

**Highlands Insurance Company (UK) Limited – in Administration
("Highlands" or "the Company")**

**High Court of Justice, Chancery Division, Companies Court
Case No. 7896 of 2007**

Joint Administrators' proposals for achieving the purpose of the Administration

20 December 2007

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1. Purpose of this document

I wrote to all known policyholders, cedants, brokers, intermediaries and agents of the Company on 16 November 2007 to advise that Highlands had entered into Administration and that Mark Batten and I had been appointed as Joint Administrators ("the Administrators") of the Company on 1 November 2007.

We were appointed as Administrators by the High Court to manage the affairs, business and property of the Company. We act until such time as our proposals for achieving the purpose of the Administration have been agreed by creditors and implemented, following which the Administration will be ended.

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.

As explained later, at this stage it is not possible to be certain whether objective (a) above can be achieved.

This document and its appendices form the Administrators' statement of proposals for achieving the purpose of the Administration as required by Paragraph 49 Schedule B1 of the Insolvency Act 1986 ("Sch.B1 IA86").

An initial creditors' meeting will be held on Tuesday, 8 January 2008 at 10:00am at Crowne Plaza Hotel, 19 New Bridge Street, London, EC4V 6DB to consider these proposals and decide whether a creditors' committee should be formed. Formal notice of the meeting, Form 2.20B, is enclosed with the covering letter to these proposals.

Please note that creditors will be bound by the resolutions passed at the meeting, including the Administrators' proposals, if they are approved at the creditors' meeting by a majority of creditors. It is therefore important that you read this document carefully. You may put forward any modifications that you wish to see incorporated into the proposals and make your views known on whether they should be accepted.

It would be helpful if a creditors' committee is formed. If you are able to assist, please put your name forward as a candidate for membership by completing the appropriate part of the proxy form (Appendix D).

1. Purpose of this document

As a creditor you can attend the creditors' meeting either in person or by submitting a proxy. Please let me have details of your claim on the enclosed statement of claim form (Appendix F) as soon as possible. **In order to vote (either in person or by proxy) written details of your claim must be submitted to the run-off manager, PRO Insurance Solutions Limited ("PRO") at the address at Appendix C of this document, no later than 12.00 noon GMT on Monday, 7 January 2008.** Please note that you are not obliged to attend the meeting or submit a proxy if you do not wish to vote and you will not prejudice your claim and entitlement to a dividend, should there be one, if you do not attend or vote.

If you have any concerns or questions regarding the background to this case or what is being proposed, please do not hesitate to contact my colleagues, Gary Bray on +44 (0) 20 7213 8900, or James Allison on +44 (0) 20 7804 4564.

Signed.....

Dan Schwarzmann

Joint Administrator of Highlands Insurance Company (UK) Limited

Dan Schwarzmann and Mark Batten have been appointed as Joint Administrators of Highlands Insurance Company (UK) Limited to manage its affairs, business and property. The Joint Administrators contract as agents of the Company and without personal liability. Dan Schwarzmann and Mark Batten are licensed to act as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.

2 The Joint Administrators' statement of proposals

a. History of the Company

Background

The Company is a wholly owned subsidiary of Highlands Holdings (UK) Limited, which in turn is wholly owned by Highlands Insurance Group, Inc. ("HIGI"), a corporation organised under the laws of the State of Delaware, USA. On 31 October 2002, HIGI (together with several subsidiaries) filed a petition for relief under Chapter 11 of the United States Bankruptcy Code. HIGI's Bankruptcy Plan became effective on 31 March 2003.

The Company has extensive reinsurance arrangements with Highlands Insurance Company, an insurance company organised under the laws of the State of Texas, USA ("HIC"), which is also a subsidiary of HIGI. In February 2002 the Texas Department of Insurance placed HIC under a supervisory order due to its financial condition. On 6 November 2003, HIC was placed under a Rehabilitation Order by the Judicial District Court of Travis County, Texas (the "Texas Court") and a Permanent Receiver, the then Texas Commissioner of Insurance, was appointed to oversee the management of HIC. On 30 January 2004, the Permanent Receiver appointed Prime Tempus, Inc. as Special Deputy Receiver ("SDR") to oversee the management of HIC. On 24 July 2006, a proposed Rehabilitation Plan (the "HIC Plan") was filed in the Texas Court by the SDR. This plan has not yet been approved.

Summary of business written in the London Market

A summary of the business written by Highlands group companies in the London market is as follows:

	Period	Description
1	1972-1975	HIC, through its unincorporated London branch, wrote business as part of an underwriting pool known as "Tower X" with London & Edinburgh Insurance Company Limited and American Home Assurance Company. Tower X wrote all classes of marine, aviation and non-marine business. HIC's London branch also wrote similar business through Highlands Underwriting Agents Limited ("HUAL"), an underwriting agency organised by HIC.
2	1975-1977	In 1975 the capacities of Tower X and HUAL were combined to form a new underwriting pool known as the "HUA Pool Account", which continued writing business until the end of 1977.
3	1978-1982	HUAL underwrote excess of loss business on behalf of HIC only. This business became known as the "HUA P Account".

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4	1982-1994	The Company, which was incorporated on 18 November 1974, began writing business in 1983 and between that date and 1994 the Company predominantly wrote London market and international excess of loss business.
5	9 October 1986	The business written by HIC's London branch between 1978 and 1982 (see 3 above) through HUAL was transferred, as a matter of English law, to the Company pursuant to section 51 of the Insurance Companies Act 1982 (the "1986 Transfer").
6	29 December 1988	The business written by HIC's London branch between 1972 and 1977 (see 1 and 2 above) through Tower X and HUAL was, as a matter of English law, transferred to the Company pursuant to section 51 of the Insurance Companies Act 1982 (the "1988 Transfer", together with the 1986 Transfer, the "Section 51 Transfers").
7	January 1994	The Company ceased underwriting new and renewal business and has since been primarily involved in the agreement of claims and making reinsurance collections.
8	1 November 2003	PRO was appointed to manage the run-off of the Company's business.

Section 51 transfers

The validity and enforceability of the Section 51 Transfers, in respect of those policies that were issued to US direct policyholders, under both applicable US law and English law has been subject to detailed and ongoing discussion with, and advice from, the Company's US and English legal advisors.

In this connection, the Company issued proceedings before the Texas Court against the HIC Plan and the consequences of the HIC Plan for the Section 51 Transfers (the "Texas Litigation"). The Company's formal objection to the approval of the HIC Plan was filed on 21 August 2006. On 18 April 2007, the Special Master of the Texas Receivership Court issued a "Memorandum of Recommendation and Findings of Fact and Conclusions of Law" in relation to the HIC Plan, following which the SDR filed a formal objection to the Special Master's recommendation and requested a trial in the Texas Court. The trial has since commenced although on 9 October 2007 the Directors reached an outline agreement with the SDR to resolve the position and, following agreement of outline terms, continuance of the Texas Litigation was granted and a 75 day period of due diligence commenced.

Following the subsequent appointment of Administrators and initial discussions with the SDR, a further motion for continuance of the Texas Litigation, pending continued attempts to settle the dispute between the SDR and the Company, was submitted to the Texas Court on 13 December 2007. This motion was agreed and a revised trial date of 12 May 2008 has been set.

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The circumstances giving rise to the Administrators' appointment

Following a series of reviews in respect of the Company's financial position undertaken during the period leading up to and including October 2007, the Directors concluded that the Company was insolvent on a balance sheet basis and was unlikely to be able to pay its debts. Accordingly the Directors filed an application to appoint an Administrator on 25 October 2007.

b. Summary of the Administrators' actions to date

Below is a summary of the main activities that the Administrators have undertaken in the period since appointment:

Management of the run-off

PRO have been retained as run-off managers to ensure that the run-off continues with minimal disruption to creditors and to retain their knowledge of the business.

Financial review

We have commenced an evaluation of the financial position of the Company and my actuarial advisors are currently performing a review of its liabilities. In particular, the main focus of this review at present is to consider whether the settlement agreed in principle with the SDR would be reasonable considering the interests of the Company's creditors as a whole.

The review is also evaluating the impact on the Company's financial position of its participation in the pooling arrangements referred to on pages 5 and 6 of this document.

It is not possible at present to estimate the value or timing of the likely dividend with any degree of certainty. In particular this is due to the fact that the Administration has only recently commenced and that a variety of strategic matters are being, or will need to be, considered as well as a number of other factors such as the eventual level of claims made against the Company and the level of recoveries.

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Liaison with the SDR of HIC

Given the importance of the Texas Litigation referred to above and the settlement agreed in principle with the SDR prior to my appointment, we have worked closely with the SDR and are pleased with the progress made to date. As mentioned previously, we have also recently obtained the agreement of the Texas Court to defer the trial date until 12 May 2008, thereby allowing time for the provision and review of information in relation to the in-principle settlement and, if appropriate, agreement of detailed terms.

Asset management

We have secured the cash assets and investments of Highlands and brought them under our control. Our treasury team has consolidated all cash balances into a portfolio of interest bearing bank accounts and has commenced steps to manage the Company's potential foreign exchange exposure.

Chapter 15 proceedings in the United States

In order to protect assets in the United States, primarily reinsurance, we applied for protection under Chapter 15 of the US Bankruptcy Code on 18 December 2007 with a Recognition Hearing anticipated to be held early in 2008.

Creditors

We have worked extensively with PRO to improve, so far as has been practicable and cost effective, the Company's policyholder/cedant name and address records.

A market circular to all known policyholders, cedants, brokers, intermediaries and agents was initially despatched on 16 November 2007 with an additional mailing to newly identified potential creditors on 18 December 2007. We have also responded to a number of ad-hoc queries from creditors.

Tax

We have commenced initial tax and VAT reviews into the affairs of the Company prior to our appointment.

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c. Proposals for achieving the purpose of the Administration

The Administrators make the following proposals for achieving the purpose of the Administration. The Administrators will at the initial meeting of creditors seek approval of proposals (i) to (iv) below as the first resolution and the approval of proposal (v) below as the second resolution.

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 Sch.B1 IA86 (Appendix G) 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 section 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:

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- (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 Sch.B1 IA86.

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. 'A creditor's guide to Administrators' fees (in accordance with Statement of Insolvency Practice No. 9)' is attached as Appendix B Part II.

2 The Joint Administrators' statement of proposals

d. Directors' statement of affairs

A statement of affairs of the Company was delivered to the Administrators by the Directors on 18 December 2007 and a copy can be found at Appendix A. The statement was signed by Lee Brandon, Director of the Company.

The Administrators make the following comments on the Directors' statement of affairs:

- (a) In accordance with the standard format of the statement of affairs, no provision has been made for the costs of realising the Company's assets or the costs of the Administration.
- (b) The Administrators have not carried out anything in the nature of an audit on the information.
- (c) The statement of affairs was prepared by the Company's Directors (as the law requires) and not by the Administrators.

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e. Statutory and other information

Court details for the Administration:	High Court of Justice, Chancery Division, Companies Court Case No.7896 of 2007
Full name:	Highlands Insurance Company (UK) Limited
Trading name:	As above
Registered number:	01190948
Registered address:	Bruton Court, Bruton Way, Gloucester, Gloucestershire, GL1 1DA
Company Directors:	Lee Christopher Brandon, Philip James Grant, Stephen Jay Greenberg
Company secretary:	PRO Insurance Solutions Limited
Shareholdings held by the directors and secretary:	None
Date of the Administration appointment:	1 November 2007
Administrators' names and addresses:	Dan Schwarzmann and Mark Batten of PricewaterhouseCoopers LLP, 12 Plumtree Court, London, EC4A 4HT
Appointor's / applicant's name and address:	The Directors of the Company c/o Bruton Court, Bruton Way, Gloucester, Gloucestershire, GL1 1DA
Division of the Administrators' responsibilities:	In relation to paragraph 100(2) Sch.B1 IA86, during the period for which the Administration is in force, the Joint Administrators will act jointly and severally so that all functions may be exercised by any or all of the Joint Administrators
Proposed end of the Administration:	Uncertain
Estimated dividend for unsecured creditors:	Uncertain
Estimated values of the prescribed part and the company's net property:	Not applicable
Whether and why the Administrators intend to apply to court under Section 176A(5) IA86:	Not applicable
The European Regulation on Insolvency Proceedings (Council Regulation(EC) No. 1346/2000 of 29 May 2000):	Not applicable as these proceedings relate to an Insurance undertaking
Any other information which the Administrators think necessary to enable creditors to decide whether or not to vote for adoption of the proposals:	None