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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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In re:	:	
	:	
Highlands Insurance Company (U.K.)	:	Chapter 15
Limited, (in administration)	:	
	:	Case No. 07-13970 (MG)
	:	
Debtor in a Foreign Proceeding	:	
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**MEMORANDUM OF LAW IN SUPPORT OF MOTION
PURSUANT TO BANKRUPTCY CODE SECTIONS
1521 AND 105(a) AND FED. R. BANKR. P. 7065
FOR PERMANENT INJUNCTION AND RELATED RELIEF**

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1521 AND 105(a) AND FED. R. BANKR. P. 7065 FOR
PERMANENT INJUNCTION AND RELATED RELIEF**

Dan Yoram Schwarzmann and Mark Charles Batten (the “Administrators”), in their capacity as the duly appointed and recognized foreign representatives of Highlands Insurance Company (U.K.) Limited (in administration) (“HIC UK” or the “Company”), by their U.S. Counsel, Clifford Chance US LLP, submit this Memorandum of Law in Support of the Motion Pursuant to Bankruptcy Code Sections 1521 and 105(a) and Fed. R. Bankr. P. 7065 for Permanent Injunction and Related Relief (the “Motion”) filed simultaneously herewith.

I. PRELIMINARY STATEMENT

The Company is an insurance and reinsurance company incorporated in England in 1974 under the U.K. Companies Act 1948. The Company ceased writing new business in January 1994 and currently is in administration in the U.K. In the administration proceeding, the Administrators have proposed a scheme of arrangement which establishes a process by which claims of direct insurance creditors of the Company will be valued and are expected to be paid in full (the “Scheme of Arrangement”). The Scheme of Arrangement will conclude the run-off of the Company’s direct insurance business earlier and in a more efficient manner than would otherwise be the case in the absence of a Scheme of Arrangement.

Pursuant to the terms of the Scheme of Arrangement, Scheme Creditors¹ are prohibited from asserting claims that are to be administered pursuant to the Scheme of Arrangement other than in accordance with the terms of the Scheme of Arrangement. Accordingly, the Administrators are seeking permanent injunctive relief that would make the Scheme of Arrangement binding and effective in the U.S., and thereby enjoin Scheme Creditors from pursuing claims other than in accordance with the terms of the Scheme of Arrangement.

A key element of the Scheme is the implementation of the resolution of a vigorously contested dispute between the Company and HIC US, a domestic insurance company in a Texas receivership proceeding, as to whether the transfers of certain insurance and reinsurance policies to the Company by HIC US in 1986 and 1988 under U.K. statutory provisions (the “Section 51 Transfers”) effected a valid novation under U.S. federal and state law, and thus, whether such policies constitute liabilities of the Company or of HIC US. This issue is of such central

¹ Capitalized terms used but not defined herein shall have the meanings given to such terms in the Motion.

importance to the Company that due to the uncertainty surrounding litigation of the issue, the Company ceased paying claims in August 2006.

In May 2008, the Administrators and the Special Deputy Receiver of HIC US entered into a Settlement Agreement resolving this dispute. The Settlement Agreement provides for the payment by HIC US to the Company of \$13 million and, in exchange, the Company will administer the Section 51 Policies. It is expected that the payment of the Settlement Amount will enable the Administrators to make payment in full to Section 51 Direct Policyholders/Claimants.² As a condition precedent to effectiveness of the Settlement Agreement, policyholders must submit claims arising under Section 51 Direct Policies exclusively against the Company and must be enjoined from asserting such claims against HIC US.

To effectuate an earlier conclusion of the run-off the Company's direct insurance business and to implement the Settlement Agreement, the Administrators proposed the Scheme of Arrangement. The Scheme of Arrangement, once given effect in the U.S., would afford certainty to the Company, its creditors and HIC US with respect to the Section 51 Direct Policies and obviate the need for the continuance of complex and protracted litigation.

The Settlement Agreement has been approved by the Texas Court (*i.e.* the court overseeing the HIC US receivership proceeding) and the Administrators expect that by the time the Motion is heard, the Scheme of Arrangement, which implements the Settlement Agreement, will also have been approved by the English Court. Giving effect to the Scheme of Arrangement

² If it is determined that the Company will be unable to pay Scheme Creditors in full (subject to discounting at a rate designed to reflect a risk free rate of return and other relevant deductions, if any), the Scheme of Arrangement, and the non-debtor injunctive relief sought in the Motion, will be terminated.

in the U.S. and granting the relief requested in the Motion is consistent with the purposes of chapter 15 (international cooperation and providing ancillary assistance to foreign courts administering cross-border insolvency proceedings).

To prevent the Company's U.S. Scheme Creditors from pursuing actions against the Company with respect to claims to be administered by the Scheme of Arrangement, the Administrators require the ancillary assistance of this Court under chapter 15 and an order that will, *inter alia*, give full force and effect to the Scheme of Arrangement in the U.S. Absent the relief requested in the Motion, the Company and its Scheme Creditors will suffer irreparable harm insofar as the assets of the Company located in the United States will be left vulnerable to individual, rather than collective, creditor action and the effectiveness of the Scheme of Arrangement, would be at risk. Moreover, absent the Scheme of Arrangement becoming effective, the Administrators currently believe that the likelihood of payment in full to effected creditors would be significantly reduced. Accordingly, through the Motion, the Administrators seek relief that will maintain the collective nature of the English Proceeding and, to that end, require the Company's U.S. direct insurance creditors to pursue their claims against the Company in a centralized, collective proceeding under the Scheme of Arrangement.

II. FACTS

The Court is respectfully referred to the Motion and the Declaration of Dan Yoram Schwarzmann in support of the Motion, which set forth the relevant facts and are incorporated by reference herein.

III. JURISDICTION AND VENUE

This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157 and the “Standing Order of Referral of Cases to Bankruptcy Judges” of the United States District Court for the Southern District of New York (Ward, Acting C.J.), dated July 10, 1984. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(P). Venue is properly located in this District pursuant to 28 U.S.C. § 1410.

IV. ARGUMENT

A. The Administrators Are Entitled to Relief Pursuant to Section 1521(a)

Upon recognition of a foreign proceeding, section 1521(a) authorizes the Court to “grant any appropriate relief” at the request of the foreign representative where necessary to effectuate the purpose of chapter 15 and to protect the assets of the debtor or the interests of the creditors, including,

- staying the commencement or continuation of an individual action or proceeding concerning the debtor’s assets, rights, obligations or liabilities;
- staying execution against the debtor’s assets;
- suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor; and
- granting any additional relief that may be available to a trustee, except for the relief available under sections 522, 544, 545, 547, 548, 550 and 724(e).

11 U.S.C. § 1521(a)(1), (a)(2), (a)(3), (a)(7). Courts may grant such relief only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected. *See* 11 U.S.C. § 1522(a).

By order dated January 22, 2008 the Court previously has granted recognition to the English Proceeding as a foreign main proceeding and the Administrators now are seeking the

relief sought in the Motion to enforce and give effect to the Sanction Order to be issued by the English Court with respect to the Scheme of Arrangement. Specifically, the Administrators have requested certain relief under section 1521 that is required to assist the English Court and the Administrators with the effective administration of the Company in the English Proceeding. Without the relief provided for in section 1521(a) with respect to the Company, the English Court would neither be able to ensure the fair and efficient administration of the Company in a manner that protects the interests of all creditors of the Company, nor protect and maximize the value of the Company's assets. Such relief therefore is necessary to effectuate the purpose of chapter 15 and is expressly authorized under section 1521 of the Bankruptcy Code.

The Administrators are specifically seeking an order, inter alia, channeling all claims of the Company's direct insurance business creditors against the Company, including claims of Section 51 Direct Policyholders/Claimants, into one collective proceeding in accordance with the Scheme of Arrangement and to protect the interests of Scheme Creditors in having their claims valued and paid on a consistent and non-discriminatory basis, in accordance with section 1522(a). Were that process to be disrupted by uncoordinated claim litigation or unilateral action by Scheme Creditors located in the U.S., the injury to the Company and its Scheme Creditors would be irreparable.

In connection with the channeling of claims set forth above, the Administrators are seeking that all Section 51 Direct Policyholders/Claimants be enjoined from asserting claims in respect of their Section 51 Direct Policies (against the Company or HIC US) other than as provided in the Scheme of Arrangement. As set forth in greater detail below, the injunction sought with respect to HIC US is an integral part of the Scheme of Arrangement and the

Settlement Agreement pursuant to which the Company will receive funds sufficient to enable it to satisfy Scheme Creditors' claims in full.

With the exception of the injunctive relief involving HIC US, which is addressed more fully in Section B below, courts have granted relief similar to the relief sought in the Motion with respect to schemes of arrangement under Part 26 of the Companies Act 2006 of Great Britain and its predecessor, section 425 of the Companies Act 1985 of Great Britain. *See, e.g. In re Petition of Thomas Klaus Freudenstein, as Foreign Representative of Global General and Reinsurance Company Limited and Global Rückversicherungs-AG*, Chapter 15 Case No. 08-14939 (RDD), Order Granting Recognition of Foreign Proceedings, Permanent Injunction and Related Relief (Bankr. S.D.N.Y. Jan. 21, 2009) (giving effect in the U.S. to scheme of arrangement under Part 26 of the Companies Act 2006); *In re Europäische Rückversicherungs-Gesellschaft in Zürich (European Reinsurance Company of Zurich)*, Chapter 15 Case No. 06-13061 (REG), Permanent Injunction and Order Granting Recognition of Foreign Nonmain Proceeding of European Reinsurance Company of Zurich Pursuant to 11 U.S.C. §§ 1507, 1517, 1521 (Bankr. S.D.N.Y. Jan. 22, 2007) (giving effect in the U.S. to scheme of arrangement under section 425 of the Companies Act 1985 of Great Britain); *In re ING Re (UK) Limited*, Chapter 15 Case No. Case No. 08-10018 (REG), Order Recognizing Foreign Main Proceeding of ING RE (UK) Limited and Permanent Injunction (Bankr. S.D.N.Y. Jan. 30, 2008) (giving effect in the U.S. to scheme of arrangement under section 425 of the Companies Act 1985 of Great Britain).

1. The Requirements for a Permanent Injunction Have Been Met in Accordance With Section 1521(e)

The standards, procedures and limitations applicable generally to an injunction also apply to relief sought under section 1521(a). *See* 11 U.S.C. § 1521(e). The relief sought in the Motion

is warranted under the standard applicable in the Second Circuit for granting a permanent injunction. That standard is essentially the same as the standard for a preliminary injunction,³ except rather than demonstrate a likelihood of success on the merits, the movant must actually succeed on the merits. *See NextG Networks of New York, Inc. v. City of New York*, No. 03 CIV 9672 RMB/JCF, 2006 WL 538189, at *8 (S.D.N.Y. Mar. 6, 2006). In addition, the movant must make a showing of the likelihood of irreparable harm, *i.e.*, an injury that cannot be redressed through financial compensation. *See id.* Irreparable harm must be likely and imminent, not remote or speculative. *See id.*; *Civic Ass'n of Deaf of New York City, Inc. v. Giuliani*, 915 F. Supp. 622, 631 (S.D.N.Y.1996).

Irreparable harm to an estate exists where the orderly determination of claims and the fair distribution of assets are disrupted. *See, e.g., Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709, 713-14 (2d Cir. 1987); *Cunard S.S. Co. Ltd. v. Salen Reefer Servs., AB.*, 773 F.2d 452, 458 (2d Cir. 1985) (“Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail.”) (citing *Canada S. Railway Co. v. Gebhard*, 109 U.S. 527, 539 (1883)); *In re MMG, LLC*, 256 B.R. 544, 555 (Bankr. S.D.N.Y. 2000) (“As a rule . . . irreparable harm exists whenever local creditors of the foreign debtor seek to collect their claims or obtain preferred positions to the detriment of other creditors.”).

In addition, the relief sought in the Motion may be obtained without undue hardship or prejudice to the rights of U.S. creditors. As shown in the Scheme Documents, the Scheme of Arrangement contemplates a means of claimant participation similar to that contemplated by the

³ The applicable preliminary injunction standard is (i) a likelihood of success on the merits and (ii) irreparable harm.

Bankruptcy Code. Moreover, the claims valuation process is applied uniformly to all Scheme Creditors, regardless of domicile. In addition, each Scheme Creditor is afforded adequate notice and an opportunity to be heard by the English Court. As such, the interests of the Company and its Scheme Creditors and other interested parties are sufficiently protected.

B. Injunctive Relief With Respect to HIC US is Necessary and Appropriate Under the Circumstances

In addition to injunctive relief with respect to the Company (*i.e.* the channeling of all claims with respect to direct insurance against the Company into the Scheme of Arrangement) and in order to enforce the Sanction Order in the U.S., the relief sought in the Motion includes an injunction prohibiting Section 51 Direct Policyholders/Claimants from pursuing claims based on Scheme Liability, including in particular any Section 51 Direct Claim against HIC US and outside the Scheme of Arrangement. Under the present circumstances, which as discussed below are highly unique and extraordinary, this Court possesses the authority under sections 105(a) and 1521 of the Bankruptcy Code to grant such relief.

Section 105(a) of the Bankruptcy Code authorizes bankruptcy courts to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code].” *See* 11 U.S.C. § 105(a). Any power that a court employs under section 105(a) must derive from some other provision of the Bankruptcy Code. *See Deutsche Bank AG London Branch et al v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142 (2d Cir. 2005). As set forth above, upon recognition of a foreign proceeding and where necessary to effectuate the purpose of chapter 15 and to protect the assets of the debtor or the interests of the creditors, section 1521(a) authorizes the Court to grant certain additional relief at the request of the Administrators, including, *inter alia*,

- staying the commencement or continuation of an individual action or proceeding concerning the debtor’s assets, rights, obligations or liabilities; and
- granting any additional relief that may be available to a trustee, except for the relief available under sections 522, 544, 545, 547, 548, 550 and 724(e).

11 U.S.C. § 1521(a).

Courts have approved non-debtor releases in cases arising under chapters 7 and 11 of the Bankruptcy Code when some, but not necessarily all, of the following factors were present: (1) the estate received substantial consideration, (2) the enjoined claims were channeled to a settlement fund rather than extinguished, (3) the enjoined claims would impact the debtor’s reorganization and (4) the plan otherwise provided for the full payment of the enjoined claims⁴. *See id.* Notwithstanding, courts have provided that consideration of the appropriateness of a non-debtor injunction is not limited to the application of a concrete set of factors, but should be granted sparingly and only under circumstances that may be characterized as unique.” *In re Metromedia Fiber Network, Inc.*, 416 F.3d 142. As noted by this Court in *McHale v. Alvarez (In re The 1031 Tax Group)*, cases in this Circuit make clear that bankruptcy courts have “very limited power to approve settlements or chapter 11 plans containing permanent or channeling injunctions in favor of non-debtors,” Case No. 07-11448 (MG), Opinion & Order Granting Preliminary Injunction (Bankr. S.D.N.Y. 2008), and that the issuance of third-party releases are proper only in rare cases and under unique circumstances. *See In re Adelpia Commcn’s Corp.*, 364 B.R. 518, 529 (Bankr. S.D.N.Y. 2007).

For the reasons that follow, an injunction channeling all claims under the Section 51 Direct Policies into the Scheme of Arrangement and prohibiting Section 51 Direct

⁴ “Nondebtor releases may also be tolerated if the affected creditors consent.” *Id. see also; Matter of Specialty Equip. Cos., Inc.*, 3 F.3d 1043 (7th Cir. 1993 (Bankruptcy courts may release non-debtors from their debts if affected creditors consent).

Policyholders/Claimants from pursuing such claims against HIC US is appropriate under the present circumstances, which are highly unique, if not singular.

Firstly, this case is not a plenary proceeding. This is a chapter 15 case that is ancillary to a foreign main proceeding and by the date the Motion is heard, the Administrators expect that the English Court will have entered the Sanction Order which will provide for the channeling of all claims arising under the Section 51 Direct Policies through the Scheme of Arrangement. As such, the relief sought in the Motion is consistent with the purpose of chapter 15, which is to provide effective mechanisms for dealing with cases of cross-border insolvency, with the express objectives of cooperation between United States courts and foreign courts involved in cross-border insolvency cases. *See* 11 U.S.C. 1501. Moreover, “chapter 15 accords the court substantial discretion and flexibility.” *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 126 (Bankr. S.D.N.Y. 2007).

The relief sought in the Motion with respect to HIC US is appropriate because (i) the Settlement Amount paid by HIC US to the Company will provide substantial consideration to the Company’s estate, (ii) each of the Section 51 Direct Policyholders/Claimants’ claims will be channeled to an administered in accordance with the Scheme of Arrangement, and (iii) it is projected that the Settlement Amount will enable the Company to make payment in full (subject to discounting at a rate designed to reflect a risk free rate of return and other relevant deductions, if any, in accordance with the terms of the Scheme of Arrangement) to creditors subject to the injunction. If the Settlement Amount will not enable the Company to make full payment to Scheme Creditors, the Scheme of Arrangement and the injunctive relief sought in the Motion, will be terminated. Courts have acknowledged that a non-debtor injunction may be appropriate in circumstances where, as here, substantial consideration is received in exchange for the release

and the creditors to be enjoined are paid in full. *See, e.g., In re Adelpia, Commcn's Corp.*, 364 B.R. at 530 (“payment in full (or provision for payment in full) to affected creditors has been another basis historically found to justify channeling injunctions”); *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 142 (noting that courts have approved non-debtor releases when, *inter alia*, the estate received substantial consideration, the enjoined claims were ‘channeled’ to a settlement fund rather than extinguished and the plan otherwise provided for the full payment of the enjoined claims); *In re Mrs. Weinberg's Kosher Foods, Inc.*, 278 B.R. 358 (Bankr. S.D.N.Y. 2002 (approval of non-debtor channeling injunction granted in a chapter 7 case where injunction was unnecessary to a reorganization, but necessary to settlement agreement entered into by chapter 7 trustee and creditors were given due notice of the proposed injunction and did not object).

The proposed injunction is an integral part of the Settlement Agreement between HIC US and the Company. Prior to the Settlement Agreement, HIC US and the Company were mired in a dispute with respect to the efficacy of the Section 51 Transfers. As such, the Section 51 Direct Policyholders/Claimants lacked certainty as to whether HIC US or the Company would be obligated or able to satisfy their claims, and the resources of both estates were likely to be further diminished in connection with the Texas Litigation. The Settlement Agreement, including the injunctive relief sought with respect to HIC US, has already been approved by the Texas Court after an evidentiary hearing. The Texas Court Order approving the Settlement Agreement contained specific findings that adequate and timely notice was provided to parties affected by the Settlement Agreement and that such parties were afforded a reasonable opportunity to object or be heard with respect to the Special Deputy Receiver’s request for approval of the Settlement Agreement. *See* Exhibit D to the Motion, Texas Court Order ¶¶ D, E. Moreover, the Texas

Court further found that Section 51 Direct Policyholders/Claimants would not be prejudiced by the Texas Court's approval of the Settlement Agreement. *See id.* at ¶ F. In addition, no party filed an objection to the Texas Court's approval of the Settlement Agreement. *See id.* p. 1.

Finally, as set forth in the Motion, the statutory requisite majority of Scheme Creditors voted to approve the Scheme of Arrangement and the Administrators anticipate that by the time the Motion is heard, the English Court also will have conducted a hearing to consider approval of the Scheme of Arrangement, which sets forth and implements the terms of the Settlement Agreement, and will have entered the Sanction Order approving such Scheme of Arrangement.

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V. CONCLUSION

For the reasons set forth above, the Administrators respectfully submit that the Motion satisfies the requirements for the injunctive and other relief sought therein. Unless the relief requested is granted, the Scheme of Arrangement may not become effective and the English Proceeding will be undermined with the consequence of imminent and irreparable harm arising to the Company and its Scheme Creditors through exposure to unilateral U.S. creditor actions in derogation of the collective interests embraced by the Scheme of Arrangement. In order to ensure equal and consistent treatment of all Scheme Creditors, each must similarly be bound and the assets of the Company similarly protected, irrespective of a diversity of domicile or location. For the foregoing reasons, the Administrators respectfully request that this Court grant the relief requested in the Motion.

Dated: July 1, 2009
New York, New York

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