

Scottish Lion: UK Court Permits Solvent Scheme to Proceed to Merits Hearing Over U.S. Policyholder Objections

by *Brian S. Scarbrough*

For nearly a year, the Scottish Lion Insurance Company, Limited (“Scottish Lion”), an insurance company that wrote coverage in the London insurance market, has been litigating with its creditors (policyholders), including many U.S. creditors, to permit it to enter into what is known under U.K. law as a solvent scheme of arrangement. A Scottish appellate court recently ruled in favor of Scottish Lion on a preliminary question of whether such a scheme could be sanctioned under U.K. law despite opposition from a minority of U.S. creditors ([click here to view opinion](#)).

Scottish Lion is a solvent company, fully able to meet its liabilities. However, U.K. law permits solvent insurance companies to close off liabilities through a scheme of arrangement subject to the approval of creditors. After a March 2009 creditor vote at which ostensibly a majority of voting creditors approved entrance into the scheme, Scottish Lion sought court approval to sanction such a solvent scheme. However, in October 2009 a Scottish court, the Outer House of the Court of Session, denied it permission to do so and dismissed a petition to sanction the scheme. Several U.S. creditors had opposed the scheme, challenging both the manner in which creditors’ votes were valued and the ability of a solvent insurance company to force unwilling creditors into

a scheme of arrangement through a majority vote. The Outer House ruled that while there was not a per se rule against sanctioning solvent schemes in the face of creditor dissent, in the case of solvent schemes, justification must be made why dissenting minority creditors should be bound by the decision of the majority. In the court’s words, there must be shown a “problem requiring a solution” in order for a solvent scheme to be sanctioned. The court reasoned that, unlike insolvent schemes where financial difficulties necessitate binding dissenting minority creditors to the will of the majority, for solvent schemes there is no such financial justification.

Scottish Lion appealed the decision. On January 29th, 2010, the Inner House of the Court of Session, a Scottish appellate court, upheld Scottish Lion’s appeal and overturned the dismissal of the petition to sanction the scheme. *Re Scottish Lion Insurance Company Limited* [2009] CSIH 6. The Inner House ruled that the Outer House erred in requiring that solvent schemes demonstrate that there was a “problem requiring a solution” or produce evidence as to why the scheme in question had advantages for the creditors. The Inner House’s decision stated that the existence of a “problem” is not a precondition to the sanctioning of a scheme, though it could be a

compelling reason why a solvent scheme should be sanctioned.

The decision of the Inner House of the Court of Session did not address the individual merits of the scheme, only whether or not Scottish Lion's petition should have been dismissed based on the preliminary question presented. Scottish Lion will now have the opportunity to argue the merits of its scheme at a sanction hearing before the Outer House at a date to be determined. It is also possible that the U.S. creditors who challenged the sanction will appeal the January ruling of the Inner House to the Supreme Court of the United Kingdom.

U.S. policyholders should monitor this case closely. Regardless of whether there is an appeal or a sanction hearing on the merits, this

case demonstrates that U.S. policyholders can forcefully object to solvent schemes in U.K. courts on a number of grounds in order to protect valuable insurance policy assets. Whether U.S. policyholders prevail on certain of these objections here and derail the proposed Scottish Lion scheme remains to be seen. Should the scheme ultimately be sanctioned, a bar date will be set by which all claims, current or future, must be filed in order for policyholders to be entitled to coverage. In such an instance, policyholders with outstanding claims or who believe they may have claims in the future, including incurred but not reported claims, under *Scottish Lion* policies must be sure to file all such claims with supporting information by such date and be prepared to state and support their position about their rights to coverage.

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