Solvent Insurance Schemes Should Not Be Recognized [Reprised]

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In December 2007 this journal published an article titled “Why U.S. Courts Should Deny or Severely Condition Recognition to Schemes of Arrangement for Solvent Insurance Companies,” which discussed the tsunami wave of solvent insurance schemes coming from the UK and seeking enforcement under Chapter 15. The article pointed out how grossly inequitable these solvent schemes are to U.S. holders of “occurrence” insurance policies who face “incurred but not reported” (IBNR) long-tail tort liability in potentially enormous amounts. It argued that the schemes did not qualify for protection under Chapter 15 because (a) the UK proceedings involving solvent insurance companies do not fall within the definition of a “foreign proceeding” in 11 U.S.C.A. § 101(23), and (b) the schemes violate fundamental U.S. policies, including the bedrock policy that commercial contracts ordinarily should be enforced according to their terms, and the equally important policy of not allowing solvent companies to misuse the bankruptcy process to shed wholesale their executory contracts. In the alternative, if U.S. courts are inclined to continue to recognize these schemes despite their incompatibility with Chapter 15 and fundamental U.S. law, the article contended that U.S. courts should provide important procedural protections to U.S. policyholders.

In August 2008 this journal published a reply by proponents of solvent insurance schemes that attempted to justify the extension of Chapter 15 protection to those arrangements (the “Scheme Proponents’ Reply”). We disagree with the positions taken by the Scheme Proponents in their Reply, which we believe do not respond to the material points made in the original article.

When Statutory Language Is Clear and Unambiguous on Its Face, Resort to Legislative History and Other Extraneous Material Is Inappropriate

The Scheme Proponents open their discussion with a reference to certain private communications that the authors apparently had with Daniel Glosband, one of the drafters of Chapter 15, in which they seemingly agreed between them, without notice to any other interested party, that Chapter 15 would cover solvent UK insurance schemes. According to the Scheme Proponents, Mr. Glosband’s view may also have been communicated to various members of the Congressional subcommittees responsible for the drafting of Chapter 15. These communications are not part of the public record or the legislative history and, in any event, can have no bearing on how courts interpret the statute. As the Supreme Court has consistently held in the context of interpreting the Bankruptcy Code, if the statutory language is clear and unambiguous and does not lead to an absurd result, reference to materials outside the text of the statutory provisions is wholly inappropriate. Even in the rare case in which a court would have recourse to extrinsic materials as an aid to interpretation, Mr. Glosband’s letters would not be considered. Courts do not accept the views of an individual drafter (let alone someone who was not a member of Congress) as an expression of the intent of the legislative body that enacted the law. Certainly nonpublic, pre-enactment correspondence between one of the persons who worked on the statute and private lawyers seeking to position their clients for future litigation can have no bearing on how courts read and interpret the resulting statutory provisions.
The Definition of Foreign Proceeding Does Not Include Solvent Insurance Schemes

As the Solvent Schemes Article demonstrated, the definition of “foreign proceeding” does not encompass solvent schemes under UK law. UK solvent insurance schemes do not invoke a foreign law related to insolvency or adjustment of debt, the assets and affairs of the scheme company are not subject to control or supervision by the foreign court, and the solvent scheme companies are not engaging in the kind of reorganization or liquidation contemplated by the U.S. Bankruptcy Code.

Bankruptcy Code sections 109(b) and 1501(c)(1) are irrelevant to the question of whether foreign solvent insurance schemes are “foreign proceedings” within the meaning of section 101(23). There is no dispute that under section 109(b) and 1501(c)(1), foreign insurance companies are entitled to file for Chapter 15 protection provided that they otherwise comply with the relevant and applicable provisions of the Bankruptcy Code. However, those sections do not override the definition of foreign proceeding in section 101(23). When, as discussed above, a particular foreign restructuring involving a foreign insurance company does not fit within the definition, as the solvent insurance schemes do not, section 1501(c)(1)'s inclusion of foreign insurance companies within the intended ambit of Chapter 15 does not change that result.

Hopewell Does Not Mandate Recognition of UK Solvent Insurance Schemes

The Scheme Proponents place great emphasis on the Hopewell case. Hopewell was the first, and one of the few proceedings brought under Code section 304, to involve a foreign solvent insurance scheme. The differences between the Hopewell scheme and the UK solvent insurance schemes, however, are numerous.

First, and fundamentally, the Hopewell scheme was a “cut-off” scheme of arrangement under Bermuda law and did not involve the UK Companies Act. Moreover, the Hopewell court 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.” Its recognition of the Bermuda scheme was premised in large part on the availability of many important procedural protections that are notably absent from the UK solvent insurance schemes. For example, the Hopewell scheme included multiple opportunities for presanction 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. In stark contrast, the solvent insurance schemes provide for no ongoing court supervision of the schemed company, nor any right of access to the courts for creditors aggrieved by the nontransparent claims adjudication process, nor any scrutiny of preferential transfers, nor any ability of creditors to terminate the proceedings. Unlike the Hopewell scheme, the solvent insurance schemes leave the policyholders completely at the mercy of the scheme proponents and their hand-picked nonlawyer “adjudicators” following sanction.

Of particular importance in this regard is the means by which disputed claims were resolved under the Hopewell scheme: claimants with unliquidated or disputed claims, like the IBNR claims discussed in the Solvent Scheme article, were sent to binding arbitration under Bermuda law, pursuant to which the arbitrators were party-appointed. The solvent schemes do not provide for arbitration of claims disputes, much less arbitration by party-selected arbitrators. Instead, the scheme proponents usually select the people who will adjudicate claims disputes, and in most schemes, the policyholders generally have no say in who the adjudicator will be.

The Hopewell court found that the vote on the scheme was unanimous and that the objectors to the section 304 proceeding, after voting in favor of the scheme in Bermuda, had changed their minds and filed their objections to the section 304 proceeding only after the law changed adversely to their interests. Even with the massive vote-
rigging adjustments that were made by the scheme proponents in BAIC and WFUM, those schemes were not supported unanimously by the policyholders.\textsuperscript{16}

The \textit{Hopewell} scheme provided for two classes of creditors, those with liquidated matured claims and those with contingent, unliquidated and/or disputed claims. The creditors with liquidated claims, Class A, were to be paid immediately in full; and the creditors with claims that had not yet matured, Class B, were to be paid only upon maturation of their claims. In contrast, the UK solvent insurance schemes have until recently provided for only one class.\textsuperscript{17} Moreover, none of them have permitted the IBNR claims to be paid upon maturation. Instead, they have all required the IBNR claimants to rapidly accelerate the valuation of their claims pursuant to estimation procedures rigidly controlled by the scheme managers.

The \textit{Hopewell} scheme also provided a four year period of time between notice to creditors and the bar date to enable creditors with unliquidated claims to value and perfect them. In contrast, even though the long tail IBNR claims of U.S. policyholders are far more difficult to calculate than the unmatured claims typical in the \textit{Hopewell} case, the UK solvent insurance schemes provide very truncated bar dates. BAIC’s proposed bar date was only 120 days after sanction of the scheme. WFUM’s was 180 days.\textsuperscript{18} Even if it were theoretically possible to accelerate the valuation of IBNR claims that by definition represent unknown exposures covered by the schemed policies, these truncated bar-date periods are grossly insufficient to enable policyholders to retain actuaries, gather and assimilate data, and perform the sophisticated quantitative modeling that would be necessary to value such contingent exposures properly.

As noted in the Solvent Schemes Article,\textsuperscript{19} although the court regarded Hopewell as technically solvent, some evidence rendered questionable its continuing solvency, and many of the 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.\textsuperscript{20} These facts are in sharp contrast to the admitted and comfortable solvency of most of the UK solvent insurance schemes.

For all of these reasons, \textit{Hopewell} provides no support for approval of UK solvent insurance schemes.

\textbf{Sanction of the Solvent Schemes in the UK Does Not Preclude U.S. Bankruptcy Court Consideration of Appropriate Objections}

Contrary to the Scheme Proponents’ contention, the U.S. bankruptcy courts should not rubber stamp UK solvent insurance schemes merely because they were sanctioned in the UK. The issues raised by the potential objections outlined in the Solvent Scheme article are substantially different from the kind of issues determined by the sanction of a scheme in the UK, and UK sanction of a scheme does not preclude a successful challenge under the different legal standards of Chapter 15. A scheme may arguably merit sanction under the very modest requirements of UK law\textsuperscript{21} yet fail to satisfy the separate and independent requirements of sections 101(23) and 1506. The UK courts’ factual determinations and legal holdings do not address these considerations or the different statutory standards that underlie them. Sanction of a UK solvent insurance scheme thus cannot have collateral estoppel effect on challenges to recognition of such a scheme under Chapter 15.\textsuperscript{22} Moreover, the unopposed orders approving solvent schemes under section 304 and Chapter 15 are not binding precedent in subsequent contested Chapter 15 cases.\textsuperscript{23}

The Scheme Proponents note that on the two occasions when policyholders have had a chance to litigate their objections to solvent schemes in the UK, the High Court has responded responsibly and fairly, given the statute and precedent that it had to work with. However, there are literally dozens of solvent insurance schemes in which no policyholder has participated in the expensive process of pursuing objections in the English court. Some of these schemes, despite their claim to be solvent, are actually close to insolvency but are reluctant to label themselves that way. Some, like \textit{La
Mutuelle Mans d'Assurances, 24 and NRG 25 primarily involved reinsurance and thus had few, if any, American IBNR policyholders. In still other cases, it is possible that the policyholders either did not receive adequate notice of the scheme or did not fully understand the consequences of the scheme. The extraordinary low number of votes in both BAIC and WFUM suggest, as noted in the Solvent Scheme article, that the scheme proponents do not succeed in giving what would be considered adequate notice to the policyholders about the schemes under U.S. constitutional standards. 26

It is, moreover, expensive for creditors to object to solvent schemes. Experiences in the BAIC and WFUM schemes demonstrate that: (a) any effort to oppose a scheme will be met with fierce resistance by the scheme proponents, represented by sophisticated UK law firms; (b) the resulting litigation will be intensive, lengthy, and quite expensive; and (c) scheme opponents face the risk of English “fee shifting” at many stages in the proceeding should they fail to prevail on particular contested issues. Given these costs and risks, in many cases individual policyholders conclude that they do not have sufficient amounts of coverage at stake to justify a formal opposition in the UK courts. While the aggregate amount of coverage placed at risk by all the solvent schemes is immense, the amount of coverage at stake for a single policyholder in a single scheme may be quite modest. It is likely the result of the above factors that so few objections are filed to the schemes, and it is hard to believe that U.S. courts would be comfortable that the process is fair when policyholder participation is so low.

Finally, U.S. courts should not relax their obligation to ensure that any solvent insurance scheme meets U.S. legal requirements; careful scrutiny of a scheme to this end is entirely consistent with comity, as the UK courts have themselves demonstrated. For example, in In Re T&N Ltd. and other companies, 27 the UK administrators of Turner & Newall, a UK subsidiary of Federal Mogul, asked the UK High Court for direction in connection with a Chapter 11 plan proposed by Federal Mogul that would have required the T&N administrators to file a scheme of arrangement in the UK court that in their view would violate UK law in material and substantial ways. The UK court observed:

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: see In re Bank of Credit and Commerce International (no 10) [1977] Ch 213, [1996] 4 All. ER 796. 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.

Nothing in Chapter 15 requires a U.S. court to ignore fundamental principals of U.S. law in considering recognition of a foreign scheme or in considering whether the rights of U.S. citizens are protected in such schemes--indeed, Chapter 15 requires the opposite. Moreover, as the UK court observed in T&N, comity does not require a court to ignore its own laws in considering whether to give effect to an order of another country, and Chapter 15 does not change this fundamental concept. Thus sanction of solvent insurance schemes under UK law does not mean that U.S. courts should recognize those schemes without regard to U.S. law.

U.S. Bankruptcy Courts Have an Obligation to Ensure that Schemes Comply with Fundamental Issues of Public Policy

There is no dispute that the purpose of Chapter 15 is to facilitate the U.S. courts' ability to provide appropriate assistance to foreign courts and foreign representatives. This general intent, however, does not override the U.S. bankruptcy court's obligation to ensure that the foreign proceeding does not violate fundamental issues of public policy and to ensure that U.S. creditors' rights are protected.
Treatement of Executory Contracts in Chapter 11 Is Wholly Unlike Treatment of Policies in Solvent Schemes

The Scheme Proponents do not argue that protection of commercial contract rights are not of fundamental concern in U.S. law. They merely contend that because contractual rights may be modified in U.S. bankruptcy cases, U.S. bankruptcy courts should be comfortable with the havoc that solvent schemes wreak on policyholders' rights under “occurrence” policies, which were specifically marketed by London Market insurers for decades as providing unlimited, “evergreen” protection to U.S. policyholders for all manner of liabilities resulting from injurious events happening during the policy periods. Apart, however, from limited statutory restrictions on certain contract damages, bankruptcy courts lack jurisdiction or authority to modify contract terms absent consent of the nondebtor party. U.S. bankruptcy courts certainly do not have the authority to abrogate acknowledged contract rights of individual insureds in the manner contemplated by the UK solvent insurance schemes.

There are only four options with regard to contacts under U.S. bankruptcy law:

1. if the contract is executory, the debtor may assume it, but in that case the bankruptcy court has no jurisdiction to modify the contractual terms over the objection of the nondebtor party, and the nondebtor party is entitled to demand complete performance thereafter by the debtor under the contractual terms;
2. the debtor may reject the executory contract, in which case the contract is deemed breached as of the petition date, and while the nondebtor party cannot demand literal performance of the contract from the debtor, it has a claim for money damages for the breach (which in the case of an insurance policy would presumably be the present value of the future insurance proceeds that would have been required to be paid once the claims matured);
3. the contract may be assumed with modifications agreed to by the nondebtor party; or
4. If the contract is nonexecutory, the debtor may refuse to perform, and the nondebtor party may then assert a claim for damages, which, in the case of insurance policies, would be measured by the present value of the future performance.

When the debtor is insolvent, the claim of a creditor for damages for breach of contract is paid on a pro rata basis with the claims of other unsecured creditors. However, when the debtor is solvent (like the solvent scheme insurers), the creditor is entitled to full payment. Regardless of whether occurrence policies for which premiums have been paid are characterized as executory or nonexecutory, we are aware of no U.S. authority that permits a solvent U.S. debtor to evade its contractual obligations to an insured under existing occurrence policies in the manner proposed by the solvent schemes.

Similarly, although solvent entities are not precluded from seeking relief under the U.S. Bankruptcy Code, a solvent entity is not entitled to seek bankruptcy relief for the sole purpose of rejecting its executory contracts and thus harming its unsecured creditors for the benefit of its shareholders (which is precisely what the solvent schemes are doing). In In re Integrated Telecom Express, Inc., a solvent debtor filed for bankruptcy for the purpose of increasing distributions to shareholders by taking advantage of the cap on liability to landlords with respect to lease rejection damages under Bankruptcy Code section 502(b)(6). The U.S. Court of Appeals for the Third Circuit held that the case was filed in bad faith and should have been dismissed, stating:

To be filed in good faith, a petition must do more than merely invoke some distributional mechanism in the Bankruptcy Code. It must seek to create or preserve some value that would otherwise be lost—not merely distributed to a different stakeholder—outside of bankruptcy. This threshold inquiry is particularly sensitive where, as here, the petition seeks to distribute value from a creditor to a company's shareholders.

The court noted that liquidation plans were permissible but that such plans must also serve a valid bankruptcy purpose, either by preserving some value as a going concern, by liquidating a company as a whole or in such a way as to preserve some goodwill, or by maximizing the value of the debtor's estate (as opposed to simply redistributing that value to other interests). The court concluded that a solvent debtor's misuse of Chapter 11 to increase the amount distributed to shareholders at the expense of any creditor by resorting to provisions of the Code that limited the creditor's claim was not a “valid bankruptcy purpose” and therefore not a good-faith filing.

Thus the ability of insolvent U.S. debtors to reject executory contracts under Chapter 11 does not justify recognition of solvent insurance schemes that violate U.S. policyholders' contractual rights to payment of covered claims as they become due.

Among the contractual rights that are violated by the schemes is the right to have claims determined under the state law governing the contract. The scheme adjudicators usually are not legally trained, and few if any are trained in U.S. law. Moreover, the schemes, while claiming that they will determine claims according to applicable law, in fact apply distorted and incorrect versions of U.S. law. For example, under most occurrence policies, like the policies at issue in BAIC and WFUM, an occurrence activates all successive policies on the risk during the extended period in which progressive injury or damage developed in a third-party claimant. Under the laws of many states, policyholders are entitled to invoke the “All Sums” methodology of determining what policies must respond to a triggering event, which enables the policyholder to recover all of its damages from any triggered insurer on the risk. It also permits the insurer(s) who are selected to pay the claim to seek contribution from the other responsible insurers. Critically, however, the insurer's right to seek that contribution vests only after it has paid the policyholder its full obligation.

Despite the clear policy language and applicable state law requiring application of the All Sums approach, the schemes instead often apply what the WFUM scheme called the “All Sums Net of Contribution” allocation, thus shifting to the policyholders the insurers' contractual obligation to indemnify the insured fully and only then to recover any contribution amounts from other insurers. This shift: (a) fundamentally abrogates the core purpose and principles of the “All Sums” rule; (b) severely prejudices policyholders by foisting onto them the burden of running down scores of other insurance companies in court and recovering their respective “pro rata” shares; (c) is contrary to the substantive state law applicable to the policies; and (d) has been rejected by U.S. courts.

Solvent Schemes Violate Policyholders' Due Process Rights

The Scheme Proponents do not argue that due process is not a fundamental public policy of the U.S. Instead, they assert that “by virtue of the U.K. High Court's involvement, the insurance company's assets and affairs are subject to judicial supervision,” which they contend ensures that policyholders' due process rights under U.S. law are protected. This claim is unsupported, and we believe it to be inaccurate. The High Court's role is extremely limited: it merely decides if the classification of policyholders is correct, if the vote was for the scheme, and if the scheme is fair according to the rather malleable UK standards. Not surprisingly, we are not aware of any UK solvent insurance scheme cases in which the High Court has engaged in a penetrating analysis of fairness in the absence of litigated objections from policyholders. Instead, the High Court appears to rely on the anemic voting that inherently mars these proceedings and to defer to the scheme proponents' paternalistic and unopposed assertions that the schemes are in everyone's best interests.

It cannot be disputed that neither former section 425, Part 26, nor the schemes themselves provide for the High Court to take any action with respect to or exercise any supervision over the schemed companies' assets or the conduct of their businesses, and the High Court plays no role in adjudicating policyholder claims or in reviewing the adjudication of the claims conducted by the nonlawyer scheme actuaries or scheme adjudicators. There is no case decided under section 304
or Chapter 15 in which a U.S. court approved, over meaningful policyholder objection, a foreign scheme in which the
court's role was so limited and the adjudicatory process so one-sided and lacking in basic procedural safeguards.  

The Scheme Proponents rely on Hopewell in support of this proposition, but as discussed above, there was significant
court participation in the every major facet of the scheme at issue in Hopewell, which is absent in the UK solvent insurance
schemes.  

**Solvent Insurance Schemes Are Not Like Chapter 11 Cases**

The Scheme Proponents suggest that solvent insurance schemes proposed under UK law are similar to Chapter 11 cases
and so should not alarm U.S. bankruptcy judges.  

On the contrary, the differences between Chapter 11 and former
section 425 and Part 26 are greater and more material than their similarities. While both statutes permit companies to
enter into arrangements with their constituents to restructure their financial relationships, that is fundamentally where
the resemblance ends. Just a few of the more salient differences are outlined below.

**Title 11** and Chapter 11 are detailed statutory schemes encompassing many sections and covering all aspects of the
reorganization or liquidation of a company in financial distress, whether solvent or not. In contrast, former section 425
was a single section with three short subparagraphs that addressed merely the agreement between the company and its
constituents and the percentages of support necessary for sanction.  

Part 26 is not materially more detailed.

Chapter 11 provides that the bankruptcy court will hear and determine all issues relating to claims objections and
estimation proceedings, with a right of appeal from adverse decisions to the district court and the court of appeals. No
similar provision exists in either section 425 or Part 26, and in fact, the policyholders have no right to judicial review of
adverse decisions made about their claims by the scheme managers, scheme actuaries, or the scheme proponents' hand-
picked “independent” adjudicator, unless they can prove actual fraud.

Chapter 11 ensures that creditors have appropriate negotiating leverage by requiring that the U.S. Trustee to appoint
a creditors' committee to act in a representative capacity for all creditors, with their costs paid for by the debtor, and
in the discharge of their fiduciary duties they aggressively assert concerns common to all creditors, comparable to the
kinds of objections to schemes that are discussed in the Solvent Scheme article. No similar provision exists in section 425
or Part 26--the solvent schemes make no provision for collective policyholder representation and indeed are structured
to minimize consultation and concerted action by policyholder creditors. Thus while the experience of a policyholder
facing a scheme may bear a facial resemblance to that of an unsecured creditor with a small claim in a Chapter 11 case,
that resemblance is misleading; the protections for small unsecured creditors under Chapter 11 are significantly greater
than those for policyholders under section 425 and Part 26.  

Although like former section 425 and Part 26, Chapter 11 leaves the debtor in possession and management of its assets,
the U.S. bankruptcy court has continuing jurisdiction to supervise the debtor's activities. Chapter 11 requires that the
debtor bring all transactions outside the ordinary course of business and all motions to assume or reject executory
contracts to the bankruptcy court for approval, after notice and hearing to all creditors. No similar provision exists in
former section 425 or Part 26, under which the scheme proponent continues to manage its business entirely without court
supervision, often with no transparency at all.

A fundamental goal of Title 11 is to ensure that similarly situated creditors are treated the same. To this end, settlement
agreements must be noticed to all creditors and are subject to court approval, and plans must provide that creditors
are properly classified and that members of a class receive the same identical payment. No similar provisions exist in
section 425 or Part 26. Scheme Proponents routinely enter into settlement agreements with their constituents for highly
dissimilar values but have no obligation to publish information about the settlements or to obtain court approval of
them. Moreover, the concept of classification in the UK is completely different from the U.S. concept and is much less formal and stratified than is the case under Chapter 11. Solvent schemes routinely place policyholders creditors who have no common interests in the same classes--policyholders with IBNR claims have been joined with policyholders with mature claims, reinsurers, and affiliates of the scheme company.

Title 11 does not permit preferential or fraudulent transfers to be made either before or after the petition date. In contrast, former section 425 and Part 26 impose no limits on the scheme proponent's ability to transfer its assets to anyone in any amount, either before, during, or after the scheme.

Chapter 11 and relevant case law require a solvent debtor to abide by its contractual obligations and do not permit a debtor to modify the terms of its prepetition contracts to the detriment of the contract party for the benefit of its equity holders. No similar requirement exists under former section 425 or Part 26, and indeed, this is presumably the principal purpose of the solvent insurance schemes of arrangement--to terminate policyholders' long-tail coverage rights prematurely and to transfer over to the shareholders the value that would otherwise go to the policyholders upon maturity of their claims.

Chapter 11 is premised on an assumption that the debtor's activities while in bankruptcy will be completely open and transparent to the court and to the creditors. It requires that creditor votes be solicited on the basis of a disclosure statement that the creditors' committee, all parties in interest, and the court see and thoroughly ventilate before it is disseminated for a vote. In contrast, the UK solvent scheme solicitation materials are prepared by the scheme proponents and are not at any stage subject to testing or review by parties in interest (including the policyholders) or the court.

The Rhode Island State Statute Does Not Relieve Federal Bankruptcy Judges From Their Obligation to Ensure that Solvent Insurance Schemes Comply with Chapter 15

The Scheme Proponents argue that a solitary and largely unused Rhode Island statute authorizing domestic Rhode Island insurance companies to enter into schemes with their policyholders, and which has some similarities with former section 425 and Part 26, should give U.S. bankruptcy courts comfort that UK solvent insurance schemes do not violate the fundamental policies of the U.S. This is a red herring for several reasons.

First, while Rhode Island has chosen to adopt this statutory scheme, 49 other states have not. A single state's adoption of a remedy comparable to UK scheme provisions does not support the assertion that solvent insurance schemes are compatible with U.S. public policy. In any event, we are not aware that any insurer has taken advantage of the Rhode Island's scheme, and so it is untested.

Second, in applying Chapter 15 to foreign insurance schemes, the U.S. bankruptcy courts must be guided by federal standards, including those articulated in the Bankruptcy Code. Whatever law a state legislature may conclude is appropriate to enact in its own state should have no weight with a federal court interpreting a federal statute faced with these fundamental issues of public policy.

Finally, the Rhode Island statutory scheme raises the same fundamental questions about violation of established contract rights and due process rights that the solvent schemes do. For those reasons we believe that it is fatally flawed, and any attempt by an insurer to utilize that statute over policyholder objections would be rejected by U.S. courts applying U.S. law.

Conclusion
Solvent insurance schemes erode and vitiate occurrence coverage for U.S. policyholders with IBNR claims. Without collective representation of policyholders in the UK, individual policyholders must either incur large legal fees to oppose the schemes, which may be unjustified in a given scheme, or trust in the scheme proponents to treat their claims fairly. U.S. courts should be aware of the ways in which solvent schemes infringe fundamental U.S. policies and should, at a minimum, assure that the interests and due process rights of U.S. policyholders are adequately protected against this form of encroachment. Courts in other countries have not hesitated to protect their own citizens and enforce their own laws when schemes or plans brought from abroad for enforcement against local creditors violate such local laws. U.S. courts should be no less willing to ensure that U.S. policyholders' fundamental contract and due process rights are secure.

Footnotes


4. In re Eastport Associates, 935 F.2d 1071, 1081, Bankr. L. Rep. (CCH) P 74021 (9th Cir. 1991) (declaration of attorney regarding effect of legislation that he drafted on behalf of client did not reflect intent of legislature regarding scope of legislation). “[C]ourts do not even rely on statements of individual lawmakers, so they should similarly not rely on statements by outside individuals who were involved in drafting the legislation.” Eastport Assoc., 935 F.2d at 1081 (citing Carmona v. Division of Industrial Safety, 13 Cal. 3d 303, 311 n.8, 118 Cal. Rptr. 473, 530 P.2d 161, 1974-1975 O.S.H. Dec. (CCH) P 19212 (1975)).

5. The leading treatise on statutory interpretation notes that the draftsman's view of the meaning or intent of legislation may be relevant in limited circumstances:

if the draftsman's views were clearly and prominently communicated to the legislature when the bill was being considered for enactment, so as to give reason to believe that the legislators' understanding of the bill would have been influenced by the draftsman's communicated views and so long as to be visible to others who are concerned to understand the meaning of the act, there is reason to invoke an exception to the general rule and attach weight to the draftsman's views.


7. Section 425 was repealed and replaced as of April 1, 2008 by Part 26 (Arrangements and Reconstructions) of the Companies Act of 2006. Part 26 does not materially alter the text of section 425 or the law applicable to solvent schemes under former section 425. See Companies Act 2006, Explanatory Notes at 176 (“The provisions of this Part... restate sections 425 to 427 of the 1985 Act”). References in the text to “Section 425” or “Section 425” schemes should be understood to apply equally to solvent insurance schemes implemented under Part 26. While former section 425 and its successor Part 26 may be used
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to restructure debt, they do not encompass insolvency proceedings, which are addressed in different UK statutory regimes, and their apparent intended use reaches to any conceivable arrangement that a solvent company might want to make with its creditors or its equity holders. See Solvent Scheme article, 16 J. Bankr. L. & Prac. 953, n. 1 and Companies Act 2006, Part 26. The Scheme Proponents attempt to distinguish In re Rose, 318 B.R. 771, 774-76, 44 Bankr. Ct. Dec. (CRR) 19, 53 Collier Bankr. Cas. 2d (MB) 900 (Bankr. S.D. N.Y. 2004), on the ground that it involved a different UK statute, but the court's judgment—that what matters is the nature of the foreign statute and that a foreign statute that is not the kind of insolvency statute contemplated by the Bankruptcy Code cannot pass muster under the precursor to Chapter 15—is equally applicable to section 425.

As noted in the Solvent Scheme Article (16 J. Bankr. L. & Prac. at 957), the Scheme Proponents' co-counsel in the WFUM case admitted as much during the UK hearings: “the 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.” 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). (G. Moss, QC speaking).


Hopewell, 238 B.R. at 50-53.

The adjudicators tend to be accountants with no legal or dispute resolution background who have deep ties to the London financial services market.

The WFUM scheme did provide that certain disputes about law or fact may be determined by an independent arbitrator in whose selection the policyholders could participate. If the parties are not able to agree, the WFUM scheme administrators have sole discretion to pick the arbitrator, and the WFUM scheme administrators assert that they also have absolute discretion to determine what disputes will be referred to the independent arbitrator. 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 to 279 and Described in the Explanatory Statement at Pages 62 to 69 Between Sovereign Marine & General Insurance Company Limited (by Way of Amendment to an Existing Scheme of Arrangement Dated 15 October 1999) Allianz Cornhill Insurance Plc Oslo Reinsurance Company (U.K) Limited Allianz Global Corporate & Specialty (France) Sovereign Insurance (U.K) Limited Atlantic Mutual Insurance Company Sphere Drake Insurance Limited Continental Reinsurance Corporation International Limited the Ocean Marine Insurance Company Limited Greyfriars Insurance Company Limited the Sea Insurance Company Limited Hedlington Insurance (U.K.) Limited Tokio Marine Europe Insurance Limited Hibernian General Insurance Limited Wausau Insurance Company (U.K.) Limited Mitsui Sumitomo Insurance Company (Europe), Limited and Their Respective Scheme Creditors (as Defined in the Scheme), dated 31st July 2006 (the “WFUM Scheme”), available online at: https://www.wfumpools.com/wfumdc/WFUM%20Pools%20Scheme%2020Document.pdf, at 2.2.4.


BAIC's failure to propose a separate class for IBNR policyholders contributed to the High Court's refusal to sanction the scheme. In the Matter of the British Aviation Insurance Company, Limited, [2006] 1 BCLC 665, [2005] EWHC, ¶ 92. WFUM
originally proposed a single class, but the High Court required two classes, one for IBNR claims and a separate class for policyholders with claims not requiring estimation. 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, ¶ 180.

The High Court noted that if it had sanctioned the BAIC scheme it would have required a bar date one year after the Effective Date. In the Matter of the British Aviation Insurance Company, Limited, [2006] 1 BCLC 665, [2005] EWHC, ¶ 127.

Solvem Scheme Article, 16 J. Bankr. L. & Prac. 593, n. 36.

Many solvent schemes, like the BAIC scheme, suffer from substantive or procedural problems that would cause them to fail even under UK law.

See Peterson v. Clark Leasing Corp., 451 F.2d 1291, 1292 (9th Cir. 1971) (state court's finding that corporate veil could be pierced did not estop debtor from contesting objection to discharge for failure to keep books and records because California corporate law did not precisely trace bankruptcy law on the point); In re Chi-Chi's, Inc., 338 B.R. 618, 626, 64 Fed. R. Serv. 3d 100 (Bankr. D. Del. 2006) (no preclusive effect when legal standards governing the actions are significantly different); James W. Moore, 18 Moore's Federal Practice § 132.02[2][h]. Notably, the Hopewell court did not hold that the Bermudan approval of the scheme stopped consideration of the objections raised to the 304 petition on their merits. See In re Board of Directors of Hopewell Intern. Ins. Ltd., 238 B.R. 25, 68, 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).

See, e.g., In re J.A. Jones, Inc., 361 B.R. 94, 105 (Bankr. W.D. N.C. 2007); In re Holloway, 337 B.R. 6, 10 (Bankr. D. Mass. 2006); and see In re petition of Catherine Geraldine Regan, as Foreign Representative of Riverstone Insurance (UK) Limited, Case. No 05-12678 (RDD), in which 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.”


Petition of Alan Boyce, as Foreign Representative of NRG Victory Reinsurance Ltd., No. 06-11052 (Bankr. S.D.N.Y., March 31, 2006).

Mr. Justice Lewison noted in BAIC that if he had sanctioned the scheme, he would have directed more extensive advertising than the scheme proponents had intended. In the Matter of the British Aviation Insurance Company, Limited, [2006] 1 BCLC 665, [2005] EWHC, ¶ 127.


11 U.S.C.A. § 502(b)(6) and (7).


An “executory contract” is generally understood to be one in which material performance obligations remain due on both sides as of the date on which a bankruptcy petition is filed. In re Ionosphere Clubs, Inc., 85 F.3d 992, 998-99, 29 Bankr. Ct. Dec. (CRR) 203 (2d Cir. 1996); Wechsler v. Hunt Health Systems, Ltd., 330 F. Supp. 2d 383, 429 (S.D. N.Y. 2004). Insurance policies are often held to be executory contracts. If a policy is held not to be executory, it is because material performance remains due only on one side-- in the event of such a holding in the solvent insurance scheme context, the material performance remaining due is by the insurers.

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largely because scheme administrators have succeeded in buying off the opposition to avoid a meaningful challenge in the U.S. Also, to date, no meaningful opposition has ever been mounted to recognition of a solvent insurance scheme under Chapter 15, largely because scheme administrators have succeeded in buying off the opposition to avoid a meaningful challenge in the U.S.
The Scheme Proponents note that in the *WFUM* case several policyholders who filed no objections to sanction of the scheme in the UK filed a three-page objection to recognition of the scheme under Chapter 15. See *In re PRO Insurance Solutions Limited*, 07 B 12934 (JMP), Objections to Petitions (Docket No. 13). The objectors put their entire argument in three paragraphs, cited only the UK *BAIC* decision in support of their objection, and defaulted at the hearing. The order granting recognition to the scheme did not allude to the objection. See Order Signed on 10/23/2007 Granting Recognition of Foreign Proceedings, Permanent Injunction and Related Relief (Docket No. 23). This order does not, therefore, stand for the proposition that U.S. bankruptcy courts should defer to UK courts which have sanctioned solvent insurance schemes without consideration of the kinds of concerns discussed in detail in the Solvent Scheme article.


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