Neutral Citation Number: [2006] EWHC 1850 (Ch)

Case Nos: 8416 of 2005; 8428 of 2005

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 29th June 2006

Before :

THE HONOURABLE MR JUSTICE PUMFREY

IN THE MATTER OF
EAGLE STAR INSURANCE COMPANY LIMITED
AND OTHERS

and

IN THE MATTER OF
THE FINANCIAL SERVICES AND MARKETS ACT 2000

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Malcolm Davis-White QC and **Gregory Denton-Cox** (instructed by **Freshfields Bruckhaus** Deringer) for the **Companies**
Richard Millett QC (instructed by **Holman Fenwick & Willan**) for **General Reinsurance** Corporation and **North Star Reinsurance Corporation**
Niall McCulloch (instructed by **John Pickering & Partners**) for **Mr and Mrs Birch**

Hearing dates: 27th - 28th March 2006
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Judgment

Mr Justice Pumfrey :

1. This is an application seeking the court's sanction to a scheme for the transfer of certain general insurance businesses between companies in the Zurich Insurance Group. In summary, four members of the group, Eagle Star Insurance Company Limited ("Eagle Star"), Midland Assurance Limited ("Midland"), Preferred Assurance Company Limited ("Preferred") and Whiteley Partnership Insurance Company Limited ("Whiteley"), all transfer certain policies to the United Kingdom branch of Zurich Insurance Company ("ZIC"). Certain policies written by Eagle Star are also transferred to Zurich Insurance Ireland Limited and certain other policies written by Midland are transferred to Eagle Star. The result of the transfers, if sanctioned, would be that Midland, Preferred and Whiteley would cease to have any business or assets or liabilities apart from possible Excluded Policies or Residual Assets/Liabilities. The effect of the scheme is thus to concentrate the business of the group in the United Kingdom in ZIC, Eagle Star retaining its policies issued by branches outside the United Kingdom and a small Life business largely written in Malta. Associated with the scheme it is proposed that the capital of Eagle Star should be reduced, first for the purpose of eliminating a deficit on profit and loss account arising in consequence of the transfers, and secondly to provide a special capital reserve which, with the sanction of the court and the FSA, can be released progressively as the business is run off and the capital is no longer required to support it.

2. I was addressed by Counsel on behalf of the companies and on behalf of Mr Howard John Birch and Mrs Eileen Denise Birch. Mr Birch is the successful claimant in an action for damages for asbestos-induced pleural plaques against certain of his former employers, who include British Nuclear Fuels Plc, Bridgewater Paper Company Limited and Cheshire Recycling Limited. Mr Birch's solicitors are concerned that one or more of Mr Birch's former employers may have relevant policies written either by Eagle Star or by Midland that will be retained by Eagle Star, and that accordingly they were persons who might be adversely affected by the scheme.

Two United States corporations, General Reinsurance Corporation ("Gen Re") and its affiliated company North Star Reinsurance Corporation, applied for an adjournment of the hearing to sanction the scheme, for the purpose of assembling expert evidence to comment upon or perhaps to challenge evidence given by the independent expert, Dr Gibson. Their challenge was to the adequacy of the capital retention by Eagle Star. I rejected the application for an adjournment for reasons that I gave at the time, which essentially turned on the lateness and lack of preparation of the objection. Gen Re had been in discussions with Zurich for some considerable time. Notwithstanding my refusal of the adjournment, the points that Mr Millett QC raised on behalf of Gen Re were in substance supported by Mr McCulloch on behalf of the Birches and provoked some discussion of the function of the independent expert's report. There were some other minor issues relating to foreign policyholders. I gave my sanction for the scheme at the conclusion of the hearing, but left over a statement of my reasons as concisely as possible in a written judgment.

Jurisdictional Matters

3. It was established that the scheme was an insurance business transfer scheme as defined by s.105 of the Financial Services and Markets Act 2000 ("FSMA"). By s.101(2) FSMA, the court must be satisfied that the appropriate certificates have been obtained, as prescribed by Parts I and II of Schedule 12, and that the transferee has the required authorisation to enable it to carry on the transferred business. This was equally established. No point arises upon it.

4. An application for the sanction of the court for a scheme is sought by an application under s.107 FSMA, and by s.109:

> "(1) An application under section 107 in respect of an insurance business transfer scheme must be accompanied by a report on the terms of the scheme ("a scheme report").
>
> (2) A scheme report may only be made by a person -
>
> (a) appearing to the [FSA] to have the skills necessary to enable him to make a proper report; and
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> (b) nominated or approved for that purpose by the [FSA].
>
> (3) A scheme report must be made in a form approved by the [FSA]."

5. The scheme report in the present case was prepared by Dr Lis Gibson of Deloitte and was supplemented by a supplemental report, also prepared by Dr Gibson, which was prepared in consequence of concerns raised first by Gen Re, to which I have referred above, but also by the Life policyholders of Eagle Star (Malta) Limited and an individual retired glass industry worker, Mr Douglas Robson, who was concerned about the transfer of certain policies in respect of long-term industrial injury claims from Eagle Star to ZIC.

6. The independent expert's report is some 70 pages long and is divided into 10 sections and supporting appendixes. Dr Gibson is the holder of a first-class degree in mathematics and her doctorate is in pure mathematics. She is a fellow of the Institute of Actuaries. In practice, her clients include general insurance companies, reinsurers, and Lloyds syndicates.

The Central Issue

7. Both for Gen Re and for Mr and Mrs Birch, the principal issue as finally identified was the adequacy of the capital retention by Eagle Star. After describing the companies and the transfers in section 4 of her report, Dr Gibson sets out in section 5 an overview of the financial implications of the transfers. She concludes that the transfers will not have a materially adverse impact on the policyholders transferring out of Whiteley,

and the transferred Irish policyholders. Equally, there will be no adverse effect upon current policyholders with ZIC or ZIIL. She proceeds, in sections 6 and 7 of her report, to consider respectively whether the financial security offered to policyholders transferring into ZIC from Midland (the UK employer's liability business) and Eagle Star is at least as favourable as that currently offered by Eagle Star, and, in section 7, in respect of the effect of the transfer upon the policyholders retained by Eagle Star or transferred to it from Midland (the London market business). Section 7 of the report is thus the crucial part of the report for present purposes.

9. In section 7.2, which is entitled "Background", Dr Gibson says this:

> "As part of the Transfers, the parties propose that the transfers of assets and liabilities from ES to ZIC are accompanied by the release of some net assets to ZIC. By its nature, any reduction in the level of capital in ES will reduce the financial security given to policyholders of ES. I need to be satisfied that sufficient capital will be retained in ES to ensure that there will be no material adverse impact on the policyholders whose policies remain with ES. Deloitte has carried out a reserve review for the remaining policyholders, showing best estimates reserves and those on a very conservative (high) basis (approximating to a chance of one in forty that the reserves need to be higher in relation to the term of ES's run-off liabilities). Zurich has carried out ICA [individual capital assessment] calculations and I have reviewed these, making any adjustments I deemed appropriate for the purpose of the Transfers. I have considered whether or not capital, in the sum of £500m, which will be retained by ES immediately after the Transfers is sufficient to protect policies remaining within ES and so that the Transfers will not have a material adverse impact on these policyholders."

10. She then explains the approach taken by Zurich to the calculation of the ICA. She says that the FSA considers that the aim of an insurer's ICA is "to satisfy the FSA that it can be confident that in adverse projected financial situations it will be able to pay its liabilities in full when they fall due". She then describes the work she has done on the ICA for Eagle Star and explains further that, while the computations have been reviewed at a high level by the FSA, they had not at the time of her report been fully reviewed. She sets out the six relevant risks which are relevant to the calculation, and in the ensuing sections of the report describes whether the proposed capital requirement is sufficient to meet the identified risks. In paragraph 7.11, she states that she has "stress tested" the key assumptions that she has made, and in particular that she has considered the adequacy of the retention of £500m to give sufficient confidence that Eagle Star will be able to pay its debts in the future as they fall due. She then sets out her conclusions. She recognises in those conclusions that, given that the ratio of ICA capital resource to ICA capital requirement is reduced following the transfers, it follows that the remaining policyholders are disadvantaged. She states, however, that the key question is "whether in absolute terms the amount of capital

required by ES following the Transfers ensures that there is no material adverse impact on the Retained ES Policyholders". She sets out a table showing the retention as a percentage of the post-transfer total reserves, and concludes that the transfers have no material adverse impact on the retained policyholders.

12. There was no challenge to what Dr Gibson states that she did. Mr Millett QC and Mr Niall McCulloch, on behalf of Mr and Mrs Birch, both contended that the court should take steps to enable the independent expert's report to be tested. Mr Millett suggested that it was contrary to the basic requirement of fairness in litigation that a *bona fide* objector should be shut out from a chance to show that the independent expert's report was in point of fact inadequate. Mr McCulloch, unwilling for obvious reasons to turn himself into a representative of an opponent, submitted that the court should promote the fairness of the proceedings as between the insurers on the one hand and the individuals on the other by affording resources to the latter by way of a pre-emptive costs order or the like, to enable them to carry out at least rudimentary enquiries for the purpose of assisting the court in discharging its functions when called upon to sanction a scheme of this description. He pointed out, as is obvious, that his clients are in an entirely different position from Gen Re, who can always carry out its own tests of what has been advanced by the independent expert.

In my judgment, the contentions advanced both by Mr Millett QC and by Mr McCulloch overlook the importance of the independent character of the independent expert and of the independent expert's report. While the transferor will have to pay for the independent expert's report, that expert has both to be approved by the FSA and to produce a report in a form satisfactory to the FSA. The FSA provides extensive guidance in respect of transfers of business in section 18 of the supervision part of the Handbook, referred to as SUP 18. SUP 18.2.14 and the following paragraph set out the qualifications that a proposed independent expert should have and point out, for example, that the FSA may wish to have preliminary discussions with a proposed independent expert, to help the FSA determine whether he is suitably qualified to address issues arising from the transfer (SUP 18.2.21). It reserves the right to appoint its own independent expert where it does not approve the parties' own nomination (SUP 18.2.22). Extensive guidance is given in paragraphs SUP 18.2.32 - 18.2.41 on the contents of the report and the matters upon which the independent expert should express an opinion. The Institute of Actuaries also issues detailed guidance on the contents of a formal report covering the actuarial aspects of a general insurance undertaking.

The foregoing considerations demonstrate that although the independent expert's report shares certain features of experts' reports prepared for the purpose of *inter partes* litigation, that is not its real nature. It is intended to be, and the FSA takes care to ensure that it is, an objective assessment of the scheme by a person to whom the importance of retaining their independence and objectivity has been repeatedly emphasised. Where it seems that the independent expert has identified the possible problems with a particular scheme and has, on what appear to be satisfactory grounds, rejected them, it seems to me that rather more than the normal requirement to give the opponent an opportunity to impugn the report is required before permitting that

> opponent either to see the independent expert's detailed workings or to instruct a further expert. It seems to me that there must be strong grounds for supposing that the independent expert has mistaken his function or made an error before a challenge to the report can be mounted. The present case is far from being such a case. When specific concerns were addressed to her, Dr Gibson produced her supplemental report. This discussed in detail the solvency position of Eagle Star post transfers, having regard to the potential exposure to asbestos claims. She describes the approach she takes to asbestos claims and the potential deterioration in asbestos claims in detail in this supplemental report, and again no substantial challenge has been mounted to what she has said in that document. In these circumstances, I think it would be quite wrong to permit her workings to be provided to other experts with a view to seeing to what extent some sort of challenge can be mounted to them.

I consider that the views which I have expressed receive some support from authority. In *Re London Life Association Limited* (unrep.) 21 February 1989 (Hoffmann J) Hoffmann J said this:

> "In providing the court with material upon which to decide this question, the Act assigns important roles to the independent actuary and the Secretary of State. A report from the former is expressly required and the latter is given a right to be heard on the petition. The question of whether policyholders would be adversely affected by the scheme is largely actuarial and involves a comparison of their security and reasonable expectations without the scheme with what it would be if the scheme were implemented. I do not say that these are the only considerations but they are obviously very important. The Secretary of State, by virtue of his regulatory powers, can also be expected to have the necessary material to express an informed opinion on whether policyholders are likely to be adversely affected."

13. The importance of the independent expert's report that appears from this statement is emphasised, in my judgment, by the judgment of Evans-Lombe J in *re AXA Equity and Law*[2001] 2 BCLC 447 at 477 where, in paragraph [44] of his second judgment, the learned judge said this:

> "[44] Save for the unchallenged evidence of AXA that its past practice in meeting tax obligations from its long-term fund accords with the practice of the overwhelming majority of other insurance companies in the same field, the differences of view between the objectors, AXA, the independent actuary, and the FSA appear to depend on which forecast of future events or which actuarial calculation of potential risk of certain events occurring, is to be preferred. This court has no actuarial skills and is in no better position (in fact in a much worse position) to forecast future relevant events and market movements than are those parties. Accordingly, my approach, as indicated by

> authority, is to accept the views of the independent actuary and the FSA as advised by the government actuaries department in preference to those of AXA and the objectors where they are in conflict except if there were a compelling reason, based on proven fact, or demonstrable mistake in calculation or forecast, which points to a contrary view. Where the views of the FSA or the independent actuary conflict I propose to prefer those of the FSA. No such compelling reason, proven facts or demonstrable mistake has emerged."

14. I would respectfully suggest that the court retains the right to reject actuarial calculations based upon manifestly unreasonable forecasts, but subject to that small qualification I consider that this passage supports the view that I take of the susceptibility of the independent expert's report to challenge.

15. Having once concluded that the retention of £500m is appropriate, the consequence of the conclusions of the independent expert is that the scheme as proposed is fair as between the different policyholders concerned. In this regard the position of the Birches, who are contingent, or speculative, claimants against the Eagle Star, has been taken into account by the independent expert's assessment of the appropriate level of reserve related to asbestos risk. It follows that it is appropriate to sanction the scheme.

16. In this judgment, I am concerned to consider only the question affecting the weight to be attached to the independent expert's report. No other minor or technical issues which required decision arose that would justify their inclusion in this judgment. Having regard to the guidance given by Hoffmann J in *Re London Life Association Limited* (above), there is one other matter to which I should refer.

17. This matter is that it has been suggested that the transfers effected by the present scheme may (or will) be followed by a Scheme of Arrangement under s.425 Companies Act 1985, having the effect of barring unnotified claims after some date in the future. As to this, Hoffmann J said, in a frequently-cited passage:

> "Although the statutory discretion is unfettered, it must be exercised according to principles which give due recognition to the commercial judgment entrusted by the company's constitution to its board. The court in my judgment is concerned in the first place with whether a policyholder, employee or other person would be "adversely affected" by the scheme in the sense that it appears likely to leave him worse off than if there had been no scheme. It does not however follow that any scheme which leaves someone adversely affected must be rejected. For example, as we shall see, one scheme which might have adopted in this case would have adversely affected many of London Life's employees because they would have become redundant. But such a scheme might nevertheless have

> been confirmed by the court. In the end the question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected. But the court does not have to be satisfied that no better scheme could have been devised. A board might have a choice of several possible schemes, none of which, taken as a whole, could be regarded as unfair. Some policyholders might prefer one such scheme and some might think they would be better off with another. But the choice is in my judgment a matter for the board. Of course one could imagine an extreme case in which the choice made by the board was so irrational that a court could only conclude that it had been actuated by some improper motive and had therefore abused its fiduciary powers. In such a case a member would be entitled to restrain the board from proceeding. But that would be an exercise of the court's ordinary jurisdiction to restrain breaches of fiduciary duty; not an exercise of the statutory jurisdiction under section 49 of the Insurance Companies Act 1982."

Absent a suggestion of bad faith or improper motive, it cannot be an objection to the scheme that a future scheme of arrangement is a possibility, or even likely.

18. Finally, I referred above to Malta Life policyholders. Dr Gibson explains that the remaining business is in a segregated fund reinsured 100% to ZIC. I do not consider that the holders of these policies can be said to be materially adversely affected by the scheme.