

THE HOME INSURANCE COMPANY**NOTE OF ADVICE**

1. We are asked to advise on the following three questions:

1. Whether Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding up of insurance undertakings (the "Directive")¹, and the Insurers (Reorganisation and Winding Up) Regulations 2003 (the "Regulations")² apply to the UK branch ("the UK Branch") of the Home Insurance Company ("the Home"). In particular, we are asked to advise whether the rules regarding the priority of different classes of creditor apply.
2. Whether the worldwide insurance creditors of the Home (i.e. not only those creditors of the UK Branch) can prove and rank alongside UK Branch creditors in an English procedure.
3. Whether English law will allow for the UK Branch's assets to be ring-fenced for UK Branch creditors, thereby potentially resulting in better returns to those creditors.

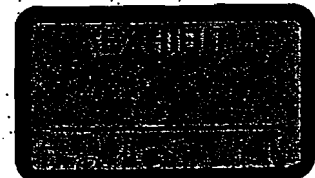
These three questions are considered in turn.

Application of the Directive and the Regulations to the Home

2. The Directive forms part of a series of EC measures, all issued in the form of Directives, designed to bring about the coordination of laws, regulations and administrative provisions in the EC member States with respect to direct insurance. The previously-issued Directives were concerned with the conduct

¹ OJ L 110/28, 20.4.2001.

² SI 2003/1102.



of such business, including its regulatory supervision.³ The purpose of Directive 2001/17 is to complement these by standardising the conditions under which "reorganisation measures" and "winding up proceedings" may take place concerning "insurance undertakings" and branches of such undertakings situated in a Member State.

3. The basic policy maintained through the series of harmonising Directives concerning direct insurance undertakings is to ensure consistent application of the principle of "home state supervision". This utilises a distinction between the "home" Member State and the "host" Member State. The former is defined in Article 2(e) of Directive 2001/17 as the Member State in which an insurance undertaking has been authorised to engage in direct insurance business in accordance with Article 6 of Directive 73/239/EEC or Article 6 of Directive 79/267/EEC. The expression "host Member State" is defined by Article 2(f) of the Directive as the Member State other than the home Member State in which an insurance undertaking has a branch. Under the principle of "home state supervision", the activities of an insurance undertaking throughout the EC, including those activities pursued by means of branches situated in other Member States, are subject to the regulatory control of a single authority, and a single system of law, namely that of the state in which authorisation has been granted. This standardised mode of treatment of insurance undertakings and their branches in other EC Member States is complemented under Directive 2001/17/EC by conferring exclusive jurisdiction in matters of reorganisation or winding up to the competent authorities of the home Member State.⁴
4. Although the primary focus of the Insurance Directives is the coordination of the conduct of business throughout the EC by insurance undertakings formed under the law of one of the Member States, the maintenance of the principle of equality within the Internal Market is considered to necessitate the application

³ The two main Directives are the so-called "First Council Directive" relating to non-life insurance (Directive 73/239/EEC of 23 July 1973, OJ L 228, 16.8.1973) and the "First Life Assurance Directive" (Directive 79/267/EEC of 5 March 1979, OJ L 63, 13.3.1979). Both main Directives have been amended.

⁴ See the Directive, Arts.4(1) and 8(1).

of the same standards of legal treatment to insurance undertakings whose headquarters are located outside the Community but which engage in business within the EC by means of one or more branches authorised by the competent local authorities of the Member State in question. Accordingly by its Articles 1(2) and 30 the provisions of the Directive are made applicable to reorganisation measures and winding up proceedings concerning branches situated in the Community of so-called "third country insurance undertakings". The basis of treatment in such cases is to designate the Member State in which the branch is located as the "home" Member State and to regard the competent authorities of that Member State as the entities responsible for "home state supervision". In consequence, the provisions of the Directive which allocate jurisdiction exclusively to the home Member State with regard to the authorising of reorganisation measures, or the opening of winding up proceedings, are applicable to the branch of a third country insurance undertaking on the premise that the "home Member State" means the Member State in which the branch has been granted authorisation according to the provisions mentioned above in paragraph 3.⁵

5. The Directive does not purport to effect a total unification of the relevant insolvency laws of all the Member States, as applicable to direct insurance undertakings. Instead, its provisions standardise the rules for exercise of jurisdiction, while allowing the proceedings themselves to be governed in almost all respects by the law of the Member State in which they are conducted, save where specific provision to the contrary is imposed under the further provisions of the Directive.⁶ For present purposes, the most significant of the specific provisions made by the Directive is Article 10, which imposes the obligation on Member States to ensure that insurance claims take precedence over any other claim on the insurance undertaking, with the only possible exception of:

⁵ See Article 30(1) of the Directive. (Where a third country insurance undertaking has branches established in more than one Member State, each branch is to be treated independently for this purpose, so that each of the relevant Member States constitutes the "home Member State" of the branch authorised to operate within its territory: Article 30(2)).

⁶ See Articles 4, 8 and 9 of the Directive, together with Articles 10 and 19-26.

Article 10(1) of the Directive. Member States are also permitted by Article 10(2) to provide for the expenses of the winding up to have precedence over insurance claims.

"Insurance claims" are defined for the purposes of the Directive by Article 2(k), whose substance is closely matched by the definitions of "insurance claim" and "insurance debt" given in Regulation 2 of the Regulations.

"EEA State" is defined by Reg 2 of the Regulations to mean a State, other than the United Kingdom, which is a contracting party to the Opote Agreement on the European Economic Area, signed on 2 May 1992.

- (i) who has permission under the Financial Services and Markets Act 2000 to carry out contracts of insurance; and
- (ii) whose head office is not in the United Kingdom or an EEA State.

defined by Regulation 48(b) as meaning a person -

7. Part VI of the Regulations applies to Third Country Insurers, which are

conformity with the purpose for which they were enacted.

to construe the Regulations in the way which will achieve the closest

necessary during the process of interpretation by the court, which should seek

Law to implement the Directive, the text of the Directive can be referred to if

means by which the UK has sought to fulfil its obligation under Community

direct insurance undertakings. However, as the Regulations constitute the

the embodiment of the law relating to insolvency proceedings concerning

means of the Regulations. It is to the latter that the English court will look as

6. The Directive has been transposed into the law of the United Kingdom by

undertaking.

accord them precedence over all other species of claims on the insurance

defined categories of preferential and secured claims, but they are required to

Thus, Member States are permitted to subordinate insurance claims to the

- (i) claims by employees arising from employment contracts and employment relationships;
- (ii) claims by public bodies on taxes;
- (iii) claims by social security systems; and
- (iv) claims on assets subject to a proprietary security interest.

According to Regulation 2(4), for the purposes of the Regulations a contract of insurance does not include a reinsurance contract. Therefore an insurer whose UK authorisation is confined to the conduct of reinsurance business would not qualify as a "third country insurer" for the purposes of Regulation 48(b).¹⁰

8. According to the evidence available to us, it appears that the Home meets the criteria in Regulation 48(b) for it to be classified as a third country insurer: the head office of the company is in the state of New Hampshire, USA, which is not an EEA State, and the company was authorised under the FSMA to conduct direct insurance business in the UK via the UK Branch. Consequently, in the event of winding up proceedings concerning the Home, Regulation 49 causes Parts III, IV and V of the Regulations to apply to the Home as if references in those Parts to a UK insurer included a reference to a third country insurer. This results in the application, *inter alia*, of Regulations 20 to 26 inclusive, which have the effect of disapplying section 175 of the Insolvency Act 1986 (which prescribes the order of priority of payment of debts in insolvency), and of substituting a modified order of priority whereby insurance debts must be paid after the company's preferential debts, and ahead of all other debts.¹¹ This provision accords with the requirements of Article 10 of the Directive described in paragraph 5 above.

Conclusion

9. We conclude that the Directive and the Regulations apply to the UK Branch of the Home, and that in the event of a winding up in England the applicable rules of insolvency law will include the modified provisions as to priority which are contained in the Regulations.

¹⁰ See also Regulation 2 (definition of "UK insurer"), which expressly excludes a person who, in accordance with permission granted under the FSMA, carries on the authorised activity *exclusively* in relation to reinsurance contracts (emphasis added).

¹¹ Regulation 21(2) of the Regulations. ("Insurance debt" is defined in Reg.2). See also Reg.21(4) which provides that insurance debts rank equally among themselves and must be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions.

**Whether the worldwide creditors of the Home are entitled to participate
alongside UK Branch creditors**

10. Regulation 8, in Part III of the Regulations, declares that the general law of insolvency has effect in relation to UK insurers (which, as explained above, must here be read as including a reference to third country insurers) subject to the provisions of that Part. Therefore, to the extent that any special rule or modification is imported into the general law of insolvency by any provision in Regulations 8 to 16 inclusive, these displace the rules of law that would otherwise apply. Part III is mainly concerned with matters of notification and publicity of insolvency proceedings, primarily for the benefit of creditors and regulatory authorities within the European Economic Area. There are also provisions in Regulation 13 designed to assist creditors in EEA States in the process of submitting their claims. However, there are no provisions which displace or modify the fundamental principle of English insolvency law that requires proceedings opened in this country to be regarded as of "universal" effect, so that they apply to the whole of the debtor's available property "wherever situated".¹² The corollary of this proposition is that the worldwide creditors of the debtor are eligible to participate in the English insolvency proceedings on terms of equality with the domestic creditors.

11. Although the right of equal participation is accorded to the worldwide creditors, the processes of admission and ranking of claims, and of distribution of the available assets, are controlled by English law, and are ultimately subject to the overarching principles of English public policy.¹³ Thus the eligibility of any particular creditor to receive dividend in the English proceedings can be overridden by the operation of an exclusionary doctrine such as that which denies to foreign sovereign states the right to enforce penal or revenue claims in English proceedings.¹⁴ Similarly, any creditors who have

¹² Insolvency Act 1986, s.436 (definition of "property").

¹³ See *Bank of Credit and Commerce International SA (No. 10)* [1997] Ch. 213, esp at 236 and 246-248, per Scott V-C. (Article 9 of the Directive expressly prescribes that the law of the home Member State shall determine these and a number of other matters).

¹⁴ *Government of India v. Taylor* [1955] A.C. 491 (H.L.).

obtained partial payment of their debts by separate actions which bring them within the scope of the "hotchpot" doctrine are obliged to account for any sums which they have received from assets which properly belong to the debtor's available estate.¹⁵ Subject to such factors arising from the circumstances of individual claimants, the worldwide creditors are eligible to receive dividend in respect of the admitted value of their claims. In each case, a creditor will rank for dividend in accordance with the order of priority prescribed by English law by virtue of the nature of the debt. In this context, the modified rules of priority imported by Regulations 20 to 26 are applicable, as already discussed in paragraphs 5 and 8 above. It is significant however that neither the modified rules of priority, nor the definitions of "insurance debt", "policyholder" and "policy" which are supplied by Regulation 2 of the Regulations,¹⁶ contain any wording to indicate an intention to create a distinction between the treatment of insurance debts owed to policyholders of the UK Branch and those which are owed to policyholders of the Home as a result of its general operations elsewhere in the world.

Conclusion

12. We conclude that in an English winding up of the Home the proceedings would assume the usual, universal character and that the worldwide insurance creditors of the home would be entitled to prove and rank alongside UK Branch creditors.

Whether English law would allow the assets of the UK Branch to be ring-fenced for UK Branch creditors, thereby potentially resulting in better returns to those creditors?

¹⁵ See *Cleaver v. Dulia American Reinsurance Co* [2001] UKPC 6, [2001] 2 A.C.328 (P.C.).

¹⁶ Regulation 2 of the Regulations incorporates by reference the definition of "policyholder" given by the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001, SI 2001/2361.

¹¹ See *Banco Nacional de Cuba v. Cosmos Trading Corp* [2001] 1 BCLC 813 (CA), at p. 820, per Scott V-C. (There is one, partial, exception to this proposition, in consequence of the entry into force of the EC Regulation 1346/2000 on Insolvency Proceedings on 31 May 2002: proceedings opened under Article 3(2) on the basis of the presence in the UK of an "establishment" of the debtor are deemed to be of territorial effect so far as concerns their application to assets of the debtor. However, Article 32 permits "any creditor" to lodge proof in any proceedings, whether main or secondary, thereby preserving the principle of universal participation by all creditors worldwide. It can be noted that Regulation 1346/2000 has no application in the case of the Home or its UK Branch, because by Article 1(2) insolvency proceedings concerning insurance undertakings are excluded from its scope).

¹² See the judgment of Scott V-C in *Re Bank of Credit and Commerce International SA (No.10)*, above note 13, at 238-246.

14. English courts have devised a practical solution to the conceptual difficulties caused when there are concurrent insolvency proceedings, each purporting to have universal effect. By developing a pragmatic policy based on the distinction between "main" and "ancillary" proceedings, the courts can encourage the English-appointed liquidator to co-operate with his foreign counterpart with a view to devising an appropriate solution for administering the debtor's worldwide estate for the benefit of the creditors worldwide.¹⁶ It is clear however that while English law will endorse the liquidator's efforts to achieve a rational and cost-effective method of administering assets and claims, this will not be allowed to circumvent the fundamental principles of English

13. It logically follows from the answer to the previous question that the answer to this third question must be in the negative. Although the jurisdiction of the English court to make an order for the winding up of the Home can be said to arise as a result of the company's activities in this country conducted via the Branch, the winding up order, if made, would relate to the Home as the entity to be subjected to a winding up by the court. The Branch has no legal identity separate from the company to which it belongs, and for English law purposes the affairs of the Home are to be treated on a unitary basis. This is so despite the fact that it will be apparent, in cases such as this, that the English proceedings will in reality take place alongside other winding up proceedings opened in the company's state of incorporation. The settled position under English law is that even in the case of concurrent insolvency proceedings the English winding up is considered to be of universal application, and there is no possibility for the winding up of a foreign company to be limited to its activities and assets in England.¹⁷

law and policy, as applicable to insolvency cases.¹⁹ Since the *pari passu* treatment of the claims of all creditors constitutes one of the fundamental principles of English insolvency law, no discriminatory treatment of claims, or distortion of the prescribed process of distribution, will be permitted.

Conclusion

15. We therefore conclude that English law will not allow for the UK Branch assets to be ring-fenced for the benefit of UK Branch creditors, at the expense of according equality of treatment to the non-UK creditors in the course of the administration of the worldwide estate of the Home.

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¹⁹ *Ibid.*