**FIRST DIVISION, INNER HOUSE, COURT OF SESSION**

**Lord President**
**Lord Reed**
**Lord Mackay of Drumadoon**

**[2009] CSIH 6**
**P1981/08**

OPINION OF THE COURT
delivered by THE LORD PRESIDENT
in Petition of
THE SCOTTISH LION INSURANCE COMPANY LIMITED
Petitioner and Reclaimer;
against
(FIRST) GOODRICH CORPORATION AND OTHERS
Respondents:

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**Act: Howie, Q.C., Delibegović-Broome; Morton Fraser LLP**
**Alt: McNeill, Q.C., Munro; Simpson & Marwick WS**

29 January 2010

**The procedural history**

[1] The petitioner has presented to the court applications under sections 896 and 899 of the Companies Act 2006 in which it seeks respectively an order for meetings of creditors and thereafter sanction of a scheme of arrangement annexed to the petition. The petitioner is an insurance company which has issued various policies of insurance, a significant number of which are "occurrence" insurance, that is, where claims may be made after, and in some cases significantly after, the relative policy has expired. The petitioner is solvent. It has not written any new business since 1994. It is in "run off".

[2] By interlocutor dated 15 December 2008 the Lord Ordinary ordered two separate meetings of

creditors. At the first of these meetings the creditors entitled to attend and vote were those who had claims other than "IBNR" claims and at the second the creditors so entitled were those who had "IBNR" claims. An "IBNR" claim is, broadly speaking, a claim with respect to which, as at the date relevant for scheme purposes, a loss has been incurred but has not been reported. These meetings were held on 2 March 2009. In a report dated 23 April 2009 the chairman of the meetings reported that, in the case of each meeting, a majority in number representing 75% in value of the creditors present and voting either in person or by proxy had voted in favour of the scheme. The actual percentages reported were as follows: at the non-IBNR creditors' meeting 78% in number and 89% in value voted in favour of the scheme; at the IBNR creditors' meeting 61% in number and 97% in value so voted. The valuation of the claims upon the basis of which these figures were calculated took into account, among other things, professional advice from a "Scheme Actuarial Advisor" and an "Independent Vote Assessor".

[3] The respondents, who are American corporations, are creditors with IBNR claims. They are insured under policies which provide protection against "long tail" losses - essentially losses by reason of exposure to asbestos, pollution and health hazard. These losses are liable to become evident long, often decades, after the exposure to which they relate. At the relevant meeting of creditors they voted against the scheme. They have also lodged answers to the petition opposing the application for sanction.

[4] The respondents challenge the decision of the chairman that the requisite majority in number representing 75% in value of the creditors voting at the meeting of IBNR creditors was in favour of the scheme. They contend that the methodology employed by the chairman to evaluate claims for voting purposes was not fair and reasonable.

[5] On 7, 8 and 9 July 2009 the Lord Ordinary heard the parties in debate on two issues of principle which had been identified in advance, namely, (1) are the respondents entitled to challenge the decision by the chairman of the creditors' meetings that the statutory majorities, both by number and value, were attained at the meetings of both classes of creditors? and (2) can it ever be fair to sanction a "solvent" scheme of arrangement in the face of continuing creditor opposition to having their occurrence cover

compulsorily terminated? As noted hereafter, the second question was in the course of the discussion reformulated. Having issued an Opinion on these issues the Lord Ordinary then put the case out By Order on 14 October. Having heard parties further on 16 October he dismissed the petition. Against that interlocutor the petitioner has reclaimed.

[6] So far as concerns issue (1) the Lord Ordinary answered it in the respondents' favour. However, no issue concerning it is raised in the reclaiming motion. It is accepted that, if the Lord Ordinary was in error in dismissing the petition, it will be necessary to have a hearing into whether the respondents' challenge to the valuation methodology is well-founded. The reclaiming motion concerns whether the Lord Ordinary was entitled to resolve the second issue (as reformulated) in the respondents' favour and to sustain their motion that the petition be dismissed without further inquiry.

**The statutory provisions**

[7] Part 26 of the Companies Act 2006 (in so far as material for present purposes) provides:

> "895(1) The provisions of this Part apply where a compromise or arrangement is proposed between a company and -
>
> (a) its creditors, or any class of them, or
>
> (b) its members, or any class of them.
>
> ...
>
> 896(1) The court may, on an application under this section, 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) An application under this section may be made by -
>
> (a) the company,
>
> ...
>
> 899(1) If a majority in number representing 75% 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 summoned under section 896, agree a compromise or arrangement, the court

may, on an application under this section, sanction the compromise or arrangement.

(2) An application under this section may be made by -

(a) the company,

...

(3) A compromise or agreement sanctioned by the court is binding on -

(a) all creditors or the class of creditors or on the members or class of members (as the case may be), and

(b) the company ...

..."

**The Lord Ordinary's decision**

[8] The Lord Ordinary, rejecting a contrary submission by counsel for the respondents, held that the scheme annexed to the petition was an "arrangement" for the purposes of Chapter 26. In addressing issue (2) he accepted a distinction made between on the one hand a company which was either insolvent or was at risk of becoming insolvent should it fail to make a compromise or arrangement with its creditors and on the other a company which was in neither of these states. A scheme proposed by a company in the latter state he described as a "solvent" scheme.

[9] In the course of the discussion issue (2) was reformulated. The Lord Ordinary identified the real question in issue between the parties as follows:

"[42] ... in what circumstances might the court sanction a solvent scheme such as this in face of opposition from dissenting creditors? Or, to put it another way, what does a petitioner seeking sanction of such a scheme in the face of such opposition have to show? Is it sufficient for him simply to say that 'the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve' (applying the test stated in *Buckley*) and rely on creditor democracy to carry the day? Or must he go further?"

The reference to "the test stated in *Buckley*" is to a passage in *Buckley on the Companies Acts* (14th ed.) at pages 473-4 where the learned authors state:

"In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting *bona fide* and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.

The court does not sit merely to see that the majority are acting *bona fide* and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme."

[10] In discussing the arguments advanced before him the Lord Ordinary said:

"[55] ... In the typical case, as [counsel for the respondents] submitted, the compromise or scheme of arrangement arises out of some difficulty or problem that needs to be addressed. A simple case is where the company is faced with financial difficulties. If it goes into liquidation, the creditors may get a very small dividend on their claims. If, on the other hand, they are willing to enter into a compromise or scheme of arrangement with the company, the company may get back on an even footing and they may recover more, albeit not their full claims. In such circumstances it is easy to see why the creditors must be required to act together and be bound by the majority. A dissenting minority should not be allowed to prevent a scheme coming into effect which is obviously for the benefit of the body of creditors as a whole. In such circumstances it is easy to see that the principle of 'creditor democracy', as it is often called, should normally prevail. The situations in *Re Equitable Life Assurance Society* [[2002] 2 BCLC 510] and *Re Cape plc* [[2006] EWHC 1446 (Ch)] were more complex, but they provide other illustrations of situations where creditor democracy is needed and will normally be respected.

[56] The examples are many and various, but it seems to me that the common thread is that the

scheme is put forward in a situation where, as [counsel for the respondents] submitted, there is a problem requiring a solution; that it is in the interests of the creditors (or classes of creditors) as a body that a solution should be found and implemented; and that, to this end, the creditors must act as one and, in identifying the appropriate solution, must agree to be governed by the wishes of the majority, because if they did not then their failure to agree would ruin it for all. That is a situation in which, in my opinion, the principle of creditor democracy applies. But I do not see why it need apply in all cases where a scheme of arrangement is proposed. A solvent scheme is an instance of a case where, subject to other considerations, creditor democracy should not carry the day.

[57] In the present case, there is no reason, apart from the wishes of its shareholders, why the Company should not continue with run-off. It is solvent and appears to have made provision to meet its potential liabilities in the future. From the point of view of the shareholders, the scheme appears to be put forward so that the period of run-off can be brought to an end and the Company would up. Unless the scheme is sanctioned, the creditors, for their part, can reasonably anticipate that as and when claims are made against them they will be able to seek an indemnity from the Company under their policies of insurance with it. If any of them wish to enter into a commutation agreement with the Company, they can do so without the participation of any of the other creditors. But if they do not wish to do so, why should they not be left in a position in which they presently find themselves? In other words, in a situation where the Company is sound financially, why should one group of creditors who might wish to enter into a commutation agreement with the Company be entitled to force other creditors to participate against their will? There may, of course, be reasons apart from financial uncertainty which might justify the majority of the creditors in attempting to coerce the minority in this way. I do not suggest that the line is necessarily to be drawn between a solvent and an insolvent scheme of arrangement, using the term solvent and insolvent in the wider sense described ... above. But in a solvent scheme, I would expect petitioners, applying for a scheme to be sanctioned, to be able to place before the court averments and supporting material justifying the proposition that in the particular case, notwithstanding that it is a solvent scheme, the minority should be bound by the decision of the

majority.

[58] The distinction between a solvent and an insolvent scheme is referred to by Lewison J in para 143 of his judgment in *Re The British Aviation Insurance Co Ltd* [[2006] BCC 14]. I have quoted the relevant passage. He does not in terms spell out the 'quite different considerations' which apply to the case of an insolvent company as opposed to the case of a solvent company. He approaches the matter on the basis that in the case of a solvent company the matters relied upon by the dissenting creditors are entitled to great weight. He emphasises that

> 'If individual policyholders wish to compound the company's contingent liabilities 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 ... require them to do that which it is unreasonable to require them to do.'

That unreasonableness seems to me to stem from the fact that where the company is solvent it is unnecessary for the body of creditors or class of creditors [to] as a whole that there should be any scheme, still less a scheme forced upon unwilling participants. I respectfully agree with that reasoning."

[11] The petitioner having declined to amend, the Lord Ordinary dismissed the petition without inquiry into various disputed factual matters. These included a claim by the petitioner (disputed by the respondents) that, although there were some possible disadvantages to the scheme, there were significant advantages to it such that as a whole it was one which an intelligent and honest creditor, acting in respect of his interest, might reasonably approve and which the court should accordingly sanction.

**Submissions by junior counsel for the petitioner and reclaimer**

[12] Mrs Delibegović-Broome introduced the reclaiming motion by highlighting that, while the question before the Lord Ordinary had originally been whether a solvent scheme of arrangement such as that proposed could ever be sanctioned, it had, as a result of a shift in the respondents' argument, been reformulated. The question ultimately addressed concerned the circumstances in which a solvent scheme

could be sanctioned: whether it was sufficient for a petitioner to satisfy "the *Buckley* test" and rely on creditor democracy or whether he needed to "go further" (para [42]). The Lord Ordinary's essential error in answering the question was his finding that one had to "go further" than the *Buckley* test: that in a solvent scheme there should be a "problem" requiring a solution, before creditor democracy would apply (paras [56] - [58]). In effect, he had created a rebuttable presumption against the sanctioning of an opposed solvent scheme. In doing so, he had addressed a general point of law, in effect an issue of competency, raised in advance of an evidential hearing and before he had reached the stage of exercising his discretion (cf paras [42] and [56] - [58]). That was important, as many of the relevant authorities had involved evidence being led before any decision as regards the scheme was taken (cf *Re The British Aviation Insurance Co Ltd*, para 15).

[13] The notion of a "problem" was uncertain; there was no warrant for the proposition that the existence of a "problem" was a precondition for the sanctioning of a solvent scheme. No issue had been taken with the classes in the present scheme. The Lord Ordinary had accepted that it was an "arrangement" within the meaning of the Act (at paragraph [60]) and the Financial Services Authority had sent a letter of non-objection. The reclaimer had, *prima facie,* obtained the statutory majority for the scheme and set forth a number of advantages, including finality and the early settlement of claims in the form of compensation which, importantly, would, in most cases, not be discounted for early payment. The alternative was a solvent run-off, although voluntary liquidation had been considered since the Lord Ordinary's decision. The company had already been in run-off for 15 years. The reclaimer's position was that these advantages outweighed any disadvantages of the scheme. The Lord Ordinary's decision did not make clear what further averments were required.

[14] If the statutory majority was obtained, the Act presented no legal hurdle prohibiting the exercise of the court's discretion. Nor did it differentiate between insolvent and solvent schemes as regards the application of creditor majority. It clearly provided for the "formidable compulsion" of the majority to bind the minority. That compulsion existed even where the dissentient objection to the scheme was reasonable. There were sufficient protections built into the system making the presumption unnecessary:

if classes were properly identified it would prevent "confiscation and injustice" (cf *Sovereign Life Assurance Company* v *Dodd* [1892] 2 QB 573, per Bowen LJ at pp 582 -583). The courts recognised that, in reality, shareholders with the same rights might nonetheless be motivated to vote in different ways (*Re BTR plc* [2000] 1 BCLC 740, per Chadwick LJ at p 747). In contrast, the decision of the Lord Ordinary, in effect, required unanimity for solvent schemes, even where the dissentient reasons were perverse. The logical conclusion of his decision was that, whenever it was known that there was opposition, there would be no point in making an order for meetings of the appropriate classes. That was not supported by the authorities (cf *Re Sovereign Marine & General Insurance Co Ltd* [2006] B.C.C. 774: [2007] EWHC 1331 (Ch); *Re Telewest Communications plc (No.2)* [2004] EWHC 1466 (Ch); [2005] B.C.C. 36). It ran the risk of minority oppression, against which the courts had warned (*Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480, per Chadwick LJ at para 33; *Re Equitable Life Assurance Society*, per Lloyd J at para [45]; *Re The British Aviation Insurance Co Ltd*, per Lewison J at para 58; *Re UDL Holdings Ltd* [2002] 1 HKC 172, per Lord Millett NPJ at p 184). The "honest man" in the *Buckley* test focused on the decision of the majority and whether it was a decision they "could" have taken (cf *Re Alabama, New Orleans, Texas, and Pacific Junction Railway Company* [1891] 1 Ch 213, per Lindley LJ at p 238).

[15] The authorities demonstrated a consistent and principled approach at the stage of sanctioning a scheme. The *Buckley* test had developed from the earlier cases (cf *Re Alabama, New Orleans, Texas, and Pacific Junction Railway Company*; *In re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385, per Lindley LJ at pp 407 - 409). If satisfied that the meeting was unrepresentative or those voting had a special interest to promote then the court would not sanction the scheme (*Re BTR plc*, per Chadwick LJ at 747; *Re Hawk Insurance Co Ltd* at para 12; cf the example of *Re PCCW Ltd* Hong Kong Court of Appeal CACV 85/2009). However, business men were better judges of what was to their commercial advantage than the courts (*In Re English, Scottish and Australian Chartered Bank*, per Lindley LJ at pp 413-414). Sophisticated groups of creditors could assess the risks in any scheme (*Re Hawk Insurance Co Ltd*, per Pill LJ at para 59). It was for the objector to justify the assertion that the scheme was commercially unviable (*Re BTR plc*, per Chadwick, LJ at page 748). This was an

arrangement, not a confiscation of rights (cf *Re NFU Development Trust Limited* [1972] 1 WLR 1548, per Brightman, J at p 1555). If a scheme was properly sanctioned, no issue arose as regards the First Protocol of the European Convention on Human Rights (*Re Equitable Life Assurance Society*, per Lloyd J at para [86]). In the present case what was proposed was compensation at the correct level. The cases provided no support for the approach adopted by the Lord Ordinary. An arrangement was wider than a compromise (*In re Guardian Assurance Company* [1917] 1 Ch 431). Other attempts to impose limitations or qualifications either on the generality of the word "arrangement" or on the discretion of the court had also met without success (*In re National Bank Ltd* [1966] 1 WLR 819, per Plowman J at pp 828-830). Numerous cases illustrated the wide interpretation given to the word "arrangement" by the courts (cf *In re Savoy Hotel Ltd* [1981] 1 Ch 351, per Nourse J at p 360; *The Singer Manufacturing Co* v *Robinow* 1971 SC 11, per Lord President Clyde at pp 3 - 14). It included solvent insurance schemes (*Re Osiris Insurance Ltd* [1999] 1 BCLC 182). It was impractical to expect companies to seek individual consent from each creditor (*In re Guardian Assurance Company*, per Warrington LJ at p 449).

[16] *Re The British Aviation Insurance Co Ltd*, cited by the Lord Ordinary in support of the presumption against solvent schemes, was decided on jurisdictional grounds (Lewison J at para 97). The comments about the unfairness of the solvent insurance scheme were *obiter* (cf para 143). In any event, the decision turned on its own facts (*Scottish Eagle* v *La Mutuelle Demans Assurances Iard* [2005] EWHC 2683, Evans-Lombe J at paras [3]-[5]; *Re Sovereign Marine & General Insurance Co Ltd*, per Warren J at para 523). An appendix to the written submissions listed numerous solvent schemes for the insurance industry which had been sanctioned. Lewison, J himself had since sanctioned a scheme involving 17 solvent insurance companies (*Re DAP Holding NV* [2006] BCC 48). An unreported case involving the Mercantile & General Reinsurance Company Limited had since been sanctioned by the Court of Session.

[17] We were also referred to a number of examples of solvent schemes of arrangement sanctioned in other jurisdictions (*In re Hudson Conway Ltd* [2000] VSC 21; *Re Mercantile Mutual Insurance (Australia) Limited* [2002] FCA 1632; *Re Colonia Re Insurance (Ireland) Ltd* [2005] IEHC 115; *NRG London Reinsurance Company Ltd* [2006] FCA 1126; *Re Reliance National Asia Re Pte Ltd* [2008] 1

SLR 569).

[18] The interlocutor of the Lord Ordinary should be recalled and the case remitted to the Outer House to proceed as accords.

**Submissions by junior counsel for the respondents**

[19] Mrs Munro submitted that the question addressed by the Lord Ordinary assumed that the statutory majority had been met. Accordingly, he had reached the third stage, namely, that of deciding whether or not to sanction the scheme (cf para [23]). It was accepted that the size of the creditor majority might be a relevant consideration in the exercise of the court's discretion. Nevertheless, whether on the grounds of irrelevancy, or by virtue of a decision to deal with the petition without further procedure (as at a first hearing in a petition for judicial review), the Lord Ordinary had reached a conclusion as regards the sanctioning of the scheme. He had been entitled to do so at that stage. The reclaimer's suggestion that the discretionary exercise required evidence was misplaced. The references in the English decisions, properly understood, concerned the "material" before the court, rather than "evidence" *per se* (*Practice and Procedure of the Companies Court*, Boyle and Marshall, para 3.6.6). The Lord Ordinary had had sufficient material to reach a decision and was not obliged to force on parties the expense of an extensive proof.

[20] The Lord Ordinary had not erred in law, but had relied on relevant authority (*Re The British Aviation Insurance Co Ltd*; *Re Sovereign Marine & General Insurance Co Ltd*). The reclaimer placed too much emphasis on his use of the word "problem". Such language had been used in other cases (cf *Re Cape plc*, per Richards J at paragraph 10). There was no basis for the suggestion that he had superimposed upon the statute a specific requirement for which there was no warrant. The reclaimer had conflated the jurisdictional issue of the statutory majority with the issue of discretion. The Lord Ordinary clearly recognised in his decision that the statutory facility was available to both solvent and insolvent companies. The essence of his decision was that, as a matter of legal analysis, and absent an objective justification for the scheme, no Lord Ordinary could sanction its imposition upon dissentients: on the

averments and material before him it was unjust or unfair. The petitioner had been given an opportunity to provide a justification, but had not done so (para [57]).

[21] Whether there was such justification would depend on the facts and circumstances of each case. In the present scheme the Lord Ordinary was entitled to reach the view that there was not: the Company was solvent; it was under no threat of financial impairment; it would continue to be solvent if the scheme was not sanctioned; it had written extensive occurrence coverage against long tail risks, which inevitably involved a long run-off; the scheme involved the termination of cover for which substantial premiums had been paid and for which there was now no substitute available; if the scheme was approved, any surplus value would be returned to shareholders following voluntary liquidation. The features of the scheme relied on by the reclaimer were not accepted as "advantages" by the respondents (cf *Re The British Aviation Insurance Co Ltd* case, per Lewison J at paras 140-141). No matter what methodology was employed to value the claims, the adequacy of compensation could only be judged retrospectively. In contrast, the indemnity provided security and certainty as regards the risks covered. The scheme did not strike a balance between the interests of the creditors on the one hand and the interests of the Company on the other (cf *Re Cape plc*, per Richards J at para 18). While the courts would be slow to differ from businessmen on matters of commercial judgment, the choice between the termination of the right to indemnity in return for compensation and the continuation of such a right involved less a matter of commercial judgment than of legal principle.

[22] The reclaimer's submission, therefore, ignored the very specific context in which the Lord Ordinary's reasoning was expressed. No solvent insurance scheme had been sanctioned by a court in the face of opposition against such a factual background. The examples cited could be distinguished, and involved different considerations as regards fairness: many concerned only re-insurance businesses, where there might be a common advantage in capping any liabilities given that all those involved were in "the business of risk"; others involved only short tail business where there were no compelling reasons to require the company to remain in run-off (cf *Re Osiris*); and others involved companies whose run-off was nearly terminated. In the only analogous cases the relevant schemes were refused, or sanctioned only

after significant additional procedure to allow for financial accommodation between parties (*Re The British Aviation Insurance Co Ltd*; *Re Sovereign Marine and General Insurance Co Ltd*).

[23] The Lord Ordinary's reasoning was entirely consistent with earlier authority. In addition to ensuring that the statutory prerequisites were met, a court had also to satisfy itself that the scheme was fair and reasonable, or "equitable" (*La Lainiere de Roubaix* v *Glen Glove Co* 1926 SC 91, per Lord Hunter at pp 100-101 and Lord Ormidale at p 101). In exercising its discretion in that regard, it was not constrained by the factors outlined in the *Buckley* test. The authorities on which that test was founded demonstrated that courts would ensure that the vote was representative and might take into account other considerations (*Re Alabama, New Orleans, Texas and Pacific Junction Railway Company* per Bowen LJ at pp 243-245 and especially Fry LJ at p 247; *In re English, Scottish and Australian Chartered Bank*, per Lindley LJ at pp 408-409 and Lopes LJ at p 414). The test was an expression of the more general proposition that the court had a duty to satisfy itself that, in all the circumstances, it was a proper scheme to sanction, which persisted even in the absence of opposition (*Re Cape plc*, per Richards J at para 29). The onus was on the reclaimer to demonstrate the fairness and reasonableness of the scheme and to lay a sufficient basis in its pleadings for the court's duty to be discharged (*La Lainiere de Roubaix* v *Glen Glove Co*, per Lord Hunter at p 107; cf *Sovereign Life Assurance Company* v *Dodd*, per Bowen LJ at p 583).

[24] Ensuring that the vote was representative meant that the court would discount the votes of those who had such personal or special interests in supporting proposals that their views could not be regarded as fairly representative of the class in question (*Re The British Aviation Insurance Co Ltd*, per Lewison, J at paras 95, 113 and 118 - 121; cf *Re UDL Holdings Ltd*, per Lord Millett, NPJ at pp 184-185). Such an issue might arise in the present case. While the precise details remained unknown, from material disclosed to the respondents it was apparent that before the meeting there had been an agreement between the Company and some of the creditors as to the valuation of IBNR claims for voting purposes. At the voting stage the claims of the respondents were substantially discounted, whereas the claims of other creditors, including those who had reached a negotiated settlement, had been accepted in their entirety. The value of the negotiated claims represented almost three-quarters of the weighted majority by value

which voted in favour of the scheme. It was not unreasonable to suppose that the vote valuation would be substantially similar to the final valuation of claims. While much of this information was not before the Lord Ordinary, it was submitted that it was an additional factor which this court could take into account in determining the fairness of the scheme.

[25] Mrs Munro invited the court to refuse the reclaiming motion and to adhere to the interlocutor of the Lord Ordinary.

**Submissions by senior counsel on behalf of the petitioner and reclaimer**

[26] Mr Howie submitted that the reclaimer had not fundamentally misread the Lord Ordinary's decision, which was directed at a matter of law and not to evidential matters. The purpose of the hearing had been to debate an issue which might bring the petition to an end or lead to a shorter hearing on evidence. The question initially identified did not concern the particular circumstances of the present case. Even the question as ultimately reformulated concerned a matter of law of general application. That was evident from the submissions made before the Lord Ordinary, particularly by Mr McNeill (para [43]). It was also seen in the language employed in the decision, which, for example, referred to the "common thread" of a "problem" before a solvent scheme was approved (at para [56]). The respondents' submission that the principle of creditor majority had already operated misunderstood the decision. While accepting that it was an important criterion for "problem" cases, the Lord Ordinary had held that in a solvent scheme it should not "carry the day" (at para [56]).

[27] The decision had been, in effect, that one could not, barring something extra, have a solvent scheme which bound a dissentient minority. The sanctioning or otherwise of a scheme should not depend on continuing opposition, as not all creditors could afford the costs involved in a legal challenge. If, unless a "problem" was identified, it was unfair to force a solvent scheme upon dissentient creditors, the logical conclusion was that such a scheme could never be sanctioned if there were votes in opposition to it. Moreover, as had been accepted by Mrs Munro, it would not matter if the reasons put forward in opposition were good, bad or indifferent. However, it was clear from the examples cited that such

schemes had been sanctioned despite such opposition. Moreover, in the case of a solvent scheme, it was not immediately clear what the relevant "problem" would have to be.

[28] Once the procedural requirements had been fulfilled the court should exercise its discretion in accordance with the *Buckley* test, which had been applied in a number of cases and had achieved canonical status. Its discretion was not unfettered, nor did it involve wide-ended considerations. There had to be an element of certainty and predictability in any test applied. The notion of "a proper scheme to sanction" was too vague a criterion. The respondents' reliance on *Re Cape plc* in that regard was misplaced: Richards J had himself referred to the *Buckley* test (at para 8). Nowhere in the authorities or the statute was there warrant for the imposition of an additional legal requirement of a "problem" for solvent schemes of arrangement. The danger of the Lord Ordinary's reasoning was that there was no reason why the test he adopted should not be applicable to all solvent schemes. Mrs Delibegović-Broome had therefore referred to cases involving a number of different circumstances, where schemes had been sanctioned despite opposition. Those cases supported the reclaimer's position; the distinctions upon which the respondents relied were irrelevant.

[29] The correct approach to the *Buckley* test was to consider whether or not the honest and intelligent man "could" or "might" approve the scheme (*Re Alabama, New Orleans, Texas and Pacific Junction Railway Company*, per Fry LJ at p 247; cf footnote to the Opinion of Lloyd J in *Re Equitable Life Assurance Society* at p 531). At the stage at which discretion was exercised one already knew what the majority of creditors "would" have done: adopting that test ran the risk of rubber-stamping their decision. In issues of commercial judgment there could be legitimate differences of view (cf. *In Re Telewest Communications plc (No.2)*, *per* Richards J at paras 20-21). There might therefore be situations where a vote either in favour or against a scheme might be considered reasonable. The test involved looking at the majority who voted in favour of the scheme. Where, as here, it was a large majority, that was a factor, albeit not conclusive, which could be taken into account in considering the fairness of the scheme. If the method of evaluating votes was disputed that was a matter for evidence at a later stage.

[30] *Re The British Aviation Insurance Co Ltd* could be distinguished. Unlike the present case, evidence

had been led allowing Lewison J to make a fully informed decision. Many of the creditors in the present case were large multinational companies which, in reality, might be considered as self-insured, or which had risk-management consultants. This was to be contrasted with a situation in which the insured were small retailers. One could not therefore simply say that the companies were not in the risk business and that the scheme was therefore unfair, these being possible avenues for examination at the evidential hearing. Moreover, the scheme did not seek to avoid paying what was owed to the creditors: given the method of valuation and the lack of any discount for early payment, what was proposed was compensation at a rate of greater than "20 shillings in the pound". It was not therefore possible to say that, compared to a solvent run-off, the claims would automatically be underestimated or be unfair. Schemes involving the estimation of IBNR claims had previously been sanctioned (cf. *Re Osiris Insurance Ltd*; *Scottish Eagle* v *La Mutuelle Demans Assurances Iard*). There was nothing inherently wrong with actuarially estimating a claim: it was routinely done in damages cases. Solvent schemes would never be approved if, as had been suggested, one could only retrospectively ascertain the fairness of an estimated claim; yet long tail insurance schemes involving such estimations had been sanctioned (*Re Mercantile Mutual Insurance (Australia) Limited* and *Re Colonia Re Insurance (Ireland) Ltd*). The reclaimer was entitled to the opportunity of leading evidence justifying its method of evaluating claims. In the last sentence of para 143 in *Re The British Aviation Insurance Co Ltd* Lewison J had misapplied Bowen LJ's observations in *Sovereign Life Assurance Company* v *Dodd*, where the topic of discussion was the identification of the correct classes.

[31] The facts relied on by Mrs Munro concerning the negotiated settlements were not accepted, but it was submitted that her submissions in that regard were, in any event, irrelevant. The material had not been before the Lord Ordinary and it was not appropriate to refer to it in a reclaiming motion.

[32] In concluding his submissions Mr Howie also referred to an, as yet, unpublished article criticising the decision of the Lord Ordinary in the present case (*Scots Cut Off Exit for Lion - A Major Hurdle for Solvent Schemes*, Gabriel Moss QC). He submitted that the absence in the legislation, the case law or the *Buckley* test of any express reference to a distinction for solvent schemes suggested there was no need for

the presumption introduced by the Lord Ordinary. The petitioner was entitled to proceed to the sanction stage and to have a decision taken on whether the scheme met the *Buckley* test. The court should recall the interlocutor and the case should be remitted to the Lord Ordinary to proceed as accords.

**Submissions by senior counsel on behalf of the respondents**

[33] Mr McNeill noted that the article by Gabriel Moss, Q.C., to which Mr Howie had referred, merely rehearsed arguments made elsewhere. Other commentators had welcomed the Lord Ordinary's decision. As this was a developing area of law, it was not enough to identify other solvent schemes of arrangement which had been sanctioned. Where there was no binding precedent, the court had to consider what the circumstances required, in light of any relevant authority, and construe the statute accordingly. Despite being widely adopted, the *Buckley* test was not part of the statutory regime. In any event, it referred to an "honest" and intelligent creditor, from which one might infer the requirement to adopt a reasonable position: one would not honestly vote for a result which imposed an unreasonable situation on others. The court was looking at a member of a class exclusively as such a member without any special interest (*Re Alabama, New Orleans, Texas and Pacific Junction Railway Company*, per Fry LJ at page 247). A judge could, therefore, refuse to sanction a scheme which was not fair and reasonable, or equitable (cf . *La Lainiere de Roubaix* v *Glen Glove Co*), particularly where, as here, the scheme was not truly "commercial" but involved "risk management". The identification of classes involved different considerations (*cf Re The British Aviation Insurance Co Ltd*, per Lewison J at para 118).

[34] The Lord Ordinary had simply exercised the discretion available to him. If his approach did involve an issue of law, the fact that it was not found in the statute did not undermine it. Other concepts considered by the courts, such as "class" or "fairness", were not defined by the statute. The Lord Ordinary was clearly addressing matters in a novel context, involving a solvent insurance scheme with long tail liabilities which otherwise would continue in a solvent run-off (paras [57]-[58]). He was also aware that the fairness of the method of claims valuation was in dispute. There were only two directly relevant reported cases, which he correctly took into account (*Re The British Aviation Insurance Co Ltd*; *Re Sovereign Marine & General Insurance Co Ltd*). He was entitled to take the view that the imposition of

an actuarially based compensation upon long tail contingent creditors was unreasonable and to request that the petitioner provide objective justification. One could identify, in each of the cases referred to, some problem, or reason (cf *In re Guardian Assurance Company*), justifying a scheme. Few of those involved compelling the minority to be part of that scheme. Moreover, the decision did not lead to the unfortunate results for which the reclaimer contended. The dissentient minority were not preventing what could otherwise be properly and honestly done. There were at least four alternatives to proceeding with this scheme: (i) continuing in run-off which would still allow the commutation of the rights of willing creditors by arrangement; (ii) allowing other insurers to take over the policies of the company; (iii) providing a scheme with opt-out clauses, so that those who did not want to be part of it might remain insured; and (iv) voluntary liquidation, which had the inbuilt creditor protection of a liquidator, the court, not the company, imposing the scheme by which the company was to be run down and the creditors, not the shareholders, being given priority. The decision of the Lord Ordinary simply prevented this scheme of arrangement from coming into force.

[35] It would be very rare that only a single creditor would hold up a scheme - by voting against it, abstaining or being untraceable. Normally very large companies were involved and the likelihood of knowing all of the creditors, which might number many thousands, and intimating the scheme was remote. In the present petition the Company believed that there were 29,500 scheme creditors of whom the names and addresses of 15,000 were known. However, it only had to obtain a double majority of those present and voting, which gave the lie to the concept of "creditor majority". In any event, it could be that in the hypothetical context of 99% approval for a scheme, the 1% who could not be contacted were fairly sure that there was a claim just round the corner. The result of imposing the scheme upon them would be that, rather than seeing the cover for which they had paid satisfied, they would get an actuarial valuation. It was difficult to see why a scheme of compensation, solely within the hands of the company, ought to be imposed where it need not be. This was not a domestic policy of insurance: risks in relation to asbestos and land pollution could arise without any warning or any claims history. It was therefore difficult to foresee how there could be an accurate actuarial valuation. If there was no requirement to impose the scheme, it was difficult to see why it did not fall within article 1 of the first

protocol of the European Convention on Human Rights (cf *Re Equitable Life Assurance Society*)

[36] In the specific circumstances of the present case the Lord Ordinary had been correct to identify the need for a reasoned justification for the scheme which would, if sanctioned, deprive dissentients of their rights under their policies. While the statute was drawn in wide terms, there was no entitlement to the sanction of a scheme. The reclaiming motion should be refused.

**Discussion**

[37] In discussing section 2 of the Joint Stock Companies Arrangement Act 1870 (an ancestor of sections 895 and 899 of the Companies Act 2006) Bowen LJ said (*Sovereign Life Assurance Company* v *Dodd*, pp 582-3):

> "[The statute] makes the majority of the creditors or of a class of creditors bind the minority; it exercises a most formidable compulsion upon dissentient, or would-be dissentient, creditors; and it therefore requires to be construed with care, so as not to place in the hands of some of the creditors the means and opportunity of forcing dissentients to do that which it is unreasonable to require them to do, or of making a mere jest of the interests of the minority."

Bowen LJ then went on to discuss what the statute meant by "class" of creditor, opining 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."

[38] That passage was cited with approval by Chadwick LJ in *Re Hawk Insurance Co Ltd*, at para 26.

[39] In the present case it has been recognised that the IBNR creditors form a different class from the non-IBNR creditors and separate meetings have been ordered and held accordingly. It was not suggested to the Lord Ordinary that that classification was otherwise than fair and appropriate. A protection has accordingly been put in place against "forcing dissentients to do that which it is unreasonable to require them to do, or ... making a mere jest of the interests of the minority." That is not the only protection. The court under section 899 has a discretion: it "may ... sanction the ... arrangement". It is not obliged to do

so. In *In re English, Scottish and Australian Chartered Bank*, Lindley LJ at p 408 cited two passages from the judgments given in *In re Alabama, New Orleans, Texas and Pacific Junction Railway Company*. He said:

> "I adhere to what I said there, and I will read a short passage from my judgment: 'What the Court has to do is to see, first of all, that the provisions of the statute have been complied with; and, secondly, that the majority have been acting *bona fide*. The Court also has to see that the minority is not being overridden by a majority having interests of its own clashing with those of the minority whom they seek to coerce. Further than that, the Court has to look at the scheme and see whether it is one as to which persons acting honestly, and viewing the scheme laid before them in the interests of those whom they represent, take a view which can be reasonably taken by business men. The Court must look at the scheme and see whether the Act has been complied with, whether the majority are acting *bona fide*, and whether they are coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and then see whether the scheme is a reasonable one or whether there is any reasonable objection to it, or such an objection to it as that any reasonable man might say that he could not approve of it.' Lord Justice Fry expressed himself to the same effect, in somewhat different language. He said: 'Under what circumstances is the Court to sanction a resolution which has been passed approving of a compromise or arrangement? I shall not attempt to define what elements may enter into the consideration of the Court beyond this, that I do not doubt for a moment that the Court is bound to ascertain that all the conditions required by the statute have been complied with; it is bound to be satisfied that the proposition was made in good faith and, further, it must be satisfied that the proposal was at least so far fair and reasonable, as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might approve of it. What other circumstances the Court may take into consideration I will not attempt to forecast.' Now, it is quite obvious from the language of the Act and from the mode in which it has been interpreted, that the Court does not simply register the resolution come to by the creditors or the shareholders, as the case may be. If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better

> judges of what is to their commercial advantage than the Court can be. I do not say it is conclusive, because there might be some blot in a scheme which had passed that had been unobserved and which was pointed out later."

[40] Although Fry LJ in the cited passage expressly left open what further considerations might require to be taken into account in a particular case when the court was exercising its discretion, the threefold function of the court has been summarised in *Buckley* in the terms previously referred to. The authorities there cited include *Edinburgh American Land Mortgage Co Ltd* v *Lang's Trustees* 1909 SC 488 (wrongly cited as [1900] SC 488) in which "the test laid down in the *Alabama* case" was followed (per Lord Low at page 492). Buckley's summary was quoted with approval by Neuberger J (as he then was) in *Re Osiris Insurance Ltd*, at pp 188-9.

[41] Although the Lord Ordinary in one formulation asked himself the question "Is it sufficient for [the petitioner] simply to say [that the *Buckley* test is satisfied] and rely on creditor democracy to carry the day? Or must he go further?", it is unnecessary, in our view, at this stage to address the content of the *Buckley* test. We observe only that it is a summary and that in any case where the sanction of the court is sought it will be necessary to have regard to the judicial authorities which that summary seeks to encapsulate.

[42] The issue before this court is whether the Lord Ordinary was entitled to dismiss the petition essentially upon a preliminary point, namely, that, this being a "solvent scheme", the petitioner could not succeed in its opposed application for sanction in the absence of an offer to establish that there was "a problem requiring a solution". It is clear, in our view, from the nature of the argument presented to him and from his treatment and disposal of it, that the Lord Ordinary regarded the point as a preliminary ("knockout") one - as distinct from his addressing on their whole respective merits the factors in favour of and against sanctioning of the scheme.

[43] Section 2 of the 1870 Act, as enacted, applied only where the company in question was being wound

up, either voluntarily or by or under the supervision of the court. The jurisdiction to sanction a compromise or arrangement was extended, by section 38 of the Companies Act 1907, to a company which was not in the course of being wound up. The 1870 Act was to apply "in like manner as it applies to a company which is in the course of being wound up". There is nothing in that statute nor in its descendents (down to and including Part 26 of the Companies Act 2006) to suggest that applications for sanction of a "solvent scheme" are in principle to be dealt with differently from those where the company is insolvent or on the verge of insolvency. That is not to say that the circumstance that the company is solvent is irrelevant when the court comes to exercise its discretion. But it does mean that it is only a factor which, with other factors, is to be taken into account for that purpose.

[44] The occasion for the presentation of an application for sanction may be where there is a "problem" - in the sense of an adverse situation facing both the company and its creditors, or a class of them, which requires to be resolved. The existence of such a problem may be a factor in favour of the granting of sanction. But it is not, in our view, a precondition to the sanctioning of a scheme, whether solvent or otherwise. *Edinburgh American Land Mortgage Co Ltd* v *Lang's Trustees* is an example of a solvent scheme where there was no "problem", simply a proposal (by the ordinary shareholders) to have the uncalled liability on their shares terminated and alternative arrangements made for the security of debenture-holders, some of whom opposed the scheme; the court sanctioned the scheme subject to modification. Fry LJ in the *Alabama* case, albeit in the context of a company in voluntary liquidation, speaks about the "proposition" and the "proposal".

[45] It is now conceded that in the present case the scheme is an "arrangement" within the meaning of section 899 of the 2006 Act. It will be for the court, having had regard to all the evidence relevantly bearing on the exercise of its discretion - including the balance, if it exists, of advantage over disadvantage of the scheme and the extent, if any, to which the requisite majorities, properly ascertained, exceed the statutory thresholds - to decide whether sanction should be given to it. The onus of satisfying it that on the whole relevant material, some of which is controversial, the scheme should be sanctioned will rest on the petitioner as applicant. The extent, if any, to which oral testimony will be necessary will

require to be determined procedurally in advance of the substantive hearing.

[46] The scheme for which sanction is sought includes, broadly, a proposal that the Company's creditors, including its contingent creditors in respect of IBNR claims, will be entitled to receive immediately certain sums based on a scheme of valuation, the payment of which will discharge their contingent claims. The respondents, for reasons which are readily understandable, would prefer to retain their existing contractual rights. But the loss of these contractual rights cannot be said *a priori* to be something which would disable the court sanctioning the scheme. It is of the very nature of the power conferred on the court under section 899 that, provided the statutory majorities are properly obtained and the requisite test for the granting of sanction satisfied, contractual rights will, notwithstanding opposition by persons in right to them, be varied or extinguished. We can see no basis in the authorities for the view that "creditor democracy" operates only where "failure to agree would ruin it for all". On the other hand, its operation is not conclusive (*In re English, Scottish and Australian Chartered Bank,* per Lindley LJ at p 409).

[47] This is not the only scheme which has in recent times been proposed by a solvent insurance company with contingent long tail liabilities to its policyholders. These include *Re The British Aviation Insurance Co Ltd* in 2005 (where the application was refused) and *Re Cape plc* in 2006 where the application was granted). The Lord Ordinary relied heavily on certain observations made by Lewison J in the former of these cases. In that case the application was dismissed on jurisdictional grounds so that the observations made by the learned judge on which the Lord Ordinary relied were *obiter*. In concluding his judgment Lewison J having considered among other matters the alleged benefits of the proposed scheme, which he largely discounted, said at para 143:

> "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 liabilities 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 do that which it is unreasonable to require them to do."

The reference to the words of Bowen LJ is, of course, to what he said in *Sovereign Life Assurance Company* v *Dodd* quoted earlier - though it is relevant to note that these observations were made in the context of identifying the appropriate classes of creditors for voting purposes, not in the context of the final discretionary decision.

[48] We do not propose to comment at this stage on Lewison J's observations, other than to notice that these were only part of his consideration of the whole circumstances bearing on the discretionary exercise, which circumstances included that only part of the applicant company's business was to be subject to the scheme; the remainder was to remain in conventional solvent run-off (para 13) - contrast the proposal under the present scheme. The argument that the proposal in this scheme is unreasonable, or is not "so far fair and reasonable as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might approve of it" (*In re Alabama, New Orleans, Texas and Pacific Junction Railway Company*, per Fry LJ at p 247), is one which should be addressed when the whole relevant factual circumstances are before the court and it is, in light of these, considering the exercise of its discretion. At that stage the argument based on the fact that insured with long tail policies are being required to accept current estimated values in lieu of their contingent claims may, possibly with other arguments, win the day. But that circumstance is not, in our view, at this stage so overwhelming a factor against the granting of sanction that the petitioner can be denied the opportunity of establishing, if it can, the positive benefits of the scheme, as well as the soundness and robustness of the procedures it has put in place for valuing claims. Subject to any relative amendment of the respondents' pleadings the court will also require to take into account any contention that some of the

creditors who voted in favour of the scheme had a special interest by reason that compositions had been agreed privately with them in advance of the vote. That might, if established, be a "blot" in the scheme.

**Disposal**

[49] For these reasons we are satisfied that the Lord Ordinary erred by resolving the preliminary point he had identified in favour of the respondents and dismissing the petition. We shall accordingly recall his interlocutor. We were advised that developments since the case was before him may call for amendment of the pleadings and for other procedural steps before a hearing on the merits is fixed. We shall accordingly remit to the Lord Ordinary to proceed as accords.

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