



**Highlands Insurance Company (UK) Limited (in Administration)**

**Joint Administrators' Report in accordance with  
Rule 2.47 of the Insolvency Rules 1986  
for the period 1 November 2007 to 30 April 2008**

**May 2008**

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### Contact details for queries

<b>Function</b>	<b>Contact</b>	<b>Address</b>	<b>Direct line</b>	<b>Email</b>	<b>Fax</b>
General queries relating to the Administration insolvency proceedings	Gary Bray James Allison	PricewaterhouseCoopers LLP Plumtree Court London EC4A 4HT United Kingdom	+44 (0) 20 7213 8900 +44 (0) 20 7804 4564	gary.bray@uk.pwc.com james.allison@uk.pwc.com	+44 (0) 20 7804 5203
Claims related queries	Ian Leighton	PRO Insurance Solutions Limited Bruton Court Bruton Way Gloucester GL1 1DA United Kingdom	+44 (0) 1452 782529	ian_leighton@Pro-ltd.co.uk	+44 (0) 1452 782582

## I Summary Information

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<b>The Company</b>	Highlands Insurance Company (UK) Limited (in Administration) (the "Company" or "Highlands UK")
<b>Registered number</b>	01190948
<b>Registered office and trading address</b>	c/o PRO Insurance Solutions Limited ("PRO") Bruton Court Bruton Way Gloucester GL1 1DA United Kingdom
<b>Activity</b>	Insurance and reinsurance run-off
<b>Court reference</b>	High Court of Justice, Chancery Division, Companies Court, Case No. 7896 of 2007
<b>Administrators</b>	Dan Schwarzmann and Mark Batten of PricewaterhouseCoopers LLP ("PwC")
<b>Date of appointment of the Administrators</b>	1 November 2007
<b>Date of approval of the Administrators' proposals</b>	8 January 2008
<b>Purpose of the Administration</b>	The purpose of the Administration is to achieve one of the following objectives:  (a) rescuing the Company as a going concern or, failing that, (b) achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration) or, finally, (c) realising property in order to make a distribution to one or more secured or preferential creditors

## II Progress Report

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### Purpose of this report

This report has been prepared in accordance with Rule 2.47 of the Insolvency Rules 1986 to provide creditors with a six monthly update on the progress of the Administration of Highlands UK following the appointment of Joint Administrators on 1 November 2007. The Joint Administrators' proposals for achieving the purpose of the Administration were despatched to all known creditors on 20 December 2007 and a copy of these proposals can be found on the Company's website at [www.ukhighlands.com](http://www.ukhighlands.com).

The following appendices accompany this report:

Appendix A	Joint Administrators' Proposals as approved by Creditors on 8 January 2008
Appendix B	Receipts and Payments Account for the period 1 November 2007 to 30 April 2008

### Overall strategy

The purpose of the Administration is to achieve one of the objectives set out on page one of this report. Due to a number of key strategic matters that are currently being addressed it remains uncertain at present which of these objectives will be achieved.

### Creditors' committee

At the meeting of creditors held on 8 January 2008 a resolution was passed to establish a creditors' committee. Following a vote taken at that meeting a committee was formally constituted, the elected members of which are:

#### Name of representative

Charles Gordon of DLA Piper UK LLP  
Trevor Rawlings of Downlands Liability Management Limited  
Gary Appleton of Markel International Insurance Company Limited  
Steve Goodlud of KPMG LLP  
Richard Dupree of The Travelers Indemnity Company

#### Creditor represented

Ace Property & Casualty Insurance Company  
London & Edinburgh Insurance Company Limited  
Markel International Insurance Company Limited  
SR International Business Insurance Company Limited  
The Travelers Indemnity Company

## II Progress Report

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A creditors' committee is limited by statute to a maximum of five members. However, as more nominations for membership were received and in order that a cross-section of the general body of creditors was represented at creditors' committee meetings, it was agreed that the following would act as observers:

<b>Name of observer</b>	<b>Creditor represented</b>
Mike Churchyard of AXA Global Risks (UK) Limited	Axa Global Risks (UK) Limited
David Strasser of Eckert Cherin & Mellott LLC	CBS Corporation

The Joint Administrators have so far met with the creditors' committee on 12 February 2008 and 9 April 2008 to discuss significant issues and the strategy relating to the Administration. I am very grateful to the members and observers for their assistance.

### **Summary of the Administrators' actions to date**

#### **(a) Financial review**

Immediately following our appointment we commenced an evaluation of the financial position of the Company. As part of this we considered the settlement agreed in principle by the Directors shortly prior to our appointment in respect of certain purported transfers of business from Highlands Insurance Company, Texas ("HIC") to Highlands UK pursuant to Section 51 of the Insurance Companies Act 1982. Further details in relation to this settlement are provided in (b) below.

The review, which also evaluated the impact on the Company's financial position of its participation in certain pooling arrangements, as referred to in (c) below, is currently focussed on reviewing the Company's liabilities to reinsurance creditors. Whilst this detailed financial review remains in progress and work continues to resolve certain key strategic issues, the Joint Administrators remain unable to estimate the value or timing of any likely dividend with any degree of certainty.

## II Progress Report

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### **(b) Liaison with the SDR of HIC**

We have continued to work closely with the Special Deputy Receiver ("SDR") of HIC during the period and are pleased with the progress made.

Under the terms of the in principle agreement with HIC, as referred to in (a) above, Highlands UK were required to provide HIC with certain claims related data. This exercise was completed to the satisfaction of the SDR in December 2007. We have also met with representatives of the SDR twice since our appointment to discuss how best to finalise outstanding matters between the Company and HIC. At this stage I can report that good progress has been made towards reaching a revised settlement that is acceptable to all parties and I expect to be able to provide details of this in my next report.

### **(c) Historic participation in underwriting pools**

It has been necessary to undertake a review of the Company's historic participation in certain underwriting pools. The review has recently been completed and the results are currently being considered by my team. During the period we have also commenced initial discussions with the other pool participants with a view to determining the most appropriate strategy going forward.

### **(d) Management of the run-off**

As previously reported, PRO have been retained as run-off managers. During the period we have worked closely with PRO to progress a number of key strategic matters and I would like to take this opportunity to thank PRO for their assistance.

### **(e) Asset management**

Since our appointment we have reviewed the performance of funds held by the incumbent investment manager, EPIC Asset Managers Limited ("EPIC"), for both sterling and US dollar investments. On our appointment sterling investments comprised a mix of cash, sterling certificates of deposits, Eurosterling bonds and UK gilts. US dollar investments comprised a mix of cash, Eurodollar commercial paper, US dollar certificates of deposits and Eurodollar corporate and US Treasury bonds.

Amongst other matters, our Treasury team considered the historic returns, costs and instrument ratings and following their recommendation I took the decision to manage the sterling investments in-house but allow EPIC to continue to manage the US dollar investments. The composition of the sterling and US dollar investments has also been amended to better match the Company's potential foreign exchange exposure. Interest of £33,832.18 and US\$504,685.28 has been earned on the Company's cash and investment assets during the period 1 November 2007 to 30 April 2008. We will continue to review the investment strategy periodically.

## II Progress Report

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My team has also recently commenced an evaluation of the Company's reinsurance protections with a view to developing an appropriate collections strategy.

In order to protect assets in the United States, primarily reinsurance, we applied for protection under Chapter 15 of the US Bankruptcy Code. I am pleased to report that an order granting the relief sought was issued by the US Bankruptcy Court on 23 January 2008.

### **(f) Creditors and claims processing**

Throughout this period we have continued to work with PRO to improve the Company's policyholder/cedant name and address records. A number of market circulars providing an update on the progress of the Administration have been sent to all known policyholders, cedants, brokers and intermediaries during the period. Copies of these circulars can be found on the Company's website at [www.ukhighlands.com](http://www.ukhighlands.com). We have also continued to receive a regular flow of ad-hoc queries from policyholders, cedants, creditors and agents during the period.

Prior to our appointment the Directors had imposed an informal moratorium on the agreement of claims effective from August 2006. However, subsequent to our appointment as Joint Administrators, PRO have been instructed to recommence claims processing and agreement. Accordingly, policyholders, cedants and brokers should continue to present claims to PRO in the normal manner.

### **(g) Information technology**

A website for Highlands UK has been made available for the purpose of providing updates on the progress of the Administration. Key correspondence and other documentation will be placed on the website as the Administration progresses. The website can be found at [www.ukhighlands.com](http://www.ukhighlands.com).

### **(h) Tax**

We have completed an initial tax review into the affairs of the Company. As a result, we have de-grouped the Company from the Value Added Tax ("VAT") group it participated in prior to our appointment in order to mitigate a potentially significant VAT liability.

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### (i) Statutory reporting

In accordance with statutory requirements we have filed the appropriate return relating to the Directors' conduct prior to our appointment. This confirmed that no evidence of matters for concern have been identified or brought to our attention.

The Court continues to be updated in respect of progress of the Administration. The Insurance Directorate of the Financial Services Authority (Run-Off Division), which has responsibility for monitoring all insurance entities, has also been advised of developments.

### (j) Administrators' remuneration

Full details of professional costs incurred by the Joint Administrators and their team in the running the Administration will be reported regularly to the creditors' committee. A detailed analysis of the actual costs for the period 1 November 2007 to 31 January 2008 and the budget for the six months period commencing 1 February 2008 were prepared and presented to the creditors' committee at the meeting held on 12 February 2008. In accordance with Rule 2.106 of the Insolvency Rules 1986 the creditors' committee passed a resolution at that meeting approving the Joint Administrators' remuneration and expenses as presented. Further details of fees incurred to date can be found below and on page nine of this report.

The value of Joint Administrator's remuneration drawn in the period 1 November 2007 to 31 January 2008 comprises £482,809.85 of fees and £12,591.03 of expenses, excluding VAT. In accordance with the provisions of Statement of Insolvency Practice, Statement No. 9, as adopted by the Institute of Chartered Accountants in England and Wales, the following information is provided to you.

- Accumulated time costs incurred as at 30 April 2008 are £861,058.35 being 3,002 hours at an average hourly rate of £286.83.
- Of the hours spent, 646 hours relate to general project management and administration, 547 hours relate to statutory compliance (the vast majority of which falls in the first three months of the Administration in an assignment of this nature), 530 hours relate to all dealings and negotiations with the SDR and general strategy, 438 hours relate to finance and assets, 400 hours relate to run-off management and 441 hours relate to dealing with all other matters including actuarial, claims, IT, legal, reinsurance, tax and the creditors' committee.

## Appendix A Joint Administrators' Proposals as approved by Creditors on 8 January 2008

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On 20 December 2007 the Administrators circulated to creditors their proposals for achieving the purpose of the Administration. The following proposals were approved by creditors without modification at a meeting held on 8 January 2008.

### First resolution

- (i) The Administrators will continue to manage the Company's business, affairs and property in such manner as they consider expedient with a view to either rescuing the Company as a going concern or, failing that, achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration). This may involve the formulation, promotion and, subject to approval, implementation of a scheme or schemes of arrangement under section 425 of the Companies Act 1985.
- (ii) The Administrators may investigate and, if appropriate, pursue any claims that the Company may have under the Companies Act 1985 or Insolvency Act 1986 or otherwise. In addition, the Administrators shall do all such other things and generally exercise all their powers as Administrators as they in their discretion consider desirable in order to achieve the purpose of the Administration or to protect and preserve the assets of the Company or to maximise realisations or for any other purpose incidental to these proposals.
- (iii) A creditors' committee will be established if sufficient creditors are willing to act on it. The Administrators propose to seek the election of a creditors' committee and to consult with it from time to time.
- (iv) The Administrators may use any or a combination of the "exit route" strategies in Paragraphs 76 to 80 and 83 to 84 of Schedule B1 of the Insolvency Act 1986 in order to bring the Administration to an end. If it is possible to rescue the Company as a going concern it is likely that the Administrators will make an application to Court to end the Administration and return management of the Company back to the Directors. However, if it is not possible to rescue the Company as a going concern and instead the objective is to achieve a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration), it is likely that the Administrators will formulate proposals for a scheme or schemes of arrangement under sections 425 of the Companies Act 1985 and, if so ordered by the Court will put them to meetings of the appropriate class(es) of creditors. If a scheme of arrangement is approved and sanctioned by the Court, the Administration will be brought to an end either:
  - (a) when the scheme of arrangement is brought to an end if it is more cost effective to run both procedures in tandem than for the Administration to be discharged, or
  - (b) by notice to the Registrar of Companies on completion of the Administration under Paragraphs 80 or 84 of Schedule B1 of the Insolvency Act 1986.

## **Appendix A Joint Administrators' Proposals as approved by Creditors on 8 January 2008**

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### **Second resolution**

- (v) That if appointed, the creditors' committee will fix the Administrators' fees and Category Two disbursements. It is proposed that the Administrators' fees will be calculated based on time properly spent on the Administration by them and their various grades of staff according to their firm's charge out rates for work of this nature and charged in accordance with their firms' policy. If no creditors' committee is appointed then the Administrators will seek a resolution from creditors that they may be remunerated on a time cost basis at a later meeting of creditors.

## Appendix B Sterling Receipts and Payments Account for the period 1 November 2007 to 30 April 2008

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Receipts	£	Payments	£
Opening value of cash at bank	185,304.45	Administrators' remuneration (3)	482,809.85
Opening value of investment portfolio (1)	979,925.78	Administrators' disbursements (3)	12,591.03
Interest received	33,832.18	Run-off fees	243,908.87
Reinsurance collections	5,240.85	Other professional costs (4)	371,819.00
Transfers from US dollar account (2)	6,050,228.01	Legal fees	315,380.90
		Legal settlements	170,000.00
		Statutory costs (5)	21,485.42
		Bank and investment management charges	1,618.05
		Transfer to US dollar account (6)	50,000.00
		VAT	202,879.45
<b>Balance carried forward</b>	<b>7,254,531.27</b>	<b>Balance carried forward</b>	<b>1,872,492.57</b>
		<b>Closing balance</b>	<b>5,382,038.70</b>

### Notes

- (1) On appointment the investment portfolio comprised a mix of cash, sterling certificates of deposits, Eurosterling bonds and UK gilts
- (2) Represents transactions undertaken to manage foreign exchange exposures
- (3) PwC charge out rates relate to the Joint Administrators and their staff. These rates are applicable to staff who are employees of PricewaterhouseCoopers Services Ltd and, where appropriate, parties who are otherwise contracted with PwC
- (4) Other professional costs include actuarial and tax services provided by PwC, amounting to £355,182.00 and £10,337.00 respectively
- (5) Includes costs relating to advertising, printing, postage and meeting room hire
- (6) To provide immediate post appointment liquidity

## Appendix B US dollar Receipts and Payments Account for the period 1 November 2007 to 30 April 2008

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Receipts	US\$	Payments	US\$
Opening value of cash at bank (1)	3,003,869.67	Legal fees	37,032.87
Opening value of investment portfolio (2)	29,002,839.49	Other professional costs	31,941.00
Interest received	504,685.28	Letter of credit draw downs	87,118.31
Reinsurance collections	13,438.85	Bank and investment management charges	6,339.50
Transfer from sterling account (3)	97,280.00	Transfer to sterling account (4)	12,000,000.00
<b>Balance carried forward</b>	<b>32,622,113.29</b>	<b>Balance carried forward</b>	<b>12,162,431.68</b>
		<b>Closing balance</b>	<b>20,459,681.61</b>

### Notes

- (1) Includes deposits held at Citibank to the value of US\$2,991,939.41 in relation to letters of credit issued prior to the appointment of Joint Administrators
- (2) On appointment the investment portfolio comprised a mix of cash, Eurodollar commercial paper, US dollar certificates of deposits, and Eurodollar, corporate and US treasury bonds
- (3) To provide immediate post appointment liquidity
- (4) Represents transactions undertaken to manage foreign exchange exposures