

London Bridges Falling Down: What's an American Policyholder to Do?



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In the last several years there has been an unprecedented number of insurance company failures in the London Market, leaving in their wake billions of dollars in liabilities and U.S. policyholders grasping for ways to pursue their claims.

This article will explain the current status of this growing disaster, some of the peculiarities of English Insolvency Law, and some ideas on protecting your rights as a policyholder.

Who is Insolvent?

The London Market insolvencies involve British based insurance companies (not Lloyd's or Lloyd's syndicates), many of which wrote excess liability and reinsurance coverage primarily for the U.S. market. The best known insolvencies include: (See box on p 4.)

The first five (collectively known as "KWELM" for the first letter in their names) all provided coverage for insurance underwritten by their sister company, H.S. Weavers (Underwriting) Ltd. which at one time was known as "London's leading U.S. liability insurance market." It is estimated that the U.S. liability for the first five companies alone will exceed \$5 billion.

All of these companies have been placed in provisional liquidation under the auspices of the British High Court. What does this mean? It means that through ancillary proceedings filed in the U.S., all actions or attempts to collect funds from these companies have been stayed by judicial order.

There is guaranty fund protection under British Law similar to the protection under U.S. law. The good news is that the British guaranty fund will protect "overseas policyholders," e.g., American policyholders, paying up to 90% of the

policyholder's claim. The bad news is that the fund (known as the Policyholders Protection Plan) will not protect corporations—just individuals and partnerships.

However, U.S. corporate policyholders should not lose heart; all is not lost. These companies have billions of dollars in assets. The liquidators of KWELM, Andrew Weir and Bryanston, for instance, all expect an eventual pay-out to creditors in the range of thirty to sixty cents on the dollar.

British Schemes of Arrangement

In most cases, payments to creditors will be made through the new and increasingly popular alternative to compulsory liquidation, the Scheme of Arrangement. A Scheme of Arrangement is a compromise or arrangement under English law (section 425 of the 1985 Companies Act) between the company and its creditors to run off the company's liabilities (at less than 100 cents on the dollar). It is the functional equivalent of a Chapter 11 Reorganization Plan in this country. For a proposed Scheme to become final and binding it must first be approved by 75% of the voting creditors (measured by value of their claims), including contingent creditors, and sanctioned by order of the English court.

In the past year, creditors of KWELM, Andrew Weir, Trinity, Bryanston and other London Market insolvencies overwhelmingly have approved such Schemes.

One of the reasons for the high approval rate for the Schemes is that they offer creditors quicker payment and a more cost effective alternative to English compulsory liquidation. There are several drawbacks to English compulsory liquidation. First, liquidation is a very lengthy process. Court-appointed liquidators are constrained by detailed provisions of English insolvency law and potential

What Should Policyholders Do?

If your insurance company is part of the London Market and has become insolvent, here are a few things you can do to protect your rights:

- ✓ Review your policies and determine what coverage was or could be affected.
- ✓ Obtain replacement coverage. The insolvent company will not cover claims incurred after an insolvency petition is filed in the English court.
- ✓ Communicate with the provisional liquidators—a claim will not be paid unless they know who you are.
- ✓ If you are an individual or partnership—see if you have guaranty fund protection under the Policyholders Protection Plan.
- ✓ If a Scheme of Arrangement is proposed, review and analyze it. This is the key document which, if approved, binds all creditors to its terms and sets out the procedures necessary to protect your rights.
- ✓ Cast your vote for (or against) the Scheme. Your vote is one way to put the liquidators on notice that you are a claimant in the liquidation.
- ✓ Team up with other policyholders in the same situation to increase your clout during liquidation proceedings. If you are a substantial creditor, you may even want to join the creditors committee.
- ✓ Monitor the liquidation proceedings in the U.K. (and the U.S.) to protect your rights.
- ✓ Pursue other remedies such as drop-down claims from your other insurance companies.
- ✓ Act. There is money out there but you cannot rely on the Liquidators to go out of their way to hand it to you. You must make an effort to grab it.

personal liability if they improperly pay one creditor in preference to another. These stringent requirements inevitably cause a liquidator to wait until all liabilities, including contingent liabilities, have been established (which may take decades) before payments to creditors are made. Second, all claims must be paid in English pounds (established at the date of the initial liquidation filing) which subjects U.S. policyholders to the risks of currency fluctuations when they get paid many years later. Third, assets controlled by liquidators must be pooled in a Bank of England account incurring high investment costs. Fourth, investment options are limited. For instance, cash assets can only be invested in UK Government Securities. Finally, dispute resolution procedures for claims can be litigious and, therefore, quite costly.

Schemes of Arrangement avoid many of these pitfalls. Under a Scheme, claims are paid faster and in the currency of the policy. Regulations concerning the pooling and deposit of assets are less restrictive. Investment policies are flexible and claim resolution can be simpler and cheaper.

How Does a Scheme of Arrangement Work?

Once a policyholder's claim becomes "fixed" (or what the British call "crystallized"), the "fixed" claim is approved for payment (which will be made on an installment basis). A fixed claim is a claim for a certain sum which has been approved or agreed upon by Scheme administrators—i.e., it is a definable loss covered under a policy as compared to a potential future loss or an existing loss which has been contested. In order to protect against preferential treatment of creditors whose claims become fixed in the early years of the run-off to the detriment of those policyholders that have contingent long-term claims that won't become fixed until later, approved claims are paid out on an annual installment basis. For example, in the first year after approval of the Scheme, an interim payment percentage of 10% may be established. If a policyholder has an approved fixed claim of \$500,000, the policyholder's first payment in that first year will be \$50,000. The second year installment will be made in the

ensuing year as further assets (reinsurance) are collected and more of the liabilities are fixed. In that second year the installment percentage may be increased to 15%, in which case the first year policyholder will get an additional 5% (\$25,000) plus interest. This procedure of incremental increases in payment percentages will continue through the life of the run-off and at the end of the run-off the policyholder can expect total payments in the KWELM Scheme (e.g., of 45 cents on the dollar).

Best Known London Insolvencies

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| 1. Kingscroft | 10. English & American |
| 2. Walbrook | 11. Chancellor |
| 3. El Paso | 12. Continental Assurance |
| 4. Lime Street | 13. Pine Top |
| 5. Mutual Re | 14. Slater Walker |
| 6. Andrew Weir | 15. St. Helens |
| 7. British & Overseas | |
| 8. Trinity | |
| 9. Bryanston | |

What About Policyholders With Contingent or Contested Claims?

As previously stated, the American policyholder is prohibited from instituting or continuing any proceedings against the insolvent company in this country.

However, under the most recent Schemes of Arrangement, the Scheme Administrators have agreed to be bound (subject to certain reservations) by any judgment or settlement obtained by a policyholder against other (solvent) insurance companies on the same insurance policy as the insolvent company. This is a very common circumstance in the London Market since those companies frequently issued policies where they participated (on a percentage basis) with numerous other insurance companies on the same policy. Once judgment or settlement is reached, Scheme Administrators are given a six-month period to review the judgment or settlement. If approval is not granted after the six-month review period, the injunction is lifted and the American policyholder can litigate the matter in any court of proper jurisdiction (including the U.S.) to resolve the dispute. In many of the Schemes, there is a further enticement for the Administrator to agree to a settlement or judgment—if he refuses to be bound and litigation ensues and the policyholder wins, the Scheme must pay the policyholder's claim plus his litigation costs and legal fees. ■

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