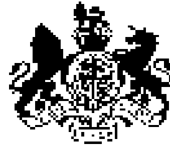

IN THE SUPREME COURT OF BERMUDA

Civil Jurisdiction

2008: No. 251

IN THE MATTER OF HARRINGTON INTERNATIONAL INSURANCE LTD.

AND IN THE MATTER OF SECTION 99 OF THE COMPANIES ACT 1981

AND IN THE MATTER OF A SCHEME OF ARRANGEMENT

REASONS FOR ORDER

Date of Hearing: 29 October and 12 November 2008
Date of Ruling: 12 November 2008

Ms. Jennifer Fraser, Appleby, for the Applicant

Introduction

1. This matter concerns an application by Harrington International Insurance Ltd. ("the Company") in relation to a proposed scheme of arrangement ("the Scheme"), in which the Company seeks the Court's permission to convene a meeting of its creditors, and for directions in connection with the Scheme proposed between the Company and those creditors defined in the Scheme documentation as "Scheme Creditors".

2. Because I raised with counsel a question concerning the ability of different classes of creditors to consult together at one meeting, I considered it would be helpful to give written reasons for the conclusion which I ultimately reached.

The Evidence Supporting The Original Application

3. This came in the form of an affidavit sworn by Roger Wiegley, a director of the Company. He set out the Company's history, with particular reference to the business which it had written. This involved both insurance and reinsurance in relation to property and marine business; in relation to its insurance operations, the Company went into run-off effective 1 January 2001, with the exception of one transaction which is not intended to be a part of the Scheme. The business to be covered by the Scheme is the Company's reinsurance business.

4. The excluded business relates to an alternative risk transfer ("ART") transaction, one of approximately twenty which the Company had entered into between 2000 and 2002. All but this one have either expired or been terminated through commutation, and this remaining policy, described as a retrocession agreement relating to a portfolio of aircraft leases, expires in 2014.

5. Mr. Wiegley's affidavit indicated that the Company was solvent as at 30 November, 2007, with its unaudited balance sheet showing a substantial surplus of assets over liabilities. As at 30 June 2008, the "ascertainment date" under the Scheme, the Company's board remained of the opinion that the Company was solvent and would be able to meet its liabilities.

6. Mr. Wiegley's affidavit then described the purpose of the Scheme, confirmed that the regulators had no objection to it, and set out the possible advantages and disadvantages of the Scheme. In paragraph 19 of his affidavit, Mr. Wiegley addressed the question of creditor classes. Since this was this issue which had originally caused me some concern, I will deal with Mr. Wiegley's comments in relation to this aspect of matters in some detail.

Creditor Classes

7. Mr. Wiegley started by indicating that the Company currently had uncommuted reinsurance contracts with approximately eighty cedants, of which less than five had any reported reserves or had reported any loss activity over the last several years. He then indicated that "the overwhelming majority" of the Company's policyholders had no reported claims or had exhausted coverage. As I now understand it, this is a reference to the seventy-five or so cedants referred to above. Mr. Wiegley then carried on to say:

> "The remaining policyholders have claims but almost all of them have Agreed Losses or Notified Outstanding Losses and most of these reported liabilities relate to major loss events that took place pre 2007. For the most part, the actual loss event is known although the ultimate payments may not have been finally resolved at this time. As such, the Company believes that the bulk of its current reinsurance reserves relate to Notified Outstanding Losses and to a lesser extent, 'Incurred But Not Reported' claims.

8. Finally, Mr. Wieley said:

> "Based on the specific circumstances of the Company and in light of recent court decisions concerning other solvent Schemes for insurance and reinsurance companies, the Company considers it appropriate to convene a single meeting of creditors within which creditors with Agreed Losses, Notified Outstanding Losses and IBNR claims have the opportunity to consult together with respect to the proposed Scheme".

9. Mr. Wiegley's affidavit carried on to summarise the provisions of the Scheme, and the Scheme documents were exhibited to his affidavit. He referred to the claims procedure as it would operate under the Scheme, the adjudication procedure, and the conduct of the proposed meeting, as well as other details in relation to the proposed operation of the Scheme. I do not need to refer to these

matters in any detail, save to say that none of those matters caused me any concern.

10. The concern that I did have on first reading the papers related to the Company's view that it was appropriate to convene a single meeting of creditors within which the three different classes of creditors (those with Agreed Losses, those with Notified Outstanding Losses and those with IBNR claims) would have the opportunity to consult together with respect to the proposed Scheme. Specifically, I was concerned that creditors with Agreed Losses might be in a very different position than creditors with IBNR claims. I communicated my concern to the Registrar with the request that this be passed on to Ms. Fraser, and that she be invited to address that concern on the first return date of the summons, which took place on Wednesday, 29 October, 2008.

The 29 October 2008 Hearing

11. Prior to the hearing, Ms. Fraser most helpfully filed written submissions and referred me to three authorities to which I will refer shortly. The written submissions dealt with a number of factual matters which had not been dealt with in Mr. Wiegley's affidavit. First, there was a fuller description of the reinsurance business written by the Company, and a breakdown of claims as at the end of 2007 was given, as well as a confirmation that the Company's independent consulting actuaries had put a figure of approximately $1 million as the appropriate level of IBNR reserve. In relation to the one outstanding ART transaction referred to above which was excluded from the Scheme, the submissions indicated that it was the Company's intention to commute/novate this contract before 31 December 2008. Ms. Fraser further indicated during the course of the hearing that this transaction was with a related party, so that no difficulty was anticipated in effecting such a commutation/novation. From this it followed that the inference that I had originally drawn that the Company was likely to remain in existence for some time was misplaced. This in turn affected the question whether the appropriate comparator was a solvent liquidation or a

solvent run-off. As Ms. Fraser indicated in her oral submissions, following the termination of the remaining ART business, and assuming that the Scheme was implemented, the Company's intention was to initiate a solvent liquidation. I took the view that these further factual matters should be confirmed on affidavit, and therefore adjourned the hearing to enable such an affidavit to be filed.

The Relevant Case Law

12. Ms. Fraser's submissions dealt with three first instance decisions of the English High Court. These are, in date order, the decision of Lewison J. in *Re British Aviation Insurance Co. Ltd.* [2005] EWHC 1621 (Ch.) *("BAIC"),* the decision of Lindsay J. in In the matter of *NRG Victory Reinsurance Ltd*. [2006] EWHC 679 (Ch.) ("*NRG*"), and the decision of Warren J. in *Sovereign Marine and General Insurance Co. Ltd. et al* [2006] EWHC 1335 (Ch.) (the "*WFUM Scheme*"). I had reviewed Lewison J.'s judgment in *BAIC* when my concerns had first arisen, but not *NRG* or the *WFUM Scheme* and I am grateful to Ms. Fraser for drawing those cases to my attention.

13. In *BAIC*, Lewison J. held that the first step to be taken when considering whether it was appropriate for there to be one or more meetings of scheme creditors was to identify the appropriate comparator. He referred to the case of *Hawk Insurance Co. Ltd.* [2001] EWCA Civ. 241, the case which had led to the issue of a practice direction in the United Kingdom, which practice direction was followed in Bermuda on 8 October 2007. In *Hawk Insurance* the appropriate comparator had been an insolvent liquidation. In *BAIC,* Lewison J. held the appropriate comparator to be a solvent run-off, since the scheme did not encompass the whole of the company's business and it was envisaged that the company would remain in being even if the scheme were to be approved; and since the business excluded from the scheme included long-tail insurance, the expectation was that the company would remain in solvent run-off for many years.

14. Lewison J. then considered the rights of policyholders with IBNR claims in a solvent run-off, describing this as a right to wait and see whether a claim materialises and if it does, to have a full indemnity against the claim. He concluded that the scheme might well disadvantage such claimants. He carried on to say (paragraph 92)

"In my judgment in the particular circumstances of a solvent scheme, where a solvent liquidation is not a realistic alternative, those with accrued claims and those with IBNR claims have interests which are sufficiently different as not to make it possible for them sensibly to consult together 'in their common interest'. In truth, they do not have a common interest at all".

15. In the *NRG* case, Lindsay J. emphasised that the *BAIC* case did not represent any change of principle in regard to the test first enunciated by Bowen L.J. in *Sovereign Life Assurance Company v. Dodd* [1892] 2QB 573 at 583, where the learned judge said

> "It seems plain that we must give such a meaning to the term 'class' as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".

16. Lindsay J. carried on to emphasise that the decision made by Lewison J. in *BAIC* was not a decision that where there are both accrued and IBNR claims, the claimants necessarily have to vote in separate classes. He indicated that whether such separate classes were truly necessary would depend on a long list of variables, such that what is right for one company and one scheme would not necessarily be right for another. He carried on to say "Lewison J., I would think, would be surprised and even perturbed were he to find that *BAIC* was being treated as if it had laid down that invariably and without more a meeting mixing accrueds and IBNRs would fail the *Sovereign Life* test".

17. Lindsay J. went on to refer to the actuarial evidence which had been put before him, which included expert opinion that "it is not reasonable to distinguish between notified and IBNR claims on the basis that the latter are more difficult to value and that any notion that there is fundamentally greater uncertainty in estimating liability in IBNR claims than for notified claims is incorrect as a general proposition". He carried on to rule so as to permit the scheme to proceed on the basis of convening the single meeting which the company had in mind. He did, however, caution that objection could still be taken by scheme creditors at the sanction stage.

18. In the *WFUM Scheme*, Warren J. cited two factual scenarios which demonstrated that Lewison J. in *BAIC* could not be taken as having laid down a general rule in relation to the need for creditors with accrued claims and those with IBNR claims to consult together in separate meetings. The first was where all policyholders had similar policies, and an almost identical mix of the three types of claim which exist in this case. In those circumstances the rights of each policyholder would be very similar, and there would be no reason at all why they should not consult together in their common interest. The second example was where the scheme company was exclusively a reinsurer. In such a case, Warren J. referred to the fact that the reinsureds would be other insurance companies well able to assess risks. Particularly, he indicated that IBNR claims for reinsurers do not present the same kind of uncertainties as for a direct insured whose business has nothing to do with insurance. Ms. Fraser confirmed that the scheme in respect of which this application is made is consequently very different from that in the *BAIC* case. I accept that submission.

Further Evidence

19. As envisaged in paragraph 11 above, the Company filed further evidence in the form of an affidavit sworn by Sharl Davis on 5 November 2008. This affidavit gave more and slightly different detail than that given by Ms. Fraser at the 29 October 2008 hearing. In relation to the reinsurance business to be covered by the

Scheme, Ms. Davis indicated that of the reinsurance contracts which had been issued to approximately eighty individual cedants between 1995 and 2002, the Company only had open claims from two parties. The cedants were identified and the claims of both fitted into the category of Notified Outstanding Claims, otherwise known as Outstanding Loss Reserves ("OSLR"). Ms. Davis carried on to indicate that in the case of the Company, discussions with its main cedants, who had notified the Company of OSLR reserves, indicated that those cedants did not believe that they would be owed any significant IBNR if and when the Company entered into the Scheme. Further, Ms. Davis indicated that the Company had sent a letter explaining the Scheme to its known creditors, and had not received any responses or enquiries in consequence of that letter.

20. There was one other matter which Ms. Davis referred to in his affidavit, which differed slightly from what Ms. Fraser had indicated to me at the 29 October 2008 hearing. This covered the position in relation to the Company's intention to enter into a solvent liquidation, following the implementation of the Scheme. Ms. Davis indicated that no decision had yet been taken by the Company in that regard, so that the present position was that following completion of the Scheme and the commutation or novation of the remaining ART transaction, the Company would either be wound up on a solvent basis, or used by its parent for a completely new line of business.

The Appropriate Comparator

21. As appears from my comments above, when I first reviewed Mr. Wiegley's affidavit, I took the existence of the ART transaction referred to, which was said to expire in 2014, as indicating, as was the case in *BAIC*, that the Company would remain in being for some appreciable period following the approval of the Scheme, and that accordingly a solvent run-off was the appropriate comparator. As indicated in paragraph 11 above, Ms. Fraser had advised at the 29 October 2008 hearing that it was the Company's intention to enter into solvent liquidation, following completion of the Scheme and termination of the ART transaction. Ms.

Davis now makes it clear that the Company may consider writing new business as an alternative to a solvent liquidation.

22. I do not think that the possibility of the Company writing new business affects the position in relation to the appropriate comparator. That is now clearly not a solvent run-off, and in my judgment the appropriate comparator is a solvent liquidation, even given the possibility that such a course may not ultimately be followed.

Conclusion

23. It seems to me that applying the comparator of a solvent liquidation, the concerns which I had on reading the papers were misplaced. I am therefore satisfied that there is no reason not to permit the Company to proceed to hold the single meeting which it has in mind. The other orders sought in the originating summons are, in my view, unobjectionable, and accordingly I make an order in terms of the summons.

24. Finally, the Bermuda practice direction, like that in the United Kingdom, does provide that directions for the resolution of creditor issues may include orders giving anyone affected by a meetings order a limited time within which to apply to vary or discharge that order. As I understood the position from Ms. Fraser, the Company has consulted with Scheme Creditors and does not anticipate that there will be any objection to the holding of a single meeting of Scheme Creditors. Consequently, like Lindsay J. in the *NRG* case, I see nothing to be gained in providing a limited time within which objection to a single meeting could be raised, and of course the position remains that there could still be objection taken at the sanction stage.

Dated this day of November 2008.

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Hon. Geoffrey R. Bell
Puisne Judge