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View from the Outback

The judicial management regime for insolvent Australian
insurers and Chapter 15 of Title 11 of the US Code

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1. Introduction

This paper looks at a number of aspects of Australian and American law which the case study which is attached for convenience (the **Case Study**) brings into focus, namely:

- the UNCITRAL Model Law on Cross-Border Insolvency, the *Cross-Border Insolvency Act 2008* (Cth) and Chapter 15 of Title 11 (Bankruptcy) of the US Code (**Chapter 15**);
- the judicial management regime in Australia; and
- the capital adequacy and reinsurance requirements imposed by the Australian Prudential Regulation Authority (**APRA**) .

The paper then deals with the particular issues which might arise in the Case Study in relation to the Australian registered general insurer, Outback.

2. The UNCITRAL Model Law on Cross-Border Insolvency

Australia has adopted the UNCITRAL Model Law (the **Model Law**), passing the *Cross-Border Insolvency Act 2008* (Cth) (**CIA**) in 2008.

2.1 Purpose of the Model Law, the CIA and Chapter 15

The purpose of the Model Law, the CIA and Chapter 15 is five-fold, according to the preamble of the Model Law. Those five purposes are to:

- facilitate co-operation between courts and other competent authorities of foreign states involved in cross-border insolvencies;
- ensure greater certainty for trade and investment, as quite often a company will be incorporated in one state and will have significant operations in a number of other jurisdictions;
- facilitate the fair and efficient administration of cross-border insolvencies which protects the interests of all interested persons, including the debtor;
- ensure the protection and maximisation of the value of the debtor's assets; and
- facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

One of the ways in which the Model Law, the CIA and Chapter 15 achieve the goals of the preamble is by staying a local insolvency regime in a jurisdiction when that jurisdiction recognises an insolvency regime operating in relation to the relevant company in another country – that foreign regime is called a 'foreign main proceeding'¹. For example, there may be a stay of proceedings pursuant to Chapter 15 in a US court when that US court recognises, upon an application, that the relevant company is already subject to a Court liquidation – a foreign main proceeding – taking place in Australia. There can however be

¹ See Article 20 of the UNCITRAL Model Law

much difficulty in establishing that an applicant's proceedings are 'foreign main proceedings'. An applicant needs to demonstrate that the main proceedings are taking place in the place where the company has its 'Centre of Main Interests' (**COMI**). The concept of a COMI will be explored further below in 6.3.

In the Case Study §1520 of Title 11 (Bankruptcy) of the US Code (which is the US enactment of Article 20 of the Model Law) will play a pivotal role in determining whether the Australian entity, Outback, can seek Chapter 15 protection in the United States.

2.2 Applicability of the Model Law, the CIA, and Chapter 15 to insurance companies

The CIA does not apply to insurance companies². The Model Law itself recognises that some enacting states may wish to exclude insurance companies from their local coverage under the law³. In the UK, the *Cross Border Insolvency Regulations 2006* do not apply to insurers⁴.

Section 1501(c) of Chapter 15 lists the entities which cannot seek protection under Chapter 15. Section 109(b)(2) of Title 11 states that a domestic insurer cannot be a debtor under Title 11, and nor can a foreign insurance company engaged in such business in the United States (see §109(b)(3)(A)). However, if a foreign insurance company is not carrying on insurance business in the United States, it would fall outside the scope of §109(b) of Title 11, so that such a company could seek the protection of Chapter 15. So as long as Outback is not carrying on business as an insurance company in the United States, it could seek protection under Chapter 15. It would however have to satisfy the relevant criteria which will be discussed in 5 below.

3. The judicial management regime in Australia

3.1 Overview

The concept of judicial management in relation to a general insurer is a relatively young one in Australia, having been introduced by the *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* (Cth) which received Royal Assent on 17 October 2008. Before the regime was introduced with respect to general insurers, a similar regime applied in relation to life insurers. Until October 2008 the forms of administration which applied to an insolvent general insurer in Australia were the same as those applying to any other Australian company, that is, the forms of administration provided for in the *Corporations Act 2001* (Cth) (the **CA**).

Judicial management is a form of administration which takes into account the interests of policyholders and financial system stability when determining what actions should be

² See Article 1(2) of Schedule 1 to the CIA

³ See Article 1(2) of the Model Law: This Law does not apply to a proceeding concerning [*designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this State wishes to exclude from this Law*].

⁴ See Articles 1(2)(j), (k) and (l) of Schedule 1 to the UK legislation

taken. External administration under the CA, on the other hand, requires the interests of creditors and / or members to be paramount.

3.2 What to expect from judicial management

There has not yet been an appointment of a judicial manager to an Australian general insurer. However, a judicial manager has been appointed to two life insurers: Occidental Life Insurance Co of Australia and Regal Life Insurance Ltd.

In *Insurance and Superannuation Commissioner v Occidental Life Insurance Co of Australia; Insurance and Superannuation Commissioner v Regal Life Insurance Ltd*⁵ the court considered whether the judicial manager was able to submit more than one report under section 62 of the *Life Insurance Act 1945* (Cth) (which is equivalent to section 62ZI of the IA). In holding that more than one report could be filed with the court, Lockhart J of the Federal Court made some helpful observations about the nature of judicial management. In particular, his Honour said (at pages 521-2):

Essentially the court puts its trust in the judicial manager and leaves it for him to decide when it is appropriate to report. But it must be remembered that the judicial management of these companies is a temporary administration akin to a provisional liquidation or receivership. It is not a full or comprehensive winding up of the affairs of the companies or their respective businesses. The extent to which the judicial manager may continue in control of the business and affairs of the companies will depend on a variety of matters and it may mean that a long time passes before the judicial management concludes.

While these comments were made with particular reference to section 62, they could be applied generally to judicial management. That is, judicial management is similar to provisional liquidation or receivership and it is not intended to be a full or comprehensive winding up of the affairs of a business.

Judicial management is not a regime which distributes assets of the general insurer under judicial management as might happen in a liquidation, Deed of Company Arrangement or a scheme of arrangement. As Lockhart J said above, it is more like a provisional liquidation or a court appointed receivership in which the judicial manager takes stock of the situation. It is a regime by which an external party is inserted by the court to take control of the general insurer, investigate its state of affairs and determine what course of action would best serve the interests of policyholders and the stability of the financial system in Australia.

Upon the judicial manager's appointment, there are various stays put in place which prevent proceedings being commenced or continued against the general insurer (see 3.7 below). The judicial manager may consider a restructure, a recapitalisation, a transfer of some of the assets to another general insurer or it may recommend the winding up of the general insurer (see 3.7 below). There is also the possibility that the Australian government would lend support to an insurer under judicial management as occurred in the successful rehabilitation of UMP through the provisional liquidation process.

The foregoing all occurs under the control and supervision of an Australian court.

⁵ (1991) 101 ALR 511

Where the judicial manager resolves that the insurer cannot carry on business in any form, APRA can apply to the Federal Court for the general insurer to be wound up: subsection 62ZU(1) of the IA. The Federal Court can order that the general insurer be wound up if it is satisfied that it is in the interests of the general insurer's policyholders: subsection 62ZU(2) of the IA. Alternatively, the judicial manager or APRA may apply to the Federal Court that an external administrator be appointed to administer the affairs of the general insurer: section 62ZQ of the IA. The judicial manager may also ask the court to permit the directors to appoint a voluntary administrator to allow the creditors to approve a Deed of Company Arrangement or the judicial manager could propose a Scheme of Arrangement or, as occurred through the successful provisional liquidation of UMP, following a successful rehabilitation of Outback allow for it to be returned to the control of the directors. Indeed, the court might agree to the judicial manager becoming the administrator, Deed Administrator, the liquidator or Scheme Manager, or another insolvency practitioner may assume one of these roles.

3.3 Most likely form of administration for a general insurer

Following the introduction of the judicial management system for Australian general insurers judicial management is the most likely form of external administration in Australia for general insurers and for life insurers. Any other form of external administration – voluntary administration, Deed of Company Arrangement, Scheme of Arrangement or liquidation – is either not likely to occur at all or likely to occur only if APRA or the judicial manager considers that it is appropriate.

3.4 Application of the judicial management regime

The judicial management regime only applies to APRA authorised insurers. As the legislation is relatively new, there has not been an appointment of a judicial manager to an Australian general insurer, although a judicial manager was appointed to two life insurers in 1991 as discussed above in 3.2. That case provides some guidance as to what to expect from judicial management.

However, a recent case did involve the appointment of a provisional liquidator to an insolvent 'insurer': *Trans Pacific Insurance Corporation*⁶. In that case, the company was incorporated in the Cayman Islands but had carried on business in Australia without registration with APRA or the Australian Securities and Investments Commission (**ASIC**). Trans Pacific became registered as a foreign company carrying on business in Australia with ASIC (but not as a general insurer with APRA) and it then approached an Australian court to have a provisional liquidator appointed in Australia. It was not placed into judicial management because it was not registered with APRA as a general insurer – instead it was placed into provisional liquidation.

3.5 Assumptions for the Case Study

For the purposes of the Case Study, Outback is assumed to be authorised by APRA to carry on insurance in Australia and is a general insurer for the purpose of sections 11 and

⁶ [2009] NSWSC 308

12 of the *Insurance Act 1973* (Cth) (the **IA**). A judicial manager may therefore be appointed to Outback pursuant to the IA: section 62M.

3.6 Appointment of a judicial manager

Either APRA or the general insurer can apply to the Federal Court of Australia to have a judicial manager appointed: section 62K of the IA.

An application for the appointment of a judicial manager can also be made, and the appointment by the court made, before the general insurer is in fact technically insolvent. Specifically, a court can order the appointment of a judicial manager to a general insurer under section 62M if it is satisfied, inter alia, that:

- it [the general insurer] is, or is likely to become, unable to meet its liabilities; or
- there are reasonable grounds for believing that the financial position or management of the insurance business may be unsatisfactory. [emphasis added]

Whilst the expression 'likely to become' has not been considered by the courts in the particular context of whether an insurer will be 'likely to become' unable to meet its liabilities, for the purposes of the IA the expression 'likely' appears in other legislation and has been considered by the courts on a number of different occasions in different contexts. For example, Heery J's decision in *Munroe Topple & Associates Pty Limited v The Institute of Chartered Accountants (Australia)*⁷ supports the view that 'likely', at least in the context of in sections 45, 46 and 47 of the *Trade Practices Act*, does not require a standard of more likely than not but rather simply a real chance or possibility. In *Tillman's Butcheries Pty Limited v Australasian Meat Industry Employees Union*⁸ Bowen CJ said:

The word 'likely' is one which has various shades of meaning. It may mean 'probably' in the sense 'more probable than not – more than a 50% chance'. It may mean 'material risk' as seen by a reasonable man 'such as might happen'. It may mean 'some possibility – more than a remote or bare chance'. Or, it may mean that the conduct engaged in is apparently of such character that it would ordinarily cause the effect specified'.

In the same case, Deane J said (at page 346):

The word 'likely' can, in some contexts mean 'probably' in a sense in which that word is commonly used by lawyers and laymen, that is to say, more likely than not, or more than a 50% chance' ... it can also, in an appropriate context refer to a real or not remote chance or possibility regardless of whether it is less or more than 50%. When used with the latter meaning in a phrase which is descriptive of conduct, the word is equivalent to 'prone', 'with a propensity' or 'liable'. ...

In *Crimmins v Glenview Home Units Pty Ltd*⁹, Palmer J of the NSW Supreme Court considered what 'likely to become' meant in the context of the opinion directors must form

⁷ [2002] 122 FCR 110; ATPR 41-879

⁸ (1979) 42 FLR 331 at 339

⁹ [2001] NSWSC 699

before they can put a company into voluntary liquidation¹⁰. His Honour held that the degree of likelihood would depend upon the circumstances of each particular case (at paragraph [52]). Further, Palmer J stated (at paragraph [52]):

It would be inconsistent with the formation of a genuine opinion of likely insolvency if a director were to consider as likely a liability which reasonable and competent directors would consider fanciful. The likelihood of incurring a particular foreseen liability must be such that competent and reasonable directors would say that it will probably be incurred or that there is a real, not remote, chance of it being incurred, rather than to say that it is merely possible that it will be incurred.

In *Crimmins*, Palmer J held that an insolvency event occurring 10 years in the future could potentially justify a conclusion that the corporation was 'likely to become' insolvent (at paragraph [51]).

3.7 Consequences of a judicial management

Judicial management takes precedence over all forms of external administration. When management of a general insurer vests in a judicial manager, the appointment of any external administrator is terminated: section 62U of the IA. The CA provides that an administration may come to an end when the management of a general insurer vests in a judicial manager: section 435C(3)(h).

When a general insurer is under judicial management, court proceedings cannot be commenced or continued against the general insurer, except with the written consent of the judicial manager or the leave of the Federal Court: section 62P of the IA.

Management of the general insurer vests in the judicial manager upon his/her appointment: subsection 62T(1) of the IA. Management of a foreign general insurer does not vest in the judicial manager to the extent that the management of that foreign general insurer relates to insurance business carried on outside Australia: subsection 62T(3) of the IA. As the management of the insurer vests in the judicial manager, the directors of the insurer can no longer manage the interests of the insurer. Therefore, after the appointment of the judicial manager, and during the period of the management, the directors are relieved of any liability for insolvent trading or for any other liability under the CA for acts taken by the judicial manager.

The appointment of a judicial manager does not prevent obligations arising under any contract from being carried out however the vesting of the management of the general insurer does not allow a contract, or a party to a contract, to:

- deny any obligations under the contract;
- accelerate any debt under the contract; or
- close out any transaction relating to that contract.

(Subsection 62V(2) of the IA)

Unlike other forms of insolvency administration in Australia, which with limited exceptions leave the rights of contractual counter-parties unaffected, the IA judicial management

¹⁰ That is, it is 'insolvent or likely to become insolvent at some future time'

provisions prevent the exercise by a counter-party of these contractual rights. The wording of the provision is however quite specific, which means that a counter-party could potentially rely on an event of default other than the appointment of a judicial manager (such as insolvency) to deny obligations under a contract, accelerate a debt under the contract or close out any transaction relating to the contract. The operation of section 62V could therefore be easily circumvented. Until we have some judicial consideration of the section we will not know how far a court might seek to extend its reach, if at all, over its express words.

Section 62V applies if the general insurer is party to a contract, whether the proper law of the contract is Australian law or the law of a foreign country: subsection 62V(1).

A judicial manager can exercise numerous powers during a judicial management including:

- bringing or defending legal proceedings;
- selling or otherwise disposing of all or any of the property of the general insurer; and
- proving in the bankruptcy of any debtor of the general insurer.

(Section 62Y of the IA)

A judicial manager also has extensive powers to facilitate the recapitalisation of a general insurer. A judicial manager can (for example):

- issue shares, or rights to acquire shares, in the company;
- reduce the company's share capital; and
- sell shares, or rights to acquire shares, in the company.

(Section 62Z of the IA)

The legislation states that any exercise of power under section 62Z is valid despite the provisions of the CA: subsection 62Z(4) of the IA. APRA may apply to the Federal Court for an order that the Court give the judicial manager instructions in relation to the judicial management: section 62ZC. The judicial management continues until the management is cancelled or the Federal Court orders the winding up of the general insurer: section 62ZE. A judicial management can be cancelled either upon the application of the judicial manager him/herself or upon the application of any other interested person: section 62ZF. A judicial manager is also required to conduct the judicial management as efficiently and economically as possible: section 62ZG. The judicial manager must submit a report to the court as soon as possible recommending the course of action to be taken which is, in his / her opinion, the most advantageous to the general interest of the policyholders of the general insurer: section 62ZI. Some of the courses of action include the transfer of the business to another general insurer or the winding up of the general insurer: subsection 62ZI(2).

Through these mechanisms a judicial manager can oversee the management of an insolvent general insurer.

4. APRA capital adequacy and reinsurance requirements

4.1 Overview

Precipitated by the collapse of HIH in 2001, the IA was amended in the same year to impose new solvency requirements upon insurance companies. Under the amended IA, APRA has the power to determine prudential standards which must be complied with by all, or by a specific class of, general insurers: section 32. APRA may issue directions to ensure compliance with the standards and the general insurer is obliged to comply: section 35.

4.2 The minimum capital requirement

A general insurer is required to maintain adequate capital to enable it to meet its obligations in a wide range of circumstances. Section 28 of the IA requires an insurer to hold assets in Australia which exceed the value of its liabilities in Australia. To this end, APRA has established minimum capital adequacy requirements which all general insurers must satisfy under APRA's Prudential Standard GPS 110 – Capital Adequacy (July 2008) (the **Standard**).

For APRA purposes, 'capital' has two tiers – Tier 1 and Tier 2. APRA Prudential Standard GPS 112 defines Tier 1 capital as capital which:

- provides a permanent and unrestricted commitment of funds;
- is freely available to absorb losses;
- does not impose any unavoidable servicing charge against earnings; and
- ranks behind the claims of policy-holders and creditors in the event of winding up.

(Paragraph 7)

Tier 2 capital is comprised of other capital instruments that do not fall within the criteria above, such as hybrid capital instruments, but which nonetheless contribute to the capital of the insurer.

The Standard requires that all general insurers, other than 'Category D' and 'Category E' insurers¹¹, maintain a Minimum Capital Requirement (**MCR**) of not less than A\$5 million: paragraph 16 of the Standard. There are also guidelines¹² which state that 'all insurers are required to maintain assets in Australia at least equal to their liabilities in Australia.' Within this MCR, a certain amount must be Tier 1 Capital. APRA Prudential Standard GPS 112 stipulates how much Tier 1 Capital must be held by an insurer. It is essential that an insurer maintains appropriate levels of Tier 1 capital.

¹¹ Category D insurers are generally insurers owned by a professional or industry association and only underwrite the risks of the association; Category E insurers are corporate or partnership captives which essentially exist to underwrite the risks of the parent company / partnership

¹² Guidelines on Authorisation of a General Insurer, APRA December 2007, page 13

Subsection 116A(2) of the IA states that a liability is taken to be a liability in Australia if it is undertaken under a contract of insurance (including reinsurance) made in Australia, or in respect of which a proposal was accepted or a policy issued in Australia.. It further states that the following are not 'liabilities in Australia':

- a liability under a contract that relates only to a liability contingent on an event which can only happen outside Australia, and which the insurer has not undertaken to satisfy in Australia; or
- if the insurer carries on business both in and outside Australia – a liability under a contract that relates only to a liability that the insurer has undertaken to satisfy outside Australia.

Summarising this position, under a contract written in Australia:

- a liability which can only occur outside Australia, but which the insurer has undertaken to satisfy in Australia, will still be a 'liability in Australia'; and
- a liability which is undertaken in or outside Australia, which the insurer has undertaken to satisfy in Australia, will also be a 'liability in Australia'.

This means that if Outback writes insurance contracts in Australia, even if they relate to contingencies occurring outside Australia, as long as Outback has undertaken to satisfy them in Australia, Outback must have assets in Australia which exceed its liabilities under those contracts.

Subsection 116A(3) concerns insurance contracts made outside Australia which are contingent upon events occurring in Australia. In those contracts, any liability under the contract which the insurer has undertaken to satisfy in Australia, or which relates to a contingency which can only occur in Australia, is taken to be a liability in Australia for the purposes of the IA. Accordingly, if Outback has written policies through its UK branch, and it has undertaken to satisfy any liabilities arising under those policies in Australia or those policies relate to contingencies which can occur only in Australia, these will also be 'liabilities in Australia' for the purposes of the IA.

Insurers have three different methods which they can employ when determining their MCR: the IMB method or the Prescribed method, or a combination of the two.

(a) The IMB method

Clause 15 of the Standard permits an insurer to determine its MCR using the Internal Model Based Method (the **IMB Method**). The IMB Method is a model developed by the insurer itself which reflects the circumstances of its business. The IMB Method can only be used for a particular insurer if APRA has approved it for that insurer: subsection 32(3A) of the IA. In particular, APRA must be satisfied that the model is well-designed, the assumptions and analysis are sound and that the results of applying the model are reasonable from a prudential standpoint: paragraph 19 of the Standard.

The IMB method was first available to insurers from 2002, however it was not until 2007 that insurers actually began to adopt it. There has only been a small number of insurers who have adopted it and they have generally only been large insurers.

(b) The Prescribed Method

If an insurer does not use the IMB Method, then it must use the Prescribed Method. The Prescribed Method is a standardised framework detailed in the Standard. It is determined by the sum of the capital charges of:

- insurance risk;
- investment risk; and
- concentration risk.

(i) Insurance risk

Paragraph 21 of the Standard states:

The Insurance Risk Capital Charge is the risk that the true value of net insurance liabilities could be greater than the value determined under GPS 310 (*Audit and Actuarial Reporting and Valuation*).

(ii) Investment risk

Paragraphs 26-7 of the Standard state:

The Investment Risk Capital Charge relates to the risk of adverse movements in the value of an insurer's assets or off-balance sheet exposures or both. Investment risk can be derived from a number of sources, including market risk and credit risk.

The method for determining the Investment Risk Capital Charge is set out in *Prudential Standard GPS 114 Investment Risk Capital Charge*.

(iii) Concentration risk

Paragraph 32 of the Standard states:

At a minimum, the Concentration Risk Capital Charge relates to the risk associated with an accumulation of exposures to a single catastrophic event at a single site... The method for determining the Concentration Risk Capital Charge is set out in *Prudential Standard GPS 116 Concentration Risk Capital Charge*.

4.3 MCR as it applies to foreign insurers

Foreign-incorporated insurers (foreign general insurers) which are authorised to operate in Australia as branches have slightly different capital requirements than those applied to domestically-incorporated insurers. Foreign general insurers are known as 'Category C insurers' and are required to maintain assets in Australia that exceed their liabilities in Australia by an amount that is greater than the MCR determined by the Standard: paragraph 11 of the Standard.

Where the foreign insurer does not comply with the MCR under the Standard, there is the possibility that a judicial manager could be appointed to manage its affairs in Australia.

4.4 Capital charges relating to recoverables under contracts with foreign reinsurers

In addition to the MCR for an APRA-registered insurer, GPS 114 – Capital Adequacy: Investment Risk Capital Charge (**GPS 114**) states that an insurer is also required to apply a

'capital charge' for reinsurance recoverables due from a foreign reinsurer for reinsurance contracts incepting on or after 31 December 2008. This means that an APRA-registered insurer must hold an amount of capital against each asset that is proportional to the value of that asset: paragraph [9] of GPS 114.

The proportion of capital that the insurer must hold is dependent upon the 'Counterparty grade' of the reinsurer¹³ – in some cases, the capital charge can be up to 100%. If, for example, the required capital charge was 100%, an APRA-registered insurer with \$10 million in recoverables from a foreign reinsurer would have to hold \$10 million of capital against those recoverables. This capital requirement is over and above the MCR – it is an extra amount of capital which must be maintained by the APRA-registered insurer.

4.5 Australian law must govern reinsurance contracts

Any reinsurance contract entered into by an insurer, as defined under the IA, is required to be governed by Australian law: paragraph 31 of APRA Prudential Standard GPS 230. Where a contract fails to comply with the requirement, the relevant reinsurance assets will be deducted from Tier 1 capital: paragraph 32 of GPS 230.

In this case therefore, any reinsurance contract entered into by Outback would need to be governed by Australian law if the potential recoveries from that contract are to be included in the insurer's Tier 1 Capital. As noted above at 4.2, a certain amount of an insurer's MCR must be Tier 1 Capital.

5. US courts' recognition of Australian insolvencies

5.1 Overview

A particular issue for Outback will be whether a US court would be willing to recognise its judicial management. One issue of concern to the judicial manager of Outback will be the fact that the US courts could refuse to recognise the judicial management in Australia as the foreign main proceeding if it is manifestly contrary to the public policy of the US: §1506 of Chapter 15. A consideration for the US court may therefore be how any US creditor may be treated if the judicial management comes to an end and a liquidator is appointed, i.e. where a US creditor is required to prove its claim in an Australian winding up.

5.2 Section 116 of the IA

Subsection 116(3) of the IA states:

In the winding up of a general insurer, the insurer's assets in Australia must not be applied in the discharge of its liabilities other than its liabilities in Australia unless it has no liabilities in Australia.

Section 116(3) only applies to companies in liquidation. The Federal Court can order the winding up of a general insurer: section 62ZU of the IA. Any such winding up is to be in accordance with the *Corporations Act 2001* (Cth): section 62ZV of the IA.

¹³ See table 2 in Annexure A to GPS 114, page 19 for the relevant capital charge rates

Accordingly, if as a consequence of the judicial management process Outback was being wound up, it would not be able to discharge any 'non-Australian liabilities' from its assets in Australia whilst it still has 'Australian liabilities' (however, after all 'Australian liabilities' were discharged it would be able to use its remaining assets in Australia to discharge 'non-Australian liabilities' and it could also discharge its non-Australian liabilities from non-Australian assets). While Outback may insure some US entities, the fact that they are non-Australian entities would not necessarily mean they would be adversely affected by the operation of section 116.

As discussed above in 4.2, section 116A of the IA requires an insurer to maintain assets in Australia which exceed its liabilities in Australia. For the purposes of the IA, insurance policies written by an Australian insurer outside Australia which insure against a contingency occurring in Australia are taken to be 'liabilities in Australia'. Thus, the policies held by any US entities, if they relate to contingencies occurring within Australia, would be 'liabilities in Australia' for Outback and the US entities' claims would not be adversely affected by section 116 of the IA in the event of a winding up.

Further, if Outback has undertaken to satisfy a liability in Australia, even though the contract relates only to a liability contingent on an event that can occur only outside Australia, that liability will also be taken to be a 'liability in Australia'. The High Court of Australia has held that the 'liabilities' referred to in the then section 116 was not an exhaustive list of the liabilities which could constitute 'insurance liabilities'. In *Assetinsure Pty Limited v New Cap Reinsurance Corporation Limited (In Liquidation)*¹⁴ when considering what constituted a liability under subsection 31(4) of the IA (the precursor to section 116 of the IA), Gleeson CJ, Heydon and Crennan JJ held that subsection 31(4) specified that if certain conditions were met, then a liability would be a 'liability in Australia' – but this did not mean that there could be no other 'liability in Australia' outside subsection 31(4) (at 342).

In this case therefore, although a reinsured risk was outside Australia, this did not alter the conclusion that it was a 'liability in Australia': New Cap Re resided in Australia, it was part of New Cap Re's business to assume such a liability, it assumed the liability in Australia and there was no evidence to suggest that the liability would be satisfied anywhere but Australia (at 342).

As a consequence of *Assetinsure v New Cap*, a liability assumed by Outback would be considered a 'liability in Australia', so long as that liability was to be satisfied in Australia. Section 116A would now ensure this outcome in any event. Indeed, the Explanatory Memorandum to the Bill which introduced section 116A explains that¹⁵:

nothing in section 116A excludes other assets and liabilities of a general insurer for the purposes of sections 116 and 28 if, under common law, they would be an Australian asset or liability.

It is important to note that the tests do not discriminate for or against creditors on the basis of nationality – they reflect Australian law requirements that insurers maintain and use certain funds to meet certain liabilities first in a winding up. In effect, the Australian

¹⁴ (2006) 225 CLR 331

¹⁵ Explanatory Memorandum to the *General Insurance Reform Bill 2001* (Cth) at [5.170]

legislation provides for a regime which establishes a category of assets which are to be used to satisfy a certain category of liabilities first in a winding up. If an asset is not considered an 'asset in Australia', then that asset can be used to satisfy a non-Australian liability or a 'liability in Australia' in a winding up.

5.3 Public policy considerations

A US court may be apprehensive about recognising a foreign main proceeding if it would have a considerably detrimental effect on US creditors. Section 1506 of Chapter 15 is the statutory recognition of this principle. A judicially overseen process such as judicial management is not likely to offend this principle. If the US court then considered what might happen if Outback subsequently went into liquidation (which is one of several probable outcomes), as noted immediately above, any US policyholders of insurance contracts written by Outback outside Australia which relate to contingencies occurring in Australia would be in the same position as any Australian policyholder of Outback. Accordingly, they would not be disadvantaged in that circumstance, at least vis-à-vis Australian creditors, if the US court were to recognise the judicial management as the foreign main proceeding and Outback was subsequently wound up.

Moreover, even if the policies held by US creditors were not held to be 'liabilities in Australia', there is US case law which suggests that companies doing business with foreign corporations subject themselves to the laws of that foreign corporation's home jurisdiction.

In *Vesta Fire Insurance Corporation v New Cap Reinsurance Corporation Limited*¹⁶ a US reinsured sought to enforce an arbitration clause it had agreed upon with an Australian reinsurer, New Cap Re, which had become insolvent. The US Bankruptcy Court ordered that there be an injunction staying the arbitration (as the Australian reinsurer had sought, and had been granted, protection under §304 of Title 11) and the US reinsured appealed the order. In affirming the order, Judge Sweet of the US Bankruptcy Court held (at page 218) that:

while New Cap's potential insolvency and the ramifications flowing therefrom presumably did not loom large in the minds of the Agreement's parties at the time of signing, by doing business with an Australian corporation Vesta implicitly subjected itself to that nation's bankruptcy law in the event of New Cap's insolvency.

Thus, by contracting with Outback, any US reinsured would have implicitly subjected itself to the Australian insolvency regime.

Incidentally, it should be noted that Vesta raised an argument based on section 116 of the IA in an appeal¹⁷ from Judge Sweet's decision – the US Court of Appeal for the 2nd Circuit dismissed the argument as Vesta had failed to raise it in the earlier proceedings which constituted a waiver.

A similar approach adopted to that adopted by Judge Sweet in *Vesta Fire Corp v New Cap Re* occurred in the House of Lords decision in *McGrath v Riddell*¹⁸. There the House of

¹⁶ 244 BR 209 (2000, SDNY)

¹⁷ 238 F.3d 186 (2nd Cir. 2001)

¹⁸ [2008] UKHL 21

Lords acceded to a letter of request from the NSW Supreme Court requesting that all assets in England of the failed insurer HIH be remitted to Australia for distribution in a winding up. In allowing the appeal, Lord Hoffman held that the distribution of assets in Australia would give effect to the intentions and expectations of parties who had contracted with HIH. In particular, his Lordship said (at paragraph [33]):

[I]t seems to me that the application of Australian law to the distribution of all the assets is more likely to give effect to the expectations of creditors as a whole than the distribution of some of the assets according to English law. Policy holders and other creditors dealing with an Australian insurance company are likely, so far as they think about the matter at all to expect that in the event of insolvency their rights will be determined by Australian law.

6. Applying the above principles to the Case Study

6.1 The inevitable appointment of a judicial manager to Outback

The directors of Outback must give APRA notice before taking any step to appoint an external administrator. APRA is then likely to apply to the Court for the appointment of a judicial manager before the directors of Outback appoint a voluntary administrator or seek to have a provisional liquidator, voluntary liquidator or court appointed liquidator appointed. Outback, or any other interested party, could apply to a court for the appointment of an external administrator. Should an applicant wish to appoint or have appointed any other external administrator it must have APRA's approval for the application beforehand.

6.2 A 'proceeding' for the purposes of Chapter 15

Chapter 15, like the Model Law and the CIA, requires that there be a 'proceeding' before the court hearing an application can grant protection under the legislation. If there is no proceeding in the foreign jurisdiction, then the application cannot be in respect of a foreign main proceeding. A number of external appointments in Australia are made without the need for any court proceedings – these include the:

- appointment of a voluntary administrator by the directors of the company¹⁹;
- appointment of a voluntary liquidator by the creditors or members of the company;
- appointment of a Deed Administrator by the creditors approving a Deed of Company Arrangement;
- appointment of a liquidator following a voluntary administration or failed Deed of Company Arrangement; or
- appointment of a receiver by a secured creditor (which is not likely in relation to an insurer).

The issues associated with demonstrating that a 'proceeding' exists in one such voluntary process were considered in *In re: Betcorp Limited (In Liquidation)*²⁰. In that case, an

¹⁹ As occurred in New Cap Re

Australian voluntary liquidator approached the US Bankruptcy Court and sought Chapter 15 protection. The liquidator was appointed after Betcorp's members voted to liquidate the company through a members' voluntary winding up.

The issue was whether the voluntary winding-up was a 'proceeding' for the purpose of Chapter 15. Judge Markell held that it was and the Australian proceeding was recognised as the 'foreign main proceeding', staying thereby any actions against Betcorp's assets in the US.

'Proceeding' is defined in the Model Law²¹ and the CIA²² as:

a collective judicial or administrative proceeding in a Foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation.

'Proceeding' is defined in §101(23) of Title 11 of the US Code as:

a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

As noted above, section 62K of the IA allows APRA or a general insurer to apply to a Court for an order that a general insurer be placed under judicial management. The Federal Court can then make an order that the general insurer be placed under judicial management: section 62L. A Federal Court order placing a general insurer under judicial management would clearly be a 'judicial proceeding' and would therefore satisfy the 'proceeding' requirement in Chapter 15. As noted in 3.2 above there are a number of alternative outcomes which the Court could sanction as the result of a judicial management including liquidation or permission for the directors to appoint a voluntary administrator. As these steps would require court approval as part of the judicial management proceeding, we think there is a good basis for arguing that the Chapter 15 recognition afforded to Outback in judicial management should extend to those processes.

6.3 The Centre of Main Interests (COMI)

For Outback to be granted protection under Chapter 15 in the US, it will need to demonstrate that the appointment of a judicial manager of its operations in Australia will be enough to constitute a 'foreign main proceeding'.

There is no definition of 'foreign main proceeding' in the Model Law, the CIA or Chapter 15. From an Australian perspective, it was intended that case law from the various international jurisdictions would guide the development of the concept²³. At the date of writing, there has only been one Australian decision concerning the Model Law.

²⁰ Case No. 08-21594 (BAM)

²¹ Article 2(a)

²² Article 2(a) of Schedule 1

²³ Explanatory Memorandum to *Cross-Border Insolvency Bill 2008* (Cth), at page 6

In *Hur v Samsun Logix Corporation*²⁴ a receiver of a Korean company, which had its registered office in Korea, applied to the Federal Court of Australia for recognition of a foreign proceeding under the CIA. Justice Jacobson held that the proceeding in Korea was the foreign main proceeding for the purposes of the Model Law. Accordingly, the receiver was entitled to relief under Article 21 of the Model Law. Unfortunately, however, the decision does not discuss the elements of establishing a COMI – Justice Jacobson simply held that he was satisfied that Samsun had its COMI in Korea (paragraph [22]). In so holding, Justice Jacobson gave effect to the presumption in Article 16(3) of the Model Law (paragraph [22]).

The Model Law, the CIA and Chapter 15 all contain a presumption that the location of the debtor's registered office is where the debtor has its COMI²⁵. This is however a rebuttable presumption.

(a) European Union

The primary case discussing the concept of COMI is *Eurofood IFSC Limited*²⁶. The issue in that case was whether the COMI was in Ireland, where a subsidiary was operating, or whether it was in Italy where the parent company was located. In determining that the COMI was in Ireland, the European Court of Justice made reference to some indicators which can suggest a COMI. In particular, the Court stated:

Where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different [states], the presumption laid down in the second sentence of Article 3(1) of the Regulation [that a debtor's COMI is where its registered office is]...can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect.²⁷

The important point to note is the reference to 'factors which are both objective and ascertainable by third parties'. Therefore, when determining a COMI, if there are objective and ascertainable factors which lead third parties to believe that a debtor's centre of main interests is not where its registered office is, such factors can be very decisive. This will be one of the keys for Outback.

(b) United States

(i) *Bear Stearns*

²⁴ [2009] FCA 372

²⁵ Model Law – Article 16(3); CIA – Article 16(3) of Schedule 1; Chapter 15 of Title 11 – §1516(c)

²⁶ 2006, European Court of Justice, C-341/04

²⁷ Note 7 at paragraph [37]

The issue in the *Bear Stearns*²⁸ decisions was whether the COMI was located where the company had its registered office in the Cayman Islands or whether it was located in the United States. In holding that the COMI was located in the United States (and more specifically New York), Judge Lifland pointed to certain aspects of the business which suggested a US COMI. In a non-exhaustive list, his Honour had regard to the:

- location of the debtor's headquarters;
- location of the manager of the funds;
- location of the company's primary assets;
- location of the majority of the creditors; and
- jurisdiction whose law would apply to most disputes.

While Judge Lifland took into consideration the location of the debtor's headquarters, his Honour made reference to the fact that the presumption laid down in Article 16(3) of the Model Law and §1516(c) of Chapter 15 is a rebuttable one – the COMI is taken to be where the registered office is, in the absence of evidence to the contrary. In Judge Lifland's view the location of the debtor's registered office is informative, but not determinative.

It was also argued in *Bear Stearns* that because no party had objected to the Cayman Islands being recognised as the COMI, the court should accede to the application. Judge Lifland held in his judgment that a court's order under Chapter 15 is not to be a 'rubber stamp' – just because no-one had objected to the application for recognition of the Cayman Islands as the COMI did not mean that a court should order that it was indeed the COMI. This was a departure from the reasoning of the court in *In re SPhinX*²⁹. In that case, no party objected to the application for recognition of a foreign main proceeding and no other proceedings had been initiated anywhere else. On this basis, the court granted recognition.

In conclusion, drawing on the *Eurofood* decision, Judge Lifland in *Bear Stearns* held that there still needs to be factors ascertainable by third parties which suggest that a COMI is in a certain jurisdiction. In that case, his Honour held that New York was where the principal interests, assets and management were located and that therefore the COMI was in New York.

- (ii) *In re Betcorp Limited (in liquidation)* Case No. 08-21594 (BAM)

²⁸ *In re: Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd (in provisional liquidation)* Case No. 07-12383 (BRL); *In re: Bear Stearns High Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd (in provisional liquidation)* Case No. 07-12384 (BRL)

²⁹ 351 BR 103

The *Betcorp* decision discussed above of course also considered the issue of demonstrating a debtor's COMI. Having established that the proceeding in Australia was a 'proceeding', the next challenge for the liquidator was to demonstrate that the COMI was in Australia to enliven the stay provision of Chapter 15.

Judge Markell made a number of references to *Bear Stearns* and also *Eurofood*, applying similar principles to those applied in those cases. Looking at the location of its headquarters, its management, its assets and its creditors, and factors ascertainable by third parties, his Honour held that the COMI was in Australia (at 33 & 34). Judge Markell went on to point out that the only thing which would not support a COMI being established in Australia was the location of two creditors: one in the United Kingdom and the other in the United States (who was objecting to the application). This fact was not enough to move the COMI from Australia to either the UK or the US.

6.4 Applying the COMI principles to Outback

As noted in 6.2 above, as a judicial manager has been appointed to Outback, there is a 'proceeding' for the purposes of Chapter 15. A court order for the judicial management of Outback falls squarely within the scope of Article 2(a) of the Model Law and §101(23) of Title 11 of the US Code. The question is then whether Outback has its COMI in Australia or elsewhere. Not only will the judicial manager of Outback want to establish its COMI in Australia to fall within the protective provisions of Chapter 15 of Title 11, but it will also want to demonstrate that Outback is a foreign insurer not carrying on insurance business in the US. The judicial manager would want to protect Outback's assets in the US so that they can be used to meet Outback's obligations. Therefore, the judicial manager will be eager to prevent proceedings being brought in relation to Outback's assets in the US by US creditors. Further, while Outback undoubtedly has a relationship with the US, as it has some reinsurance assets there, it is not a foreign insurer carrying on insurance business in the US and therefore it will not fall foul of §1501(c) and §109(b)(3)(A) of Title 11.

As Outback is registered in Australia, it would be able to rely upon the presumption in Article 16(3) of the Model Law and §1516(c) of Title 11 of the US Code, that a debtor's COMI is presumed, in the absence of evidence to the contrary, to be where its registered office is. As noted in *Bear Stearns*³⁰ and *In Re Betcorp*³¹, five important considerations³² are:

- the location of the debtor's headquarters;
- the location of the manager of the assets;
- the location of the company's primary assets;

³⁰ See above at 5.2(b)(i)

³¹ See above at 5.2(b)(ii)

³² *Bear Stearns* at page 10; *In re Betcorp* at page 27

- the location of the majority of the company's creditors; and
- the jurisdiction whose law would apply to the most disputes.

(a) Location of the debtor's headquarters

The fact that Outback is incorporated in Australia and is registered as an insurer with APRA will support the judicial manager of Outback's argument that its COMI is in Australia. As noted above however, this is not decisive.

(b) Location of the manager of the assets

While Outback has local management, the CEO or CFO works and lives in Bermuda. Although the CEO or CFO works and lives in Bermuda, the CA requires that proprietary companies must have at least one director and that director must ordinarily reside in Australia: section 201A(1) of the CA. Public companies must have at least three directors, two of whom must ordinarily reside in Australia: section 201A(2) of the CA. Therefore, Outback would have to have at least one director who ordinarily resides in Australia. This would be a factor supporting an Australian COMI.

(c) Location of the company's primary assets

Outback has significant reinsurance and other assets in the US. As Outback is authorised by APRA to carry on insurance business in Australia, it must have considerable assets in Australia to comply with its capital adequacy requirements as stipulated in APRA Standard GPS 110. Therefore, Outback's primary assets would have to be in Australia. This would be a factor supporting an Australian COMI.

As noted above in 4.4, in addition to its requirements under GPS 110, GPS 114 also requires Outback to hold capital against its reinsurance recoverables due from Island. Depending on Island's 'Counterparty grade', Outback would need to apply a capital charge of between 60% and 100% for the recoverables due from Island. Accordingly, Outback would need to maintain significant capital in Australia to satisfy the requirements of GPS 114, in addition to its MCR. This would be a factor supporting an Australian COMI.

(d) Location of the majority of the company's creditors

The 10 largest creditors by value of Outback are situated in the US, Canada, the UK and Europe. While the 10 largest creditors by value are not Australian, the balance of the creditors are Australian, mostly being Australian policyholders. Accordingly, the majority of the creditors of Outback are Australian. This would be a factor supporting an Australian COMI. The existence of large foreign creditors, in and of itself, should not be sufficient to displace an Australian COMI: *In re Betcorp*.

(e) Jurisdiction whose law would apply to most disputes

Although Outback is incorporated in Australia, the policies held by the creditors are governed by the jurisdiction of the policyholder. While Outback's 10 largest creditors are non-Australian, the majority of policyholders are Australian so that

Australian law would govern most disputes. This would be a factor supporting an Australian COMI.

As noted above at 4.5, APRA Prudential Standard GPS 230 requires that any reinsurance contract entered into by an Australian insurer be governed by Australian law. As Outback is reinsuring with Island, that reinsurance would need to be governed by Australian law. If the reinsurance is not governed by Australian law, the relevant reinsurance assets will be deducted from Outback's Tier 1 capital. Therefore, to maintain its MCR, Outback's reinsurance contracts with Island would have to be governed by Australian law. This would be a factor supporting an Australian COMI.

Other factors supporting an Australian COMI would be that an Australian court has appointed a judicial manager to Outback and that judicial management is the most appropriate regime to deal with the insolvency of an Australian registered insurer.

(f) Factors ascertainable by third parties

One of the main indicators of a COMI in *Eurofood* was whether there were objective factors ascertainable by third parties which led the third party to believe that the COMI was in the jurisdiction where those factors were ascertainable. Policyholders dealing with an insurance company named 'Outback' are dealing with a company whose very name evokes images of Australia. In addition, Outback has conducted a significant marketing campaign, including the print advertisements attached at the end of this paper, complete with pictures of the Sydney Opera House, the Sydney Harbour Bridge, Paul Hogan, koalas, kangaroos, meat pies, Bondi Beach, Sydney Harbour, the Crocodile Hunter Steve Irwin, Uluru and slogans such as 'Outback – insure with your mates' and 'Outback – the safety of Australian regulation and the comfort of Australian values'. Outback's very descriptive name coupled with this advertising campaign, and the fact that policyholders have been dealing with an Australian incorporated insurer, means that there are objective factors ascertainable by third parties that Outback's COMI was in Australia.

Whilst Australian law provides a different distribution mechanism that ought not, in and of itself, be a sufficient reason to displace the COMI.

(g) Judicial management is overseen by an Australian court

As the Australia legislature has specifically provided for a process of judicial supervision of APRA registered insurers, any Australian court is going to be very unlikely to recognise any foreign process as having pre-eminence over that proceeding. In particular, an Australian court would be most unwilling to allow assets in Australia of an Australian APRA approved general insurer, which is under Australia's court supervised judicial management, to be removed from Australia particularly while there are unsatisfied 'Australian liabilities' including, but not limited to, liabilities owed to Australian insurance creditors. Further, as Outback has considerable creditors in Australia, and as it is required to maintain assets in Australia which exceed its 'liabilities in Australia' and bearing in mind the Australian characteristics of Outback, it is very unlikely that an Australian court would

recognise foreign proceedings as the main insolvency proceedings should any foreign court send a letter of request to the Australian court seeking assistance under section 581 of the CA. As noted in 2.2 above the Model Law does not apply to insurers in Australia.

6.5 A US court would not object on public policy grounds

As noted in 5.3 above, §1506 of Title 11 of the US Code allows a US court to refuse to recognise a foreign main proceeding if it would be manifestly contrary to US public policy to recognise it. A US court is most unlikely to find that a process supervised by an Australian court which may lead to a wide range of outcomes is contrary to US public policy. To the extent that the US court would be concerned with the priority regime which would apply in any liquidation of Outback should that occur, as has been demonstrated, any liability arising under a reinsurance contract written in Australia, which is to be satisfied in Australia, for a foreign reinsured is held to be a liability in Australia for the purposes of the IA. Accordingly, any US reinsured of Outback under a policy with those characteristics would not be disadvantaged by section 116 of the IA in a subsequent winding up of Outback should that occur.

In any event, as Judge Sweet held in *Vesta v New Cap*, by contracting with Outback the US reinsured would have implicitly subjected itself to the Australian insolvency regime and that logic should be applied in connection with Chapter 15. This reasoning has also found support with Lord Hoffman in the House of Lords in *McGrath v Riddell*, as discussed above in 5.3. Although that was not a Model Law case the reasoning is similar to that in *Vesta Fire Corp v New Cap Re* and it should be the approach followed.

The Australian insolvency regime does not discriminate against insureds by location, geography or nationality – it sets up a regime to facilitate the control and potential rehabilitation of APRA registered general insurers involving court supervision. Should a winding up result the regime then provides for identifiable funds to be used to meet identifiable liabilities which have a particular connection with Australia, for example, having been written in Australia, being payable in Australia or covering occurrences in Australia.

Therefore, there should be no US public policy ground preventing the US court from recognising Outback's judicial management as the foreign main proceeding.

Also, considering that the application in question is to recognise the judicial management of Outback, the issue of section 116 of the IA should not be the focus of the US court's attention. This is because, as discussed above in 3.2, judicial management is not a regime in which assets are distributed on a *pari passu* or other insolvency basis among the policyholders of the general insurer; it is a regime under which a judicial manager takes stock of the insurer and investigates what options are available and in the best interests of the policyholders and the stability of the financial system in Australia. Accordingly, judicial management is a preliminary step and is akin to a provisional liquidation or receivership³³.

³³ See above in 3.1 per Lockhart J in *Insurance and Superannuation Commissioner v Occidental Life Insurance Co of Australia*.

6.6 Summary

In light of the above, Outback's COMI should be found to be in Australia. The majority of its creditors are located there, third parties believe that its COMI is there, it is managed in Australia and it also has significant assets there. The parties who have contracted with Outback have also implicitly subjected themselves to Australian insolvency law as they knew it was an Australian corporation. In addition to this, it is an Australian incorporated company which is registered with APRA. A US court should not have a difficulty with recognising such a process supervised by an Australian court. In any event it is also highly unlikely that an Australian court would recognise any foreign regime when the legislature has specifically provided for it to supervise a judicial manager. An Australian court is also very unlikely to allow the removal of 'assets in Australia' from Australia while there are unsatisfied 'liabilities in Australia'.

Even if the possible distribution regime which would apply in a liquidation was considered by a US court as part of this Chapter 15 application, there should also be no objection on public policy grounds as US policy holders of insurance contracts written by Outback will not necessarily be adversely affected by section 116 of the IA. If Outback has undertaken to satisfy the liabilities under those contracts in Australia, or written those policies in Australia, or should those policies cover risks in Australia, those liabilities will be 'liabilities in Australia' and will not offend section 116. In any event, the ultimate distribution of assets through a liquidation (if one were to occur) is only one possible outcome of judicial management as the judicial management is a preliminary process to determine the best course of action for the insurer, bearing in mind the interests of policyholders and the stability of the financial system in Australia. It is that preliminary process which is the subject of the application under Chapter 15 and section 116 should therefore not be a critical determinant for the US court's decision. For the reasons noted above, even if it is taken into account it should not be a sufficient reason for the US court not to recognise an Australian COMI³⁴.

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³⁴ See *Vesta Fire Corp v New Cap Re* above in 5.3

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Case Study

Background and Group Structure

Island Insurance Company Limited is the Bermudian group holding company for a group of insurance and reinsurance subsidiaries in the UK (two subsidiaries - Regal Insurance Company Limited and Monarch Insurance Company Limited), the Netherlands (Orange Insurance Company Limited), Canada (Maple Insurance Company Limited), Australia (Outback Insurance Company Limited) and Genovia (Genovia Insurance Company Limited).

The Island Group companies write all classes of general insurance business with a speciality in covering credit default swaps and other financial products.

Outback, Maple and Genovia each write business through a UK branch. Genovia writes 50% of its business through its UK branch and 50% in Genovia.

Regal ceased writing business in 2000, at which time Monarch took over the main UK underwriting function for the group.

each of Regal, Monarch, Orange, Maple, Outback and Genovia reinsure with Island Insurance Company Limited.

Island is also the main reinsurance company for American Eagle Fidelity Company, a US Monoline insurer.

Island has made a lot of money in recent years building up its credit reinsurance book and American Eagle is its best customer, having cornered the market in providing financial guarantees and wrap products on both sides of the Atlantic; in the US principally to the municipal authorities and throughout the EU in relation to Eurobond issuances.

Following the first strains of credit crunch in 2007 and the global financial crisis that followed in the wake of the Lehman's collapse in September 2008, problems start to appear.

The Eagle lands on the Island (with a thud)

As the year wears on and the number of Bond defaults increase, American Eagle's rating comes under pressure from Standard & Poor and Moody's and eventually American Eagle is down graded from AAA to AA with the result that it ceases to write any new business.

The New York Insurance Department places American Eagle into Rehabilitation but as the situation worsens, the company is placed into liquidation.

The number of claims being made against American Eagle places a strain on the balance sheet of Island which itself eventually capitulates. The Island board resolves to cease writing new business, present a winding up petition and appoint joint provisional liquidators.

The Lord of the Ring Fence?

Islands' demise creates a domino effect across the group and forces Monarch, Maple, Outback and Genovia to file for local insolvency proceedings. UK Administrators are appointed in respect of Monarch and Liquidators are appointed to Maple and Genovia in their home jurisdictions. In Australia, Judicial Manager are appointed to Outback.

Maple, Outback and Genovia then seek the appointment of joint provisional liquidators in the UK in respect of their substantial UK assets.

The insolvency officeholders of Maple, Outback and Genovia seek the remission of the UK assets back to Canada, Australia and Genovia.

The Australian and Canadian officeholders make a request under section 426 of the UK Insolvency Act 1986.

The Genovian officeholder relies on common law principles of comity and private international law. Under Genovian law, Genovian domiciled policyholders, whether direct or cedants, rank senior in priority to all other creditors, including foreign policyholders and cedants.

The UK provisional liquidators of each company resist these requests.

COMI Over

Monarch, Maple, Genovia (through its Genovian liquidator) and Outback have significant reinsurance and other assets in the US and seek Chapter 15 protection.

The UK joint provisional liquidators of Genovia also seek Chapter 15 protection and oppose the Genovian liquidator's application.

As it transpires, the centre of main interests ("**COMI**") of Maple and Outback is uncertain and arguably may be in the US. This is news to the Australian officeholders but for the ring fence debate - it is too late.

In addition to reinsurance with Island, Maple, Genovia and Outback have reinsurance recoverables from third party reinsurers, about 35% of which is from US based reinsurers, 15% Canadian based and the balance European. A significant portion is secured on a funds withheld basis which are held in various NY and Bermudian based institutions.

The main executive functions for the Island group are carried out by officers who reside in Bermuda from the group's headquarters. Each subsidiary has local management but the CEO or CFO of each subsidiary live and work in Bermuda. The Bermuda offices of Island have a full time support staff of 3 people and is also used by group executives for meetings conveniently tacked on to the front or back end of holidays.

Maple and Outback maintain records in NY and in their Canada and Australia offices respectively. Genovia holds all of its records in London at the address of its UK branch with the exception of the records relating to its Genovian originated business and no records in NY or Bermuda.

Maple and Outback are charged via an intercompany account for a share of the cost of hiring meeting space in NY and Bermuda office overhead.

3 of the top 10 creditors by value of each company are US based, 1 is Canadian, 1 UK and the rest of the top 10 are distributed across Europe. The policies are governed by the law of the jurisdiction of the policyholder.

Solvent Abuse?

Despite the collapse of the Island group, Regal and Orange manage to remain solvent but go into run-off.

The CEO of Islands European Operations wishes to understand how to use the European Operations for the benefit of the Island group as a whole. Not surprisingly, the Bermudian provisional liquidator is equally as keen to understand how this might work.

The European CEO is seriously considering if it might be possible to transfer the Orange book into the UK subsidiary - Regal - by way of the UK Part VII process of something similar under Dutch law for the purpose of potentially subjecting both to a solvent scheme and whether such processes could obtain foreign recognition. He is concerned however that such a process might trigger termination or acceleration provisions in the underlying monoline contracts.