INSOL International

Re HIH Casualty and General Insurance Ltd and Other Companies: McMahon and Others v McGrath and Another

9th April 2008

Case Study Series - 2

Acknowledgement

INSOL is pleased to present the second case study under its International Case Studies Series. This study is on the well known *HIH Casualty & General Insurance Ltd. & Other Companies.*

Until its collapse in March 2001, the HIH group was the second largest insurance group in Australia. This case relates to four of its companies of which three were based and operating in London.

The central issue in the case was how to distribute the companies' assets located in England. Unlike English insolvency law, Australian law of the Corporations Act of 2001 gives priority to insurance creditors with respect to reinsurance recoveries. English insolvency law, on the other hand, does not recognize such a preference and would allow a distribution to all creditors involved on a *pari passu* basis. Thus, certain creditors in Australia would gain if Australian law were to be applied, whereas certain English creditors would lose if Australian law were to be applied.

This study provides the background information of the case, the procedural history, issues in disputes and the ruling and analysis of the court.

INSOL would like to thank Mr. Geoffrey Raicht of McDermott Will & Emery, USA for preparing this excellent case study at a time when most insolvency practitioners are extremely busy. We are grateful for his assistance in this project.

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A. Case Name and Date of Decision

Re HIH Casualty and General Insurance Ltd and other Companies; McMahon and Others v. McGrath and Another, 9 April 2008

B. Case Information

Tribunal – House of Lords, United Kingdom

Judge's name – Lord Hoffman, Lord Phillips of Worth Matravers, Lord Scott Foscote, Lord Walker of Gestingthorpe, Lord Neuberger of Abbotsbury.

Australian liquidators – Mr. McGrath and Mr. Macintosh

English provisional liquidators - Mr. McMahon, Mr. Riddell and Mr. Wardrop

Australian insurance creditors representatives – Amaca Pty. Ltd. and Amaba Pty. Ltd.

C. Background Summary

The HIH group was comprised of 274 companies involved in various insurance and reinsurance businesses in Australia, England and the United States, among other countries. The holding company of the HIH group was named HIH Insurance Ltd. Until its collapse in March 2001, the HIH group was the second largest insurance group in Australia.

The present case relates to four companies (the "Companies") in the HIH group: HIH Casualty and General Insurance Ltd. ("HIH"), FAI General Insurance Co. Ltd. ("FAIG"), World Marine & General Insurances Pty. Ltd. ("WMG") and FAI Insurance Ltd. ("FAII"). The Companies were incorporated and were operating in Australia. HIH, FAIG and FAII were also registered as "Overseas Companies" in the United Kingdom. All three companies were authorized under the Insurance Companies Act of 1982 to carry on insurance business in the United Kingdom.

HIH operated a branch office in London, England, and was actively participating in the London insurance and reinsurance markets. While in operation, HIH underwrote various marine and non-marine insurance and reinsurance policies, with a focus on liability pro rata, liability excess of loss, property, political risk and trade credit, film finance and accident excess of loss. The majority of HIH's outstanding liabilities arising from its London operations related to reinsurance. In addition, a significant number of HIH creditors were based in the United Kingdom.

FAIG was also involved in the reinsurance business in London, England, and to a lesser extent, in the insurance business. Its reinsurance business was mostly comprised of companies registered or operating in the United Kingdom. The majority of reinsurance agreements entered by FAIG had arbitration clauses requiring arbitration to take place in London, England.

WMG conducted business in the United Kingdom since the 1950s (through an underwriting pool). WMG's business was primarily related to the issuance of asbestos, pollution and health hazard insurance policies. The managing agents for WMG were located in England and were responsible for holding all moneys and collecting reinsurance recoveries.

Finally, FAII underwrote casualty risks for policyholders in the United States, and only a few of its creditors were located in the United Kingdom.

Although the majority of assets of the Companies were located in Australia, a significant number of assets were located in England. The approximate figures (in US millions) of assets and liabilities for the Companies are as follows:

Assets	**HIH**	**FAIG**	**FAII**	**WMG**
Australia	864	799	33	15
United Kingdom	206	23	10	8
Elsewhere	41	70		
Total	1,111	892	43	23
Liabilities				
Australia	3,488	2,274	1,903	35
United Kingdom	882	5	85	12
Elsewhere	129	50	154	0
Total	4,500	2,329	2,142	47

D. Procedural History

On March 15, 2001, the board of directors of 17 companies in the HIH group, including all of the Companies, applied to the Supreme Court of New South Wales (the "Australian Court") to request the appointment of provisional liquidators. The Australian Court appointed provisional liquidators for the HIH group.

On March 16, 2001, the Australian liquidators moved the Australian Court to issue a letter of request to the High Court in England (the "English Court") to appoint a joint provisional liquidator ("JPL") for HIH in accordance with the English Insolvency Act of 1986. The letter of request was issued by the Australian Court and JPLs were appointed that same day. The same actions were taken for FAIG on March 23, 2001 and for FAII and WMG on April 10, 2001.

On July 16, 2001, HIH Systems International Ltd., a member of the HIH group and a creditor of the Companies, was granted leave by the English Court to present winding up petitions against the Companies.[1] The petitions were presented on July 24, 2001 by the JPLs in order to protect the English creditors since English and Australian bankruptcy laws contain different priority schemes for the creditors of a liquidated entity. The JPL's belief was that the Companies would remain in provisional liquidation and that winding-up orders would not be issued until appropriate schemes of arrangement were negotiated among the creditors.[2] However, on August 27, 2001, the Australian Court issued winding-up orders in connection with the Companies and appointed Australian liquidators for the Companies.

On September 10, 2001, the Australian Court requested that the English Court appoint provisional liquidators for the Companies. The English Court agreed and appointed new JPLs (the "English JPLs").

1 The winding up petition begins the process of liquidation.

2 The purpose of a scheme of arrangement in a cross-border insolvency case is to agree on a universal method of collecting assets and making distributions to creditors in accordance with the laws of the relevant jurisdictions.

On June 24, 2005, the English JPLs applied to the English Court for direction as to how the assets of the Companies were to be wound up given the differences between the Australian and English insolvency laws and priority schemes. In response, on July 4, 2005, the Australian liquidators requested that any assets collected by the Companies be remitted to the Australian Court for distribution in accordance to Australian insolvency law and priority schemes. The Australian liquidators sought and obtained a letter of request from the Australian Court which was sent to the English Court seeking the English Court's assistance.

The central issue in the case was how to distribute the Companies' assets located in England. Unlike English insolvency law, Australian law under section 526A of the Corporations Act of 2001 gives priority to insurance creditors with respect to reinsurance recoveries. English insolvency law, on the other hand, does not recognize such a preference and would allow a distribution to all creditors involved on a pari passu basis. Thus, certain creditors in Australian would gain if Australian law were to be applied, whereas certain English creditors would lose if Australian law were to be applied.

On October 7, 2005, the English Court ruled that it did not have the power to remit the English assets to the Australian Court because the Australian priority scheme and distribution order was different from the one applied in England. Since, in this instance, the English Insolvency Act of 1986 would require distribution on a pari passu basis, the English Court ruled that remitting assets for distribution not on a pari passu basis, but rather in accordance to a scheme where specific creditors are given a higher rank in accordance with the Australian priority scheme, would violate the English Insolvency Act of 1986. The Australian liquidators appealed this decision.

On June 9, 2006, the English Court of Appeals, Civil Division, held that it did have the power to remit the assets to the Australian Court but declined to do so because it ruled that it would prejudice the interests of the non-insurance creditors. The English Court of Appeals explained that remitting assets to a foreign court which would apply a different distribution scheme is permitted only if the country of the principle liquidation proceeding produced advantages for the non-preferred creditors in order to counteract the prejudice they would face by remitting the assets. The English Court of Appeals held that the instant case provided no such advantages, resulting in the denial of the request for remittance. The Australian liquidators appealed the decision of the English Court of Appeals.

E. Main Parties in Dispute/Involved

Debtor	HIH Casualty and General Insurance Ltd., FAI General Insurance Co. Ltd., World Marine & General Insurances Pty. Ltd. and FAI Insurance Ltd.
Australian liquidators	Mr. McGrath and Mr. Macintosh
Lawyer	Jonathan Sumption QC
Lawyer	Simon Mortimore QC
Lawyer	Tom Smith
English provisional liquidators	Mr. McMahon, Mr. Riddell and Mr. Wardrop
Lawyer	William Trower QC

Lawyer	Jeremy Goldring
Australian Insurance creditors representatives	Amaca Pty. Ltd. and Amaba Pty. Ltd.
Lawyer	Geoffrey Vos QC
Lawyer	Peter Arden

F. Issues in Dispute

The first issue in this case is whether the English provisional liquidators have the power to remit assets located in England to the Australian Court despite differences between English bankruptcy law and Australian bankruptcy law regarding the priority scheme of distribution. The second issue is the following: in the event the English provisional liquidators have the power to remit assets to the Australian Court, should they exercise such power in the instant case.

G. Court Ruling and Analysis

The House of Lords held that the English provisional liquidators did have the power to remit the assets to the Australian Court and that such power should be exercised in the instant case. The various judges on the panel of the House of Lords, however, disagreed about what would constitute the exact legal basis for the provisional liquidators to exercise such power.

With respect to the power to remit assets to the Australian Court, the House of Lords considered two possible basis for such authority. The first such basis, which all the judges agreed was a valid basis, was section 426 of the English Insolvency Act of 1986 (the "1986 Act"). Section 426 of the 1986 Act reads as follows:

> "The courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having corresponding jurisdiction in … any relevant country."

Australia was determined to be a "relevant country" by the Secretary of State of England. Since a request for assistance was made to the English Courts, the requirements of section 426 of the 1986 Act were met. In adopting this reasoning, the House of Lords rejected the argument that remitting assets to be distributed in accordance to Australian insolvency law as opposed to in accordance with English insolvency law would be contrary to the 1986 Act.

The second possible basis for the power to remit is based upon what the House of Lords describes as "principles of international comity." The reasoning of the Court relied heavily on past English case law and judicial practices. Lord Hoffman, the strongest advocate of the international comity line of reasoning, focused on judicial practices of the late nineteenth century where English courts would treat the winding-up of a foreign company in England as ancillary to the winding up of such company by the court of the company's domicile. Lord Hoffman noted that these English courts had the power to distribute the assets in accordance with English law under the statutory trust theory, which posit that foreign assets located in England were held in trust by English courts to be distributed in accordance with the English statutory scheme. Yet, courts refused to apply the statutory trust theory based on the pragmatic reason that foreign courts would not adhere to an English court's ruling affecting the assets of a company domiciled in the foreign court's jurisdiction. Thus, a form of universalism was already present in older English decisions which tried to promote international cooperation. Despite the arguments made by Lord Hoffman, the international

comity argument was not unanimously adopted. One judge agreed with Lord Hoffman while two others disagreed. The final judge refused to opine on the issue.

Regarding the second issue of whether or not the court should exercise its authority to remit the assets to the Australian Court, the judges of the House of Lords unanimously agreed that the assets should be remitted because (i) the Australian distribution and priority scheme is not contrary to English public policy, (ii) English insolvency law now includes a similar preferential provision for insurance creditors, (iii) different countries will inevitably give different preferences to different creditors, and (iv) the expectation of creditors would most accurately be met by applying Australian bankruptcy law since creditors knew that they were dealing with Australian companies.

H. Commentary on Cross-Border Relevance

This decision is important because it used a universal approach as opposed to a territorial approach to cross-border insolvencies. Moreover, the case strengthens the argument that there is a common law basis for remitting assets to the home country of a foreign entity in an insolvency proceeding. However, the issue of whether assets could be remitted where section 426 of the 1986 Act does not apply remains an open issue.

I. Useful Information

Links to court website

High Court of England: http://www.hmcourts-service.gov.uk/

English Court of Appeals, Civil Division:
http://www.hmcourtsservice.gov.uk/cms/civilappeals.htm

House of Lords: http://www.parliament.uk/lords/index.cfm