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

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In re: :  
: :  
Highlands Insurance Company (U.K.) Limited, : Chapter 15  
(in administration) : :  
: Case No. 07-13970 (MG)  
: :  
Debtor in a Foreign Proceeding :  
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**MOTION PURSUANT TO BANKRUPTCY CODE  
SECTIONS 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 Motion Pursuant to Bankruptcy Code Sections 1521 and 105(a) and Fed. R. Bankr. P. 7065 for Permanent Injunction and Related Relief (the “Motion”) and respectfully represent as follows:

**BACKGROUND**

**A. The English Proceeding and the Chapter 15 Case**

1. HIC UK is an insurance and reinsurance company incorporated in England in 1974 under the U.K. Companies Act 1948.

2. The Company is a wholly-owned subsidiary of Highlands Holdings (U.K.) Limited, which in turn is wholly-owned by Highlands Insurance Group, Inc., a corporation organized under the laws of the State of Delaware, U.S. (“HIGI”).<sup>1</sup>

3. On October 25, 2007, the directors of the Company filed an application with the High Court of Justice of England and Wales (the “English Court”) requesting the appointment of the Administrators as the joint administrators of the Company. Pursuant to a hearing held on November 1, 2007 (the “Administration Date”), the English Court entered an order commencing the administration proceeding (the “English Proceeding”) and appointing the Administrators as the joint administrators of the Company to manage its affairs, business and property (the “Administration Order”). Pursuant to the Administration Order, the English Court authorized the Administrators to commence this Chapter 15 case.

4. On December 18, 2007, the Administrators filed with this Court the Verified Petition for Recognition of a Foreign Main Proceeding and Motion for Related Relief Pursuant to 11 U.S.C. §§ 1504, 1517, 1520, 1521 (the “Verified Petition and Motion”) seeking recognition of the English Proceeding as a foreign main proceeding and granting related injunctive relief. See Docket No. 2.

5. On January 22, 2008, this Court entered the Order Granting Recognition of English Proceeding as Foreign Main Proceeding and Related Injunctive Relief (the “Recognition Order”). See Docket No. 23.

## **B. The Scheme of Arrangement**

6. A scheme of arrangement pursuant to Part 26 of the Companies Act 2006, such as the scheme of arrangement dated 1 May 2009 and proposed in respect of the Company (the “Scheme of Arrangement”), is a compromise or arrangement between a company and its creditors or any class of them.

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<sup>1</sup> On October 31, 2002, HIGI, together with several subsidiaries, filed a petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. As a result of HIGI’s bankruptcy plan, which become effective on March 31, 2003, all the shares of HIGI were cancelled and new shares were issued to a Liquidating Trust, which now manages HIGI.

7. The Scheme of Arrangement, once effective, will establish a process by which the claims of direct insurance creditors of the Company will be valued and paid earlier than would be the case if such claims were permitted to mature and crystallize in the ordinary course of the administration proceeding.

8. In the absence of the Scheme of Arrangement, the Administrators do not expect the claims against the Company to mature and crystallize for a number of years. As such, the Administrators believe that the Scheme of Arrangement will be the most efficient and effective method of making payment to persons who have, or may in the future have, a claim against the Company in relation to a direct insurance contract underwritten, entered into or assumed by the Company in the shortest practicable time.

9. In order for a scheme of arrangement to become legally binding, (a) a majority in number representing not less than 75% in value of creditors, or any class of them, must vote in favor of the scheme of arrangement at a specially convened meeting held at the direction of the English Court, (b) the English Court must enter an order sanctioning the scheme of arrangement, and (c) a copy of such order must be delivered to the Registrar of Companies in England and Wales. The Scheme of Arrangement provides that it shall not become effective until the first date on which (a) a copy of the English Court's order sanctioning the Scheme of Arrangement is filed with the Registrar of Companies and (b) this Court enters an order granting permanent injunctive relief under Chapter 15 of the Bankruptcy Code (the "Effective Date").

10. On April 30, 2009, the English Court conducted a hearing and subsequently entered an order (the "April Order") directing the Administrators to convene a creditors' meeting (the "Creditors' Meeting") for the purpose of allowing Scheme Creditors to consider and vote on the Scheme of Arrangement. A certified copy of the April Order is attached hereto as Exhibit A.

11. In accordance with the April Order, by letter dated May 1, 2009, the Administrators notified Scheme Creditors that the Scheme of Arrangement was being proposed and that the Creditors' Meeting was scheduled to occur on June 18, 2009.

12. On May 1, 2009, the Administrators caused, amongst other things, a letter explaining the main provisions of the Scheme of Arrangement, a notice of the Creditors' Meeting and voting form (and guidance notes for completion thereof) (collectively the "Scheme Documents") to be mailed to those parties in respect of whom the Company's records indicate that they have or may have a claim against the Company, and, where known, to agents, representatives and brokers identified by the Company as having placed insurance business with or on behalf of the Company (collectively, the "Notice Recipients") at their last known address. A copy of the Scheme Documents is attached hereto as Exhibit B.

13. The Scheme of Arrangement is proposed between the Company and its Scheme Creditors<sup>2</sup> and generally will apply in respect of liabilities under a contract or policy of direct insurance to which the Company was subject as of the Administration Date or thereafter.

*The Settlement Agreement*

14. Highlands Insurance Company ("HIC US"), is an insurance company organized under the laws of the State of Texas and is also a subsidiary of HIGI. The Company has extensive reinsurance arrangements with HIC US.

15. In 1986, certain business written between 1978 and 1982 by HIC US's London branch was transferred to the Company (the "1986 Transfer") by way of statutory novation pursuant to Section 51 of the Insurance Companies Act 1982 of Great Britain. In return for the 1986 Transfer, HIC US entered into a 34% quota share reinsurance treaty with the Company in relation to the liabilities so transferred.

16. In 1988, the business written by HIC US between 1972 and 1977 through certain underwriting agents was also transferred to the Company by way of statutory novation (the "1988 Transfer", and together with the 1986 Transfer, the "Section 51 Transfers"). In exchange for the 1988 Transfer, HIC US entered into

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<sup>2</sup> Capitalized terms not defined herein shall have the meaning given to such terms in the Scheme of Arrangement. To the extent that any definitions contained herein are inconsistent with or differ from definitions contained in the Scheme of Arrangement, the definition given to such term in the Scheme of Arrangement shall apply.

a quota share reinsurance treaty pursuant to which HIC US reinsured the Company in respect of 100% of the transferred business.

17. On November 6, 2003, HIC US was placed under a Rehabilitation Order by the Judicial District Court of Travis County, Texas (the “Texas Court”) and a Permanent Receiver was appointed to oversee the management of HIC US. The Permanent Receiver then named a Special Deputy Receiver to oversee the management of HIC US. On July 24, 2006, the Special Deputy Receiver filed a proposed rehabilitation plan in respect of HIC US in the Texas Court (the “Original Rehabilitation Plan”).

18. On August 21, 2006, the Company filed an objection to the Original Rehabilitation Plan in the Texas Court on the basis that the Original Rehabilitation Plan did not properly treat all creditors of HIC US in the same class equally. In particular, the Company was concerned that the policies transferred pursuant to the Section 51 Transfers (the “Section 51 Policies”) written in favor of U.S. domiciled insureds covering risks in the U.S. (the “US Section 51 Policies”) would not be treated equally with “class 2” creditors of HIC US under such plan. As discussed below, the enforceability of the Section 51 Transfers was in dispute and was the underlying cause of the objection.

19. In this regard, the Company requested that the Special Deputy Receiver, whether pursuant to a revised rehabilitation plan or through a liquidation of HIC US, treat all such claimants equally and ensure that they were paid *pari passu* in the event of any inability of HIC US to pay the claims in full.

20. On April 18, 2007, the Special Master of the Texas Court issued a “Memorandum of Recommendation and Findings of Fact and Conclusions of Law,” which ultimately found that the Original Rehabilitation Plan lacked sufficient evidence to prove that all creditors of the same class would be paid in full and treated equally.

21. The Special Deputy Receiver filed an objection to this decision and requested a trial in the Texas Court, which request was granted. Following commencement of the trial (the “Texas Litigation”),

proceedings were discontinued pending settlement of the dispute between HIC US and the Company. A central component of the dispute was the extent to which the Section 51 Transfers were enforceable in the U.S., and accordingly, whether the Company or HIC US was the proper entity obligated to policyholders on account of the U.S. Section 51 Policies.

22. Given the uncertainty surrounding the Texas Litigation and its outcome, the Company ceased paying claims in August 2006. Since the commencement of the English Proceeding, the entry into a binding resolution of the Texas Litigation has been one of the Administrators' key objectives.

23. On May 9, 2008, the Special Deputy Receiver, acting on behalf of HIC US, and the Administrators entered into the Settlement Agreement Between Highlands Insurance Company in Receivership and Highlands Insurance Company (U.K.) Ltd. in Administration (the "Settlement Agreement"). A copy of the Settlement Agreement and the first amendment thereto is attached hereto as Exhibit C.

24. On October 13, 2008, after notice and a hearing, the Texas Court entered the Order Approving Application for Authority to Settle ("Texas Court Order") and thereby approved the Settlement Agreement. A copy of the Texas Court Order is attached hereto as Exhibit D.

25. The Settlement Agreement provides for HIC US to pay a settlement amount to the Company in the amount of \$13,000,000 (the "Settlement Amount") in two installments and in return, the Company will administer the Section 51 Policies. The Settlement Amount will be utilized to discharge claims arising out of those Section 51 Policies which are direct policies or contracts of insurance (the "Section 51 Direct Policies"), as well as the other purposes specified in the Scheme of Arrangement.

26. A key benefit of the Settlement Agreement is that it provides certainty to the Company, HIC US and policyholders as to which party (*i.e.* the Company or HIC US) is obligated to make payments on claims arising under the Section 51 Policies and thereby obviates the need to litigate the issue on a one-off basis. As a result of the Settlement Agreement, creditors holding claims under the Section 51 Direct Policies ("Section

51 Direct Policyholders/Claimants”) should now be able to avoid the potential cost and uncertainty of claiming against two estates where the liability of both is in dispute.

27. Pursuant to the Settlement Agreement, payment of the Settlement Amount by HIC US is conditioned on a number of factors, including approval by the English Court of the Scheme of Arrangement and an order of this Court, pursuant to Chapter 15 of the Bankruptcy Code, enforcing and giving effect to the Scheme of Arrangement, which provides, *inter alia*, that (a) Section 51 Direct Policyholders/Claimants shall assert such claims solely against the Company, (b) such claims shall be administered exclusively through the Scheme of Arrangement and (c) Section 51 Direct Policyholders/Claimants shall be precluded and enjoined from asserting such claims except as specifically provided for under the Scheme Arrangement.

28. Accordingly, Part 3, Section 3.3.3. of the Scheme of Arrangement provides that:

No Scheme Creditor shall be entitled to commence or continue any Proceedings or other judicial, quasi-judicial or regulatory process whatsoever against HIC(US) in any jurisdiction for the purpose of obtaining payment directly or indirectly of a Scheme Liability, in particular any Section 51 Direct Claim. For the avoidance of doubt, the Scheme Administrators shall not consent to the commencement by a Scheme Creditor of any Proceedings as against HIC(US) or its Property in any jurisdiction for the purpose of obtaining payment directly or indirectly of any Scheme Liability.

See, Exhibit B, Scheme of Arrangement at §3.3.3 (pp. 72-73).

29. Thus, as contemplated by, and to give effect to, the Settlement Agreement, the Scheme of Arrangement provides that Section 51 Direct Policyholders/Claimants’ claims shall be administered solely by the Scheme of Arrangement and Scheme Creditors shall be prohibited from asserting such claims against HIC US.

30. The Company’s receipt of the Settlement Amount means that the Company will have additional assets available to it and thereby makes it more likely that the allowed claims of Scheme Creditors will be paid in full. The Administrators currently anticipate that once each Scheme Creditor’s claim is valued and properly established, such claims will be paid in full. If the claims of Scheme Creditors are paid in full (as is

currently anticipated), the ability of the Section 51 Direct Policyholders/Claimants to pursue HIC US would be immaterial.

31. In the event that the Administrators determine that it is not possible to pay all Scheme Creditors in full, an event which the Administrators currently consider to be unlikely, the Scheme of Arrangement shall terminate and as a result, Scheme Creditors would no longer be prohibited from pursuing claims against HIC US.

### **C. Approval of the Scheme of Arrangement**

32. In accordance with the April Order, on June 18, 2009, the Administrators convened the Creditors' Meeting, at which the requisite statutory majority of creditors voted in favor of the Scheme of Arrangement.

33. The Administrators anticipate that the English Court will conduct a hearing on or around July 30, 2009 to consider whether to sanction the Scheme of Arrangement. If the English Court enters an order approving the Scheme of Arrangement, the Administrators will promptly file a notice with this Court and attach a certified copy of such order thereto.

34. Within 7 days of the Effective Date, the Administrators will cause notice to be mailed to the Notice Recipients at their last known address informing them that the Scheme of Arrangement is effective and a Claim Notification and a Final Claim Form will be enclosed therein.

35. Such notice will also advise Scheme Creditors that a Claim Notification must be submitted such that it is received by the Company no later than 5:00 p.m. (London time) on the first business day falling 90 elapsed calendar days after (but not including) the Effective Date and that a Final Claim Form must be submitted such that it is received by the Company no later than 5:00 p.m. (London time) on the first business day falling 180 elapsed calendar days after (but not including) the Effective Date. If a Scheme Creditor does not complete and return a Claim Notification and a Final Claim Form by the applicable deadline, and unless

the claim has already been agreed to by the Administrators, then such Scheme Creditor's claim, if any, will be valued at zero and the Scheme Creditor will not be entitled to receive any payment in respect of its claim.

36. The Administrators will also cause notices to be placed in *Insurance Day*, in the U.K., *Business Insurance*, in the U.S., *NRC Handelsblad*, in The Netherlands and the international editions of each of the *Financial Times* and the *Wall Street Journal*. Such notices also will be posted on the Company's website at [www.ukhighlands.co.uk](http://www.ukhighlands.co.uk).

### **JURISDICTION AND VENUE**

37. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. §§ 157 and 1334 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).

38. Venue is proper before this Court pursuant to 28 U.S.C. § 1410.

### **RELIEF REQUESTED**

39. The Administrators respectfully request the entry of an order by this Court, substantially in the form annexed hereto as Exhibit E (the "Proposed Order"), granting a permanent injunction and related relief, including a permanent non-debtor injunction in favor of HIC US, pursuant to sections 1521 and 105(a) of the Bankruptcy Code and Rule 65 of the Federal Rules of Civil Procedure, as made applicable by Rule 7065 of the Federal Rules of Bankruptcy Procedure, ordering that as of the Effective Date:

- (a) The Scheme of Arrangement (the "Scheme") shall be given full force and effect and be binding on and enforceable against all Scheme Creditors in the U.S.;
- (b) All claims of Scheme Creditors shall be administered and adjudicated exclusively pursuant to the terms of the Scheme;

(c) Section 51 Direct Policyholders/Claimants ("Section 51 Direct Policyholders/Claimants") shall be required to make any and all claims in respect of their Section 51 Direct Policy and seek payment of such claims exclusively in accordance with the provisions of the Scheme and shall be precluded and enjoined from making any such claims except as specifically provided for under the Scheme;

(d) all Scheme Creditors asserting a claim under a Section 51 Direct Policy shall be prohibited and enjoined from asserting any and all claims in respect of their Section 51 Direct Policy or seeking payment of such claims (including asserting or effecting a set-off based on such claims) against HIC(US);

(e) except as provided in the Scheme, all Scheme Creditors shall be permanently enjoined and restrained from taking any actions in contravention of, or that are inconsistent with, the terms of the Scheme or its administration, implementation or enforcement, including:

(i) transferring, relinquishing or disposing of any property of the Company located within the territorial jurisdiction of the United States or the proceeds of such property (the "US Property");

(ii) taking or continuing any act to obtain possession of, or exercise control over, the Company or any of its US Property;

(iii) commencing or continuing any action or proceedings (including, without limitation, arbitration, mediation or any judicial, quasi-judicial, administrative or regulatory action, proceedings or process whatsoever), including by way of counterclaim (each individually, an "Action"), against the Company or any of its US Property;

(iv) enforcing any judicial, quasi-judicial, administrative or regulatory judgment, assessment or order or arbitration award against the Company obtained in connection with any Scheme Liability;

(v) commencing or continuing any act or proceeding to create, perfect or enforce any lien, attachment, set-off or other claim against the Company or any of its US Property, including, without limitation, rights under the Insurance Contracts;

(vi) except as prohibited by § 1501(d) of the Bankruptcy Code, invoking, enforcing or relying on the benefits of any statute, rule or requirement of federal, state, or local law or regulation requiring the Company to establish or post security in the form of a bond, letter of credit or otherwise as a condition of prosecuting or defending any Actions arising out of a Scheme Liability (including, without limitation, arbitration, mediation or any judicial, quasi-judicial, administrative or regulatory action, proceedings or process whatsoever) and such statute, rule or requirement will be rendered null and void for proceedings; provided however, that nothing in the order shall in any respect affect any Security Interest in existence at the Effective Date or the replacements for such Security Interest;

(vii) except as prohibited by § 1501(d) of the Bankruptcy Code, drawing down any letter of credit established by, on behalf of or at the request of the Company unless expressly authorized by the terms of any contract or agreement pursuant to which the letter of credit has been established; and

(viii) except as prohibited by § 1501(d) of the Bankruptcy Code, withdrawing from, setting-off against, or otherwise applying US Property that is the subject of any trust or escrow agreement or similar arrangement in which the Company has an interest in excess of amounts expressly authorized by the terms of the contract and any related trust or other agreement pursuant to which such trust, escrow or similar arrangement has been established.

(f) except as provided in the Scheme, all Scheme Creditors that are parties to any trust, escrow agreement or similar arrangement in which the Company has an interest, shall be required to:

(i) provide notice to the Administrators' United States counsel, Clifford Chance US LLP, 31 West 52nd Street, New York, New York 10019 (Attn: Sara Tapinekis), of any withdrawal from, set-off against, or other application of property that is the subject of any such trust or escrow agreement or similar arrangement in which the Company has an interest, together with information sufficient to permit the Company to assess the propriety of such withdrawal, set-off or other application, including, without limitation, the date and amount of such withdrawal, set-off or other application and a copy of any contract, related trust or other agreement pursuant to which any such withdrawal, set-off or other application was made, and provide such notice and other information contemporaneously; and

(ii) turn over and account to the Company for all funds resulting from such withdrawal, set-off or other application in excess of amounts expressly authorized by the terms of the contract, any related trust or other agreement pursuant to which such trust, escrow or similar arrangement has been established;

(g) except as provided in the Scheme, all Scheme Creditors shall be required to:

(i) turn over and account to the Company for any US Property of the Company, or proceeds thereof, that relate to any Scheme Liability, of which they have possession, custody or control;

(ii) deliver to the Company any books, papers or records of the Company that relate to any Scheme Liability, of which they have possession, custody or control and all Scheme Creditors having any books, papers or records that the Company or Scheme

Adjudicator may reasonably require in relation to their duties or related to any matter that may affect the implementation of the Scheme shall preserve them and submit them to the Company or Scheme Adjudicator, or their designees, for examination at all reasonable times; and

(iii) to the extent they have a claim of any nature or source against the Company or any US Property or are a party to any proceeding in which the Company is or was named as a party, or as a result of which a liability of the Company may be established, notify the Company, in accordance with the terms of the Scheme, and to put the Administrators' United States counsel on the master service list of any such proceeding and to take such other steps as may be necessary to ensure that they receive (A) copies of any and all documents sent by the parties to such proceeding or issued by the court, administrator, arbitrator, regulator or similar official having jurisdiction over such proceeding, and (B) any and all correspondence or other documents circulated to parties named in the master service list;

(h) nothing in the order would prevent the continuance or commencement of proceedings against any insurer other than the Company, provided however, that if any third party shall reach a settlement with, or obtain a judgment against, any person or entity other than the Company, such settlement or judgment shall not be binding on or enforceable against the Company;

(i) this Court shall retain jurisdiction with respect to the enforcement, amendment or modification of the order or requests for any additional relief in the case filed under Chapter 15 of the Bankruptcy Code and all adversary proceedings in connection therewith properly commenced and within the jurisdiction of the Bankruptcy Court;

(j) no action taken by the Company, its successors, agents or representatives, or any of them, or its counsel, in preparing, disseminating, applying for, implementing or otherwise acting in furtherance of the Scheme, the order, the Chapter 15 case, any further order for additional relief

in the Chapter 15 case, or any adversary proceedings in connection therewith, will be deemed to constitute a waiver of the immunity afforded to the Company, the Administrators, the Scheme Adjudicator or their successors, agents, attorneys or representatives pursuant to section 1510 of the Bankruptcy Code; and

(k) nothing in the order shall alter or affect the terms of the Settlement Agreement or the venue and jurisdiction provisions thereof.

#### **BASIS FOR RELIEF**

40. For the reasons set forth herein and in the memorandum of law in support of the Motion (the “Memorandum of Law”) filed simultaneously herewith and because the requested relief is necessary to effectuate the purpose of Chapter 15 and to protect the assets of the Company and the interests of the Company’s creditors, the Administrators respectfully request that this Court enter an order substantially in the form attached hereto as Exhibit E, pursuant to sections 1521 and 105(a) of the Bankruptcy Code and Rule 65 of the Federal Rules of Civil Procedure, as made applicable by Rule 7065 of the Federal Rules of Bankruptcy Procedure.

41. No previous application for the relief requested herein has been made in this or any other court.

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## CONCLUSION

WHEREFORE, the Administrators respectfully request that the Court enter an order substantially in the form of the Proposed Order attached hereto as Exhibit E granting the relief requested herein and such other and further relief as is just and proper.

Dated: New York, New York  
July 1, 2009

## CLIFFORD CHANCE US LLP

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