies for the Sole Purpose of Terminating Contractual Obligations with U.S. Policyholders Are Filed in Bad Faith. When there is a genuine foreign proceeding, one in which a court or other official body takes jurisdiction over a debtor's assets and affairs to encompass its reorganization or liquidation, Chapter 15 presumes the foreign proceeding will be recognized and affords a streamlined procedure to provide U.S. enforcement. In considering whether to recognize a foreign scheme, however, a U.S. court must still be mindful of whether the scheme is abhorrent to U.S. law and policy. Courts may consider the motives behind a Chapter 15 in deciding whether and how to grant it recognition. See, e.g., In re SPHInX, Ltd., 51 in which the court refused to recognize a Cayman Islands proceeding as a foreign main proceeding, when the sole purpose of the petition was to secure a litigation advantage in another U.S. bankruptcy case.

While insolvency is not a mandatory prerequisite to bankruptcy relief in the U.S., the courts have categorically rejected the proposition that financially healthy debtors can use the bankruptcy courts for the purpose of capping or limiting their
contractual liabilities to creditors for the sole benefit of their equity holders. “It is not the objective of the bankruptcy laws to confer windfalls on debtors.” Indeed, when a debtor is solvent... the presumption is that a bankruptcy court’s role is merely to enforce the contractual rights of the parties, and the role that equitable principles play in the allocation of competing interests is significantly reduced.

In solvent debtor cases, “rather than considering equitable principles, courts have generally confined themselves to determining and enforcing whatever pre-petition rights a given creditor has against the debtor.”

Chapter 11 petitions filed by solvent debtors to defeat their contractual obligations have often been dismissed as filed in bad faith. In *In re SGL Carbon Corp.* the court held that where the company was financially healthy, had a healthy balance sheet, had the ability to raise money and to meet its debts as they came due, had no overdue debts, had no defaults, and there was no evidence of a valid reorganizational purpose, the petition should be deemed to have been filed in bad faith, despite the possibility that the company might in the future suffer a potentially crippling judgment in a pending class action litigation. Thus, even where a solvent company bases its need for Chapter 11 protection on anticipated future obligations, the courts demand that it also demonstrate current financial difficulty to prove that its petition was filed in good faith.

Numerous other courts have similarly dismissed as “antithetical to the structure and purposes of the Bankruptcy Code” petitions that simply seek to cap claims against a solvent debtor, or to remake contracts the debtor in retrospect considers unfavorable, principally for the benefit of its equity holders. It is an “axiomatic principle of business law” that “because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business’ collapse--up to the full amount of their investment.” The *Integrated Telecom* court “emphatically reject[ed]” the idea that Integrated's attempted use of the bankruptcy court to try to force a better settlement with the claimants in the suits against it was a valid or legitimate use of bankruptcy proceedings. The court also rejected Integrated's attempt to claim as legitimate, good faith purposes for its petition its intended dissolution, intended distribution of assets, or its “purpose of obtaining a quick, efficient, and orderly winding down” of its business. After noting that neither “dissolution” nor “distribution” alone is a valid bankruptcy purpose under the Bankruptcy Code, the court held that while the Bankruptcy Code “allows for a distribution of the debtor's estate pursuant to a valid plan of reorganization or liquidation,” a distribution that “simply facilitates dissolution on terms favorable to equity interests” cannot be considered a good faith purpose sufficient to withstand dismissal of the debtor's petition.

Filing Chapter 15 petitions to enforce solvent schemes against U.S. policyholders for the purpose of terminating contract rights would constitute bad faith under the principles discussed in these cases. Indeed, the relevance of the petitioner's motive in filing a Chapter 15 was central in the court's decision not to grant recognition to a foreign proceeding as a main proceeding in the *SphinX* case. A good faith standard should be applied to Chapter 15 petitions, and should result in dismissal of solvent schemes that fail to protect IBNR policyholders.

Solvent Schemes Are Manifestly Contrary to the Public Policies of the U.S. Section 1506 authorizes U.S. courts to deny recognition to a petition if the encompassed scheme “would be manifestly contrary to the public policy of the United States.” Notably, the House Report does not include the UNCITRAL Guide's restrictive statement that relief under 1506 be granted under the provision only in “exceptional circumstances” and uses the phrase “fundamental policies” rather than “matters of fundamental importance” to delineate the provision's reach. The provision is entirely consistent with long-standing U.S. comity jurisprudence, pursuant to which comity should not be “extended to contradict the forum state's law or policy.”
The sanctity of contract rights and the obligation to provide due process before depriving contract parties of those rights are without question among the fundamental policies of the U.S. Solvent schemes, which deny U.S. policyholders of valuable contract rights without adequate consideration and without due process of law, violate these fundamental and manifest public policies.

Sanctity of contract is without any doubt a fundamental policy of the U.S. See Morta v. Korea Ins. Corp. 64 (“Despite recent cynicism sanctity of contract remains an important civilizing concept.”); University of Dist. of Columbia Faculty Ass’n/NEA v. Board of Trustees of University of Dist. of Columbia 65 (describing sanctity of contract as a “core value of American society”). Respect for the sanctity of contract renders courts unwilling to intervene to relieve a party of an improvident bargain: “[T]he general rule of freedom of contract includes the freedom to make a bad bargain.... It is a fundamental principle of contract law that [w]ise or not, a deal is a deal.” 66

Bankruptcy courts honor the sanctity of contracts. 67 As the court stated in In re Schenck Tours, Inc., 68 in denying a vendee's motion to cancel a land sales contract with a debtor on the ground of frustration or mutual mistake where the land was later found to be contaminated:

Sanctity of contract constitutes the most fundamental underpinning of commerce. The community's legitimate need for the stability of business dealings requires the enforcement of contracts according to their terms. This need finds cogent expression in a strong public policy of upholding the validity of freely negotiated contracts, even unwise ones. Courts do not generally relieve a party competent to contract from an improvident agreement in the absence of fraud, misrepresentation or bad faith. 69

Solvent schemes ask the U.S. courts to do exactly what Morta and Schenck held violated the sanctity of contract: relieve parties from their valid contractual obligations simply because they have come to believe that they entered into a bad deal.

The guarantee of procedural due process is also undeniably a manifest and fundamental policy of the U.S. 20 Foreign insolvency proceedings must comport with U.S. notions of fairness and due process. 71 In Interpool Ltd. v. Certain Freights of the M/V Venture Star, 72 the court noted that the provision of adequate procedural rights to creditors in a foreign proceeding is of “paramount importance” and that “before a § 304 Petition may be granted, this Court must be convinced that the foreign Court has or will abide by fundamental standards of procedural fairness.” Having determined that “the procedural protections available to creditors in the United States were not given to the United States creditors in Australia. This is a serious omission” and that “the laws and the public policy of the United States will be violated if the case is permitted to proceed under Australian law,” the court held that it did “not intend to stand idly by while United States[] citizens and creditors are harmed.” 73

Due process requires a fair and impartial process, including a neutral and independent decision maker. 74 Solvent schemes deny due process to IBNR policyholders in a number of ways: (a) there is no proper and adequate advance notice of the scheme; (b) the votes of many of the IBNR creditors are devalued in a secretive and self-interested process that would not be countenanced in a U.S. court (and is not countenanced in U.K. courts when policyholders object, as evidenced in BAIC and as suggested in the WFUM discovery order); (c) there is no fair, honest and open proceeding before an impartial decision maker regarding the valuation of claims; (d) there is no visibility regarding the acts and omissions of the scheme's proponents to enable policyholders to determine whether the scheme is being fairly and equally applied; (e) contrary to the requirements of the contracts, the U.S. policyholders are denied a U.S. forum and the application of U.S. law to determine the legitimacy of claims under the policies; and (f) there is no judicial review of decisions that deprive policyholders of millions of dollars of promised insurance proceeds. 75
The principal scheme representatives responsible for estimating IBNR values are not qualified, neutral, and independent decision makers. They are instead U.K. actuaries chosen by the scheme proponents in their sole discretion, and paid by the scheme companies. It is not unreasonable to expect that these persons may act in the interest of the scheme companies--either deliberately or subconsciously--if they want to continue to obtain these assignments. Certainly there is an appearance of bias when the same individual is selected in at least 27 solvent and insolvent schemes.

The inherently unfair nature of the claims process is exacerbated by the denial of judicial review of the scheme adjudicators' claims decisions. In a proceeding under the Bankruptcy Code, in contrast, while the trustee or debtor in possession is charged with the duty of examining the claims of creditors and, if necessary, disputing those claims, the final decision regarding the valuation and allowance of disputed claims always lies with the bankruptcy court and is subject to appeal to higher courts. As Judge Politan stated in *Interpool*, the courts cannot stand by while U.S. citizens and creditors are harmed by procedurally deficient schemes. The Bankruptcy Code recognizes that the right of judicial review in the claims reconciliation process is a basic right derived from fundamental U.S. policies regarding fairness and due process. A foreign proceeding that does not guarantee such fundamental due process is contrary to the public policy of the U.S. and should be denied recognition under section 1506.

Courts Should at a Minimum Condition Recognition of Solvent Schemes on the Provision of Due Process Protections for the Policyholders. Section 1522 of the Bankruptcy Code provides the court with discretion to condition relief granted to the petitioner to ensure that the interests of creditors are protected. In *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, Judge Lifland recently admonished U.S. bankruptcy courts not to rubber stamp Chapter 15 petitions. Accordingly, even in the absence of objection, the courts should scrutinize the petitions filed by solvent scheme proponents. Assuming the courts conclude that the schemes do not violate manifest U.S. policies under section 1506, and otherwise qualify for Chapter 15 relief, they should nevertheless consider whether substantial and meaningful conditions to that relief should be imposed.

Section 1522 provides explicitly that the court may grant relief under section 1519 or 1521, or may modify or terminate relief under subsection (c), only if the interests of the creditors and other interested parties, including the debtor, are sufficiently protected. This provision directs the courts to consider whether the schemes do in fact adequately protect the rights of U.S. policyholders. The court may also subject relief granted under section 1519 or 1521, or the operation of the debtor's business under section 1520(a)(3), to conditions it considers appropriate, including the giving of security or the filing of a bond. Finally, the court may, at the request of the foreign representative or an entity affected by relief granted under section 1519 or 1521, or at its own motion, modify or terminate such relief.

While no U.S. court has considered the imposition of conditions on a solvent scheme for the protection of U.S. policyholders, in 2004 a Canadian court demanded that a solvent reinsurance scheme incorporate new protections for Canadian policyholders. In *Re Cavell Insurance Co.*, although the court granted recognition to a solvent reinsurance scheme over policyholder opposition, it required the scheme adjudicator to reach a valuation of claims based on the Canadian rules applying to such valuations. It also imposed a right of judicial appeal if the scheme adjudicator failed to apply the Canadian rules, and it explicitly required the scheme administrator and the scheme adjudicator to act in good faith and to treat the Canadian policyholders fairly.

Certainly U.S. courts should be no less aggressive in protecting U.S. policyholders from solvent schemes. A wide variety of conditions to Chapter 15 relief could be imposed to achieve this end.

For example, a U.S. court could require as a condition to approval of a solvent scheme under Chapter 15 that all claims determinations of U.S. policyholders will be made by the U.S. bankruptcy court, or alternatively by a claims resolution facility, administered by persons trained in the relevant legal standards, with right of judicial review.
A court might require instead that in the event of a dispute about the value of a claim, the parties must mutually select a neutral and independent claims adjudicator with legal training, again with right of judicial review from a disputed adverse decision.

At a minimum the court should require that the law specified in the policies will control the claims determination, and the correlative requirement that persons trained in that law will make the claims decisions, rather than U.K. actuaries, coupled, again, with a right of appeal to a court of law from a disputed adverse decision.

Alternatively, a court might require that the scheme proponent establish a fund to protect the policyholders with future claims whose claims are disallowed by the scheme proponents as being insufficiently supported, in the event that the claims ripen into liquidated claims in the future.

The court might also require that the scheme include an opt out provision so that any policyholder who is aggrieved by the claims dispute resolution procedure can opt out of the scheme and would be free to pursue its remedies against the insurer in any appropriate forum in the U.S.

Some combination of these procedural protections are essential to ensure that the contract rights of U.S. policyholders--some of whom may well be debtors now or in the future--are not eviscerated by solvent insurance schemes.

Footnotes

1 Section 425 provides in pertinent part:
   (1) Where a compromise or arrangement is proposed between a company and its creditors, or any class of them, or between the company and its member, or any class of them, the court may on the application of the company or any creditor or member of it, or in the case of a company being wound up [or [in administration], of the liquidator or administrator], 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) If a majority in number representing three-fourths 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, agree to any compromise or arrangement, the compromise or arrangement, if sanctioned by the court, is binding on all creditors or the class of creditors or on the members or class of members (as the case may be), and also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.


6 This difficulty is alluded to in Mr. Justice Lewison's discussion of the alternatives to a solvent scheme in the case of the British Aviation Insurance Company, Limited (BAIC): Under the scheme, a policyholder with an accrued claim will have that claim paid in full. If the scheme is not approved, he will still have his claim paid in full. The measure of the claim will be the amount for which he is entitled to indemnity under the policy in respect of the known claim. By contrast, the position of a policyholder with an IBNR claim is different. Under
the scheme he will be entitled to have his contingent claim valued. He will then be entitled to be paid the full amount of the valuation (less a discount for the time cost of money). Although a valuation of a future (and contingent claim) can be made, and may even be described as a fair valuation, it is only a valuation. It is not an indemnity. Indeed, whatever else one may be able to say about a valuation of a future contingent claim the one thing that one can say with near certainty is that, barring a miracle, the valuation will not be the same amount as the indemnity. If, on the other hand, the scheme is not approved, the Company will remain in run-off. It will pay claims as and when they arise; and the measure of the payment will be the full indemnity to which the policyholder is entitled. It may be that anticipated claims by some policyholders will never arise; in which case the Company will not have to pay. But that is what insurance is all about. The policyholder bargains for the insurer to bear the risk of a contingency materialising. The insurer is in the risk business; and the policyholder is not.... The essence of the scheme is that it retransfers the risk from the insurer (who had contracted to bear it) to the policyholder (who did not). Thus the rights of a policyholder with an IBNR claim are fundamentally different under the scheme from the rights that he would have in the absence of the scheme.


7 See for example European Union Regulation on Insolvency Proceedings, Council regulation 1346/2000, 29 May 2000, on insolvency proceedings, 200 O.J. (L160), Article 1(1): “This Regulation shall apply to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator.” Notably, the EU regulations do not apply to proceedings relating to insurance “since they are subject to special arrangements and, to some extent, the national supervisory authorities have extremely wide-ranging powers of intervention.” Similarly, the U.S. Bankruptcy Code does not permit domestic insurance companies and foreign insurance companies doing business in the U.S. to seek liquidation under Chapter 7, see 11 U.S.C.A. § 109(b), although section 1501(1) does permit foreign insurance companies, like solvent schemes, to seek Chapter 15 relief. See 11 U.S.C.A. § 1501(c)(1).


9 It is not clear why more objections have not been posed to these schemes. Some schemes may be more egregious on their face than others. Some, while claiming to be solvent may in fact be financially distressed, so that the policyholders may be well advised to accept even a forced commutation at virtually any level. It is also possible that many policyholders take the schemes’ assurances of payment of allowed claims in full at face value, not realizing that once the scheme is sanctioned they have no judicial recourse and consequently very little if any leverage in negotiating with the scheme proponents about what their allowed claims should be. In many cases the amount of available coverage for each policyholder may not justify the exorbitant expense of mounting a challenge to the schemes.

10 In the Matter of the British Aviation Insurance Company, Limited, [2005] EWHC 1621 and [2006] 1 BCLC 665, ¶ 7, http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html and Proposal in Relation to a Solvent Scheme of Arrangement, Pursuant to Section 425 of the Companies Act of 1985, between the British Aviation Insurance Company Limited and its Scheme Creditors, January 21, 2005 (the BAIC Scheme). BAIC wrote aviation insurance and reinsurance. Over 90% of its policyholders were U.S. citizens. It stopped writing new aviation insurance in 1990 (although it continued to write other kinds of business—it only included its aviation insurance lines in the proposed scheme) and entered “run-off,” in which case the Company will remain in run-off. It will pay claims as and when they arise; and the measure of the payment will be the full indemnity to which the policyholder is entitled. It may be that anticipated claims by some policyholders will never arise; in which case the Company will not have to pay. But that is what insurance is all about. The policyholder bargains for the insurer to bear the risk of a contingency materialising. The insurer is in the risk business; and the policyholder is not.... The essence of the scheme is that it retransfers the risk from the insurer (who had contracted to bear it) to the policyholder (who did not). Thus the rights of a policyholder with an IBNR claim are fundamentally different under the scheme from the rights that he would have in the absence of the scheme.

11 See generally WFUM Pools Scheme: A Proposal in Relation to Scheme of Arrangement Pursuant to Section 425 of the Companies Act of 1985 Concerning Business Underwritten And/Or Administered By Willis Faber (Underwriting Management) Limited (“Wfum”), Devonport Underwriting Agency Limited (Dual) And Willis Faber & Dumas Limited (WF&D) On Behalf Of The Scheme Companies Referred To Below, Together With Other Liabilities Of Sovereign Marine & General Insurance Company Limited And Its Subsidiaries As Defined In Appendix A To The Scheme At Pages 275

In the Matter of the British Aviation Insurance Company, Limited, [2005] EWHC 1621 and [2006] 1 BCLC 665p. 5, http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html; WFUM Scheme at 15-16, https://www.wfumpools.com/wfumdc/WFUMPoolsSchemeDocument.pdf. It is conceivable, of course, that a scheme could be proposed by an insurance company that purports to be solvent but which is truly in financial distress. In that case, as suggested in n. 7 supra, policyholders may well be advised to accept the forced commutation of their contracts.

BAIC Scheme p. 11.

4th May 2006 Transcript, at p. 660; 664-66; 668, In the Matters of Sovereign Marine & General Insurance Company Limited and Others, High Court of Justice, Chancery Division, Companies Court (Warren, J.) [Unreported].


In the Matter of the British Aviation Insurance Company Limited, [2005] EWHC 1621 (Ch). and [2006] 1 BCLC 665, pp 22-26, http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html. As Mr. Justice Lewison noted in the BAIC case, reinsurers “have vested interests in commuting their reinsurance obligations to the Company, because such commutations typically cap the exposure that they would otherwise have under their treaties and facultative reinsurance certificates if the Company were to continue to run-off its long-tail claims in the normal course. They have a vested interest in ascribing a low or nil value to future claims because this limits their exposure as reinsurers.... Unlike the direct insureds, the reinsurers are in the risk business. Given the uncertainties of the extent of potential exposure to asbestos and other long-tail claims, it makes perfect sense for them to be keen to cap their liabilities. If the Company's liabilities are capped, so are their liabilities as reinsurers. Their mutual liabilities are to be set off under the scheme. This does not apply to the direct insureds, who remain liable to those who contract asbestos diseases.” In the Matter of the British Aviation Insurance Company Limited, [2005] EWHC 1621 and [2006] 1 BCLC 665, ¶ 120-121 http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html.

In BAIC the objecting policyholders did not object at the stage of the initial convening hearing, but the Court permitted them to raise the class arguments at the sanction hearing. In the Matter of the British Aviation Insurance Company Limited, [2005] EWHC 1621 and [2006] 1 BCLC 665, http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html.

In the Matters of Sovereign Marine & General Insurance Company Limited and Others, High Court of Justice, Chancery Division, Companies Court, [2006] EWHC 1335 and [2007] 1 BCLC 228. Neither Mr. Justice Lewison nor Mr. Justice Warren accepted the objectors' argument that reinsurers who were also policyholders and affiliates should not be included in the IBNR class.


BAIC Scheme, 5.2.14: “Insofar as the law allows, any determination of the Scheme Adjudicator on any matter referred to him or under this Part 5 generally shall be final and binding on the Company and the relevant Scheme Creditor and there shall be no right to appeal form such decision. Neither the Company, the Scheme Manager or any Scheme Creditor shall have any right to make any claim or bring any Proceeding against the Scheme Adjudicator in any capacity in respect of any decision or determination in relation to any Scheme Liability or any matter upon which the Scheme Adjudicator has made a determination.”

WFUM Scheme § 6.4.9: “So far as the law permits, a Scheme Adjudicator's and the Actuarial Adjudicator's determination in respect of the matter referred to him shall, in the absence of Manifest Error, be final and binding on the Scheme Company and the relevant Scheme Creditor and subject to the provision of clause 6.6 there shall be no right of appeal or review therefrom or to make any claim in respect thereof.”

The Scheme Adjudicator proposed in both WFUM and BAIC , BAIC Scheme 5.1.2, 5.1.5; WFUM Scheme § 2.4, https://www.wfumpools.com/wfumdc/WFUMPoolsSchemeDocument.pdf, also served as Scheme Adjudicator for at least 27 other solvent and insolvent schemes. See curriculum vitae of Peter Matthews, included in the WFUM scheme documentation at https://www.wfumpools.com/wfumdc/SchemeDocumentation.aspx. In both BAIC and WFUM it was proposed that he would decide, in his sole discretion, whether the schemes or the creditor must pay his costs and expenses. BAIC Scheme 5.2.8.; WFUM Scheme § 6.5 at p. 191. In neither case was his compensation or his decision that a creditor pay his costs subject to judicial review.

Mr. Matthews' personal integrity is not in question. The problems with his repeated selection by the scheme proponents as scheme adjudicator are: (a) the appearance of bias that arises because of his frequent retention by scheme proponents, (b) his lack of training in applicable U.S. law, and (c) the policyholders' lack of voice in the selection of the person who will adjudicate their claims.

Mr. Justice Lewison indicated that had he approved the BAIC scheme, he would have directed that the bar date would be one year after the scheme became operative, not 120 days as the scheme proposed. In the Matter of the British Aviation Insurance Company Limited, [2005] EWHC 1621 and [2006] 1 BCLC 665 ¶ 127, http://www.bailii.org/ew/cases/EWHC/Ch/2005/1621.html. The bar date in the WFUM Scheme is 180 days after the scheme's effective date. WFUM Scheme p. 126, https://www.wfumpools.com/wfumdc/WFUMPoolsSchemeDocument.pdf.


4th May 2006 Transcript, at p. 664, In the Matters of Sovereign Marine & General Insurance Company Limited and Others, High Court of Justice, Chancery Division, Companies Court (Warren, J).


4th May 2006 Transcript, at p. 34, and see p. 75, p. 342, In the Matters of Sovereign Marine & General Insurance Company Limited and Others, High Court of Justice, Chancery Division, Companies Court (Warren, J.).
Schemes typically provide that they will not be effective until after the U.S. bankruptcy court has granted relief. See, e.g., WFUM Scheme p.2, https://www.wfumpools.com/wfumdc/WFUMP#oolsS#hemeD#ocument.pdf, providing that the effective date of the scheme will occur after the hearing on the Chapter 15 petition in the U.S.

In re Board of Directors of Hopewell Intern. Ins. Ltd., 238 B.R. 25, 34 Bankr. Ct. Dec. (CRR) 1273 (Bankr. S.D. N.Y. 1999), order aff’d, 275 B.R. 699, 48 Collier Bankr. Cas. 2d (MB) 362 (S.D. N.Y. 2002), was the first, and one of the few proceedings brought under section 304 or Chapter 15, involving a “solvent scheme” by foreign insurers. It was a “cut-off” scheme of arrangement under Bermuda law and did not involve section 425 of the Companies Act. Although the court regarded Hopewell as technically solvent, some evidence rendered questionable its continuing solvency, and many of its retrocessionaires which insured a significant percentage of its exposures had already stopped performing and were in crisis, which the court held to be “no small consideration” with regard to the future rights of creditors (Hopewell, 238 B.R. at 35). In addition, the court, citing Petition of Tam, 170 B.R. 838, 25 Bankr. Ct. Dec. (CRR) 1635 (Bankr. S.D. N.Y. 1994), and Petition of Ward, 201 B.R. 35, 3617 (Bankr. S.D. N.Y. 1996), corrected, (Oct. 10, 1996), took a searching look at “the amount of judicial involvement and supervision, or, conversely, the degree of access to the court available at various stages to creditors so that they may voice any objections they may have” (Hopewell, 238 B.R. at 50), and based its determination to recognize the Bermuda scheme on the availability of many important procedural protections that are notably absent from the BAIC scheme. The Hopewell scheme included multiple opportunities for pre- and postsanction redress in the courts regarding such matters as replacement of the liquidators, determination of claims, valuation and compensation, preferential treatment of insiders, and the ability of creditors to terminate the proceedings. These factors distinguish Hopewell from the section 425 solvent schemes, in which there is no court involvement or supervision of the company, nor any right of access to the courts for aggrieved creditors.


See S. Rep. No. 989, 95th Cong., 2d Sess. 35, reprinted in 1978 U.S.C.C.A.N. 5787, 5821, explaining section 304 and discussed in In re Maxwell Communication Corp. plc by Homan, 93 F.3d 1036, 1048, 29 Bankr. Ct. Dec. (CRR) 788 (2d Cir. 1996). See also H.R. Rep. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977) p. 324 (“this section governs cases filed in the bankruptcy courts that are ancillary to foreign proceedings. That is, where a foreign bankruptcy case is pending concerning a particular debtor and that debtor has assets in this country, the foreign representative may file a petition under this section”). See also In re Treco, 240 F.3d 148, 156, 37 Bankr. Ct. Dec. (CRR) 125 (2d Cir. 2001) (“§ 304 addresses situations in which a bankruptcy proceeding has been instituted in a foreign country and the debtor has assets in the United States.”).


Even if true, that would not suffice because, as discussed above, solvent schemes are not judicial proceedings and the scheme companies' assets are not subject to judicial control.


One other U.S. court has been asked to pass on a Part VII scheme, in which, like Rose, the assets of several solvent U.K. insurers were to be transferred to another U.K. insurer. In re petition of Catherine Geraldine Regan, as Foreign Representative of Riverstone Insurance (UK) Limited, Case. No 05-12678 (RDD). Objections to the recognition of the scheme were resolved before the final hearing. Because the parties had reached agreement, the court agreed to sign the order granting the section 304 petition. Recognizing the serious legal grounds for dispute about the validity of this outcome, however, the court expressly required that the order provide that it “shall have no precedential value in any other case or controversy either in this Court or in any other Court.”
If a solvent scheme is not a “foreign proceeding,” the scheme proponents by definition cannot be “foreign representatives” under section 101(24) of the Bankruptcy Code.

Before the amendment, section 101(23) provided that a foreign proceeding “means proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, or discharge, or effecting a reorganization.”


Cf. In re Netia Holdings S.A., 277 B.R. 571 (Bankr. S.D. N.Y. 2002), which declined to extend the Master Home Furniture decision to a Polish proceeding, holding that there was sufficient judicial oversight by the Polish court prior to the court's determination of whether an Arrangement Proceeding should be opened to constitute a “foreign proceeding.” In re Netia Holdings S.A., 277 B.R. at 585 (“This Court agrees with Netia that given creditors' ability to be heard and the Polish Court's substantial involvement--including conducting hearings and examining witnesses--in the Arrangement Proceeding currently underway in Poland, the Arrangement Proceeding allows for, and has already involved, considerably more involvement on the part of the court and creditors than the Taiwanese proceeding in Master Home.”).

Netia does not, however, mean that solvent schemes must be recognized. It was decided before the 2005 revisions to the Bankruptcy Code, when section 304 did not require control or supervision of the debtor's assets by the foreign court. Now, in contrast, Chapter 15 explicitly requires such court supervision in the definition of a “foreign proceeding.” 11 U.S.C.A. § 101(23). In addition, the concern expressed in Netia about a “run at a debtor's assets” or the “piecemeal distribution of a debtor's estate” do not apply when the scheme company is highly solvent and well able to satisfy its obligations as they come due.


Matter of Chicago, Milwaukee, St. Paul and Pacific R. Co., 791 F.2d 524, 527 (7th Cir. 1986). See also Ruskin v. Griffiths, 269 F.2d 827, 832 (2d Cir. 1959) (holding that it would be “the opposite of equity” to allow a solvent debtor to escape its contractual obligations); Esopus Creek Value LP v. Hauf, 913 A.2d 593, 603 (Del. Ch. 2006), judgment entered, 2006 WL 4782263 (Del. Ch. 2006) (“It therefore seems an abuse of the bankruptcy process for a robust and healthy company, encumbered by virtually no debt, to seek out the vast and extraordinary relief a bankruptcy court is capable of providing.... Truly, '[c]hapter 11 was designed to give those teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade' other contractual and state law obligations.”); In re 139-141 Owners Corp., 313 B.R. 364, 369, 43 Bankr. Ct. Dec. (CRR) 146 (S.D. N.Y. 2004).


In re Integrated Telecom Express, Inc., 384 F.3d 108, 112, 43 Bankr. Ct. Dec. (CRR) 175, Bankr. L. Rep. (CCH) P 80168 (3d Cir. 2004), cert. denied, 545 U.S. 1110, 125 S. Ct. 2542, 162 L. Ed. 2d 286 (2005) (“[A] Chapter 11 petition filed by a financially healthy debtor, with no intention of reorganizing or liquidating as a going concern, with no reasonable expectation that Chapter 11 proceedings will maximize the value of the debtor's estate for creditors, and solely to take advantage of a provision in the Bankruptcy Code that limits claims on long-term leases,” was filed in bad faith”; good faith necessarily requires some degree of financial distress on the part of the debtor).


JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V., 412 F.3d 418, 423, 44 Bankr. Ct. Dec. (CRR) 254, Bankr. L. Rep. (CCH) P 80309 (2d Cir. 2005). See also In re Treco, 240 F.3d 148, 157, 37 Bankr. Ct. Dec. (CRR) 125 (2d Cir. 2001), (“The principle of comity has never meant categorical deference to foreign proceedings. It is implicit in the concept that deference should be withheld where appropriate to avoid the violation of the laws, public policies, or rights of the citizens of the United States.”); Pravin Banker Associates, Ltd. v. Banco Popular Del Peru, 109 F.3d 850 , 854 (2d Cir. 1997) (comity should not be extended “when doing so would be contrary to the policies or prejudicial to the interests of the United States”). The U.K., which is also a UNCITRAL signatory, applies similar principles in considering whether to give effect to U.S. bankruptcy orders. See e.g. Re T&N Ltd and other companies, [2004] EWHC 2361 (ch): “Comity, as a means of achieving cooperation between different jurisdictions in cross-border insolvency cases, is of great importance. It is a highly relevant factor in the exercise by the court of discretionary powers. It does not, however, enable the court to alter or dispense with mandatory
provisions of the law which it administers. This is the case even in an ancillary winding up in England of a foreign-registered company. Further, if the position were reached that the English Court considered that CVAs or schemes of arrangement designed to implement the Plan were unfair and would thus not be sanctioned or allowed to stand, it is very difficult to see that the Court would nonetheless give effect to it as a matter of comity, always assuming that it had the jurisdiction to do so.”

Morta v. Korea Ins. Corp., 840 F.2d 1452, 1460 (9th Cir. 1988) (citing Charles Fried, Contract as Promise 1, 132 (1981).)


Morta v. Korea Ins. Corp., 840 F.2d 1452 (9th Cir. 1988) (internal quotations and citations omitted); see also In re Schenck Tours, Inc., 69 B.R. 906, 913 (Bankr. E.D. N.Y. 1987), order aff'd, 75 B.R. 249 (E.D. N.Y. 1987) (stating that “a party should not be excused from what may have become a hard bargain.... Equity does not relieve from hard bargains merely because they are such.... A party may not abrogate a contract just because it might be commercially disadvantageous to perform it. If such abrogation would be permitted, all commercial contracts would be placed in dire jeopardy.”) See also In re Treco, 240 F.3d 148, 160, 37 Bankr. Ct. Dec. (CRR) 125 (2d Cir. 2001), in which the Court of Appeals for the Second Circuit held that because security interests are recognized as property rights under the Fifth Amendment, the failure of Bahamian law to protect the security interests of U.S. citizens in a Bahamian procedure required the U.S. court to deny recognition to the Bahamian procedure. Contract rights are of course included in the kind of property rights to which courts afford constitutional protection against governmental taking. Lynch v. U.S., 292 U.S. 571, 54 S. Ct. 840, 78 L. Ed. 1434 (1934); Ganci v. New York City Transit Authority, 420 F. Supp. 2d 190 (S.D. N.Y. 2005), judgment aff'd, 163 Fed. Appx. 7 (2d Cir. 2005). The Supreme Court's recent decision in Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co., 127 S. Ct. 1199, 167 L. Ed. 2d 178, 47 Bankr. Ct. Dec. (CRR) 265, 57 Collier Bankr. Cas. 2d (MB) 314, Bankr. L. Rep. (CCH) P 80880 (U.S. 2007), supports this point, in its holding that creditors' rights in bankruptcy are generally governed by their contracts with the debtors as interpreted by applicable state law.

While it is certainly true that debtors are able to reject executory contracts under section 365 of the Bankruptcy Code (11 U.S.C.A. § 365), if they are solvent they must pay rejection damage claims in full before delivering value to their equity holders.


See, e.g., Joint Anti-Fascist Refugee Committee v. McGrath, 341 U.S. 123, 171-172, 71 S. Ct. 624, 95 L. Ed. 817 (1951) (Frankfurter, J., concurring).

Drexel Burnham Lambert Group Inc. v. Galadari, 777 F.2d 877 (2d Cir. 1985).


Drexel Burnham Lambert Group, Inc. v. Galadari, 127 B.R. 87, 100 (S.D. N.Y. 1991) (refusing to grant comity to a foreign bankruptcy proceeding because the proceeding did not comply with fundamental fairness and due process under U.S. law when the foreign entity ruling on creditors' claims was not impartial). See also Hooters of America, Inc. v. Phillips, 173 F.3d 933, 938-40, 79 Fair Empl. Prac. Cas. (BNA) 629, 75 Empl. Prac. Dec. (CCH) P 45822 (4th Cir. 1999) (court refused to compel arbitration when the employer's arbitration rules-- which among other things allowed the employer to control selection of the arbitration panel--were biased and one-sided); Hudson v. Chicago Teachers Union Local No. 1, 743 F.2d 1187, 1195, 20 Ed. Law Rep. 56, 117 L.R.R.M. (BNA) 2314 (7th Cir. 1984), judgment aff'd, 475 U.S. 292, 106 S. Ct. 1066, 89 L. Ed. 2d 232, 30 Ed. Law Rep. 649, 121 L.R.R.M. (BNA) 2793 (1986) (finding that the union's grievance procedure was constitutionally inadequate when there was no independent arbitrator because the arbitrator was paid by the union and had a financial incentive to decide cases favorably to the union).


See Drexel Burnham Lambert Group, Inc. v. Galardi, 127 B.R. 87, 100 (S.D. N.Y. 1991) (denying comity under section 304 to foreign proceeding because, among other things, the foreign proceeding failed to afford a U.S. creditor procedural due process when the committee overseeing the proceeding acted as both trustee and judge with respect to the determination of claims); cf. Pravin Banker Associates, Ltd. v. Banco Popular del Peru, 165 B.R. 379, 386 (S.D. N.Y. 1994) (holding that Peruvian bank liquidation procedures comported with U.S. notions of due process when, among other things, the liquidation procedures included the right to appeal claims determinations to Peruvian courts and the trustees overseeing the case were “suitably independent”).


The case and its implications are discussed by Goodmans LLP at http://www.goodmans.ca/pdfs/crossbordersurisdiction.pdf.

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