



**TO ALL SCHEME CREDITORS, BROKERS, AGENTS AND INTERMEDIARIES OF HIGHLANDS INSURANCE COMPANY (U.K.) LIMITED (IN ADMINISTRATION) (THE "COMPANY")**

**THIS LETTER IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

May 2011

Dear Sir/Madam

**PROPOSAL FOR A SCHEME OF ARRANGEMENT**

1. We are writing to inform you that the Company intends to propose a scheme of arrangement under Part 26 of the Companies Act 2006 (the "**Scheme**") in relation to certain of its creditors ("**Scheme Creditors**").
2. Scheme Creditors principally comprise creditors in respect of:
  - (a) any liability to which the Company was subject at 1 November 2007 (the date the Company went into administration); or
  - (b) any liability to which the Company may become subject after that date, under any Reinsurance Contract. A "**Reinsurance Contract**" is any contract or policy of reinsurance or retrocession entered into by or on behalf of the Company or in relation to which the Company has assumed liability. Scheme Creditors also include non-insurance creditors, whose claims rank *pari passu* with reinsurance creditors by virtue of the Insurers (Reorganisation and Winding Up) Regulations 2004 (the "**2004 Regulations**").
3. For the avoidance of doubt, the Scheme is not intended to apply to any liability arising directly or indirectly out of any contract or policy of direct insurance of any kind whatsoever. Claims arising out of contracts or policies of direct insurance rank in priority to most other debts in the insolvency of the Company by virtue of the 2004 Regulations and are, except in respect of contracts written pursuant to the Employers Liability (Compulsory Insurance) Act 1969, being dealt with in accordance with a separate scheme of arrangement which became effective on 19 August 2009 (the "**Direct Scheme**"). Copies of the Direct Scheme document may be obtained by visiting the Company's website at [www.ukhighlands.co.uk](http://www.ukhighlands.co.uk).
4. Where the Company wrote a Reinsurance Contract as a member of a pool, the Scheme will only apply to a claim for an amount representing the Company's percentage participation in such Reinsurance Contract.
5. We are writing to you as this Scheme might affect you, either as a Scheme Creditor or, alternatively, as a broker, agent or other intermediary who acted on behalf of such a Scheme Creditor in placing business with the Company. Brokers, agents and intermediaries are requested to forward a copy of this letter to those parties they believe may be affected by the Scheme. If this communication should have been directed to somebody else within your organisation, please would you pass it on and provide us with the correct contact information.

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T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652, [www.pwc.co.uk](http://www.pwc.co.uk)*



6. We would strongly encourage you to read this letter in its entirety and would in particular draw your attention to paragraphs 17 and 18 below, which set out details of the deadline for submitting claims under the Scheme and the consequences of a failure to comply with the deadline.

## Background

7. The Company was incorporated in England and Wales on 18 November 1974 with registered number 01190948, although it did not write business until 1983.
8. The Company is a wholly owned subsidiary of Highlands Insurance Group, Inc. ("**HIGI**"). HIGI is a corporation organised under the laws of the state of Delaware, USA and is also the immediate parent of Highlands Insurance Company ("**HIC(US)**"), an insurance company organised under the laws of the State of Texas, USA.
9. Between 1972 and 1975, HIC(US), through its unincorporated London branch, wrote business as part of an underwriting pool (the "**Tower X Pool**") with London & Edinburgh Insurance Company Limited and American Home Assurance Company, through the underwriting agent Tower Underwriting Management Limited ("**TUM**"). The Tower X Pool wrote all classes of marine, aviation and non-marine business. During this period, HIC(US)'s London branch also wrote similar business through Highlands Underwriting Agents Limited ("**HUAL**"), a new underwriting agency organised by HIC(US). In 1975, the capacities of TUM and HUAL were combined with a new underwriting pool (the HUA Pool Account), which together with the Tower X Pool continued writing business until the end of 1977.
10. From the beginning of 1978 until 1982, HUAL underwrote excess of loss business on behalf of HIC(US) only. This business became known as the "HUA P A/C".
11. The Company began writing business on its own account in 1983. Between 1983 and 1994 the Company predominantly wrote London and international market excess of loss business.
12. In the mid-late 1980's the business written by the London branch of HIC(US) was transferred to the Company, by virtue of two separate transactions, both pursuant to Section 51 of the English Insurance Companies Act 1982 (the "**Section 51 Transfers**"). The first Section 51 Transfer, on 9 October 1986, transferred the policies written between 1978 and 1982 (as referred to in paragraph 10 above) and the second Section 51 Transfer on 29 December 1988 transferred the policies written between 1972 and 1977 (as referred to in paragraph 9 above), (together the "**Section 51 Policies**").
13. The Company ceased underwriting new and renewal business in January 1994.
14. On 25 October 2007, the directors of the Company applied to the English High Court of Justice (the "**Court**") for the appointment of joint administrators to the Company pursuant to paragraph 12(1)(b) of Schedule B1 to the Insolvency Act 1986, declaring in such application that they believed that the Company was, or was likely to become, unable to pay its debts. At a hearing of the application on 1 November 2007, Dan Schwarzmann and Mark Batten, both partners of PricewaterhouseCoopers LLP, were appointed as joint administrators (the "**Administrators**").
15. The respective rights and obligations of the Company and HIC(US) in respect of the Section 51 Policies, particularly in relation to US domiciled insureds, have been the subject of extensive litigation in the Texas Courts since August 2006. However, pursuant to the terms of a settlement agreement approved by the Texas Court on 13 October 2008, the Company and



HIC(US) resolved outstanding matters and agreed that HIC(US) would pay the Company the sum of US\$13 million subject, amongst other things, to the Company implementing the Direct Scheme. The Direct Scheme became effective on 19 August 2009 and the payment of US\$13million was made to the Company on 11 March 2010. The final claims submission deadline was 15 February 2010 and all claims under the Direct Scheme have been dealt with and paid in full.

### **The Scheme**

16. The primary purpose of the Scheme is to determine and settle the Company's liabilities to Scheme Creditors and enable the Administrators to deal with the Company's estate more efficiently and effectively than would be the case if the liabilities were to be dealt with in the ordinary course or through an insolvency process.
17. **Scheme Creditors with actual, contingent and future claims (including notified outstanding and incurred but not reported ("IBNR") claims) will be asked to submit to the Company a claim form setting out their claims in full (the "Claim Form") within 180 calendar days after the date the Scheme becomes effective (the "Claims Submission Date").**
18. **If a Scheme Creditor fails to submit a Claim Form to the Company by the Claims Submission Date, the Company will attribute a zero value to any claims that Scheme Creditor might have.**
19. The Company will assess the claims filed by Scheme Creditors and will seek to reach an agreed valuation of each Scheme Creditor's claim, after taking into account any offsetting liabilities that a Scheme Creditor may have to the Company and any available security interests (such as letters of credit). Where the Scheme Creditor and the Company fail to reach an agreement there will be a procedure for the adjudication of these disputed claims by Colin Czapiewski, an independent adjudicator. Scheme Creditors will then receive a dividend based on the net value of their claims.
20. It is intended that the Scheme will also be made effective and enforceable in the USA. Accordingly, there will be an application by the Company under Chapter 15 of the US Bankruptcy Code for a permanent injunction recognising and giving effect to the Scheme in the USA.

### **Classes of Scheme Creditors**

21. On 15 April 2002, the Court issued a Practice Statement that requires any company proposing to implement a scheme of arrangement to notify those affected by it (i) that a scheme is being promoted; (ii) the purpose that the scheme is designed to achieve; (iii) the meetings of creditors the company believes are required for the purposes of voting on the scheme; and (iv) the constitution of those meetings. Points (i) and (ii) have been covered above.
22. More than 50% in number representing not less than 75% in value of those creditors who vote at a meeting of creditors convened for the purposes of considering the Scheme (the "**Scheme Meeting**") must vote in favour of the proposed Scheme in order for it to be approved. Where creditors have rights which are so different as to make it impossible for them to consult together with a view to their common interest they must be split into separate classes and a separate Scheme Meeting must be held for each class.



23. The Company has considered the position of Scheme Creditors generally including those who may have predominantly notified outstanding or IBNR claims (as opposed to unpaid agreed claims).
24. Having taken into account the recent decisions of the Court, the Company intends to convene a single Scheme Meeting of all Scheme Creditors. This is considered appropriate given that for Scheme Creditors with notified outstanding and/or IBNR claims, as opposed to unpaid agreed claims, the relevant comparator in circumstances where the Scheme is not implemented is likely to be an insolvent liquidation or other insolvency proceeding of the Company, where such claims will be subject to a similar valuation procedure in any event. As such, Scheme Creditors' rights are not so different as to make it impossible for them to consult together with a view to their common interest.

#### **The Court hearing**

25. The date of the Company's application to Court for leave to hold the Scheme Meeting has not been set, but it is anticipated that it will take place in June 2011. The exact date of this application will be notified to you on the following website [www.ukhighlands.co.uk](http://www.ukhighlands.co.uk)
26. If any potential Scheme Creditor has concerns regarding the proposed constitution of classes, please would they inform us in writing, using the contact details below, as soon as possible. Any concerns that Scheme Creditors communicate in writing to us on this issue will be drawn to the attention of the Court at the hearing.
27. Scheme Creditors are not required to attend this hearing but they do have a right to be present for the purpose of making representations. We ask that any Scheme Creditor who intends to attend the hearing informs us at least seven days prior to the hearing date.

#### **Recommendation in respect of the Scheme**

28. The Company considers that the implementation of the Scheme will offer Scheme Creditors the most effective, economical and timely method for agreeing their claims and, for these reasons, all Scheme Creditors are encouraged to support the Scheme.

#### **Next steps and further assistance**

29. If the application is approved by the Court, Scheme Creditors, brokers, agents and intermediaries will be notified of the date from which a letter constituting a short-form explanatory statement, prepared in accordance with Section 897 of the Companies Act 2006, will be made available on the website [www.ukhighlands.co.uk](http://www.ukhighlands.co.uk) and will also be provided with details of where and when the Scheme Meeting will be held. A copy of the Scheme and accompanying Explanatory Statement will also be made available on the website.
30. Scheme Creditors are encouraged to make contact if they have any queries or concerns in relation to this letter or if they require further information regarding their reinsurance contracts or policies in relation to the Scheme. Please also make contact if you wish to discuss the value of your claims for voting purposes. In any of these respects, please contact either the Administrators or PRO Insurance Solutions Limited, the run-off managers of the Company, as follows:



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Address:	PricewaterhouseCoopers LLP 7 More London Place London SE1 2RT United Kingdom	PRO Insurance Solutions Ltd Bruton Court Bruton Way Gloucester GL1 1DA United Kingdom

Yours faithfully  
For and on behalf of  
Highlands Insurance Company (U.K.) Limited

A handwritten signature in blue ink, appearing to read 'Dan Schwarzmann', with a long horizontal line extending to the right.

Dan Schwarzmann  
**Joint Administrator**

*Dan Schwarzmann and Mark Batten have been appointed as joint administrators of Highlands Insurance Company (U.K.) Limited to manage its affairs, business and property as its agents. Dan Schwarzmann and Mark Batten are licensed in the United Kingdom to act as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.*