

Hearing Date and Time: October 23, 2007
10:00 a.m.
Objection Deadline: October 16, 2007
5:00 p.m.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re:

Petition of Anthony James McMahon and Philip Wedgwood Wallace, as Joint Provisional Liquidators of SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED

Debtor in Foreign Proceedings.

An Ancillary case under
Section 304 of the
Bankruptcy Code

Case No. 97-B-44652 (JMP)

**MOTION PURSUANT TO SECTIONS 105 AND 304 OF THE
BANKRUPTCY CODE TO MODIFY PERMANENT INJUNCTION ORDER**

TO: THE HONORABLE JAMES M. PECK,
UNITED STATES BANKRUPTCY JUDGE:

Michael Steven Walker and John Mitchell Wardrop, as the Scheme Administrators (the "Scheme Administrators")¹ of Sovereign Marine & General Insurance

¹ Capitalized terms not defined herein shall have the meanings ascribed to them in the Scheme Document attached hereto as Exhibit B.

Company Limited ("Sovereign Marine"), by their US counsel Allen & Overy LLP, in support of their request, pursuant to sections 105(a) and 304(b) of the United States Bankruptcy Code (the "Bankruptcy Code") to modify a permanent injunction order entered by this Court on December 30, 1999 (the "Permanent Injunction Order", a copy of which is attached hereto as Exhibit A), to aid the enforcement of the Amended Scheme of Arrangement, dated July 31, 2006 (the "Amended Scheme" and, together with the related Explanatory Statement, the "Scheme Document"), attached hereto as Exhibit B promulgated pursuant to section 425 of the Companies Act 1985 of Great Britain (the "Companies Act"), respectfully allege as follows:

INTRODUCTION

1. By this Motion (the "Motion"), the Scheme Administrators seek an order in the form attached hereto as Exhibit C (the "Amended Scheme Permanent Injunction Order") modifying the Permanent Injunction Order previously entered in support the Scheme of Arrangement (the "Original Scheme"), between Sovereign Marine and its Scheme Creditors. Such modification would give full force and effect in the United States to the Amended Scheme.

2. Upon their appointment on July 11, 1997, the Joint Provisional Liquidators of Sovereign Marine were required to determine whether a scheme of arrangement would best serve the general body of creditors. Subsequently, the Joint Provisional Liquidators proposed the Original Scheme, which was approved by Sovereign Marine's creditors on November 29, 1999, and sanctioned on December 20, 1999, by the High Court of Justice of England and Wales in London, England (the "High Court") pursuant to the Insolvency Act 1986 of England, Scotland and Wales. The Original Scheme allows a Scheme Creditor's claim (a "Scheme Claim") against Sovereign Marine to be processed and established either by agreement between the Scheme Creditor and the Scheme Administrators or, following dispute resolution procedures set out in the Scheme, by litigation.

3. The Scheme Administrators, supported by the current Creditors' Committee, have determined that it is no longer cost-effective and not in the best interests of its creditors to continue the run-off under the Original Scheme. As discussed more fully below, the Scheme Administrators proposed a "closing" scheme by way of amendment to the Original Scheme, which Amended Scheme will have the effect of estimating and crystallizing all of Sovereign Marine's contingent liabilities apart from the Protected Scheme Claims of Sovereign Marine's Protected Policyholders. Protected Scheme Claims will continue to be dealt with in much the same way as under the Original Scheme and will, subject to eligibility, be entitled to receive payment from the Financial Services Compensation Scheme Limited directly whenever they become payable.

4. The majority of Sovereign Marine's and its subsidiaries' liabilities (approximately 95%) arise from their participation in a certain insurance and reinsurance pooling arrangement formerly administered by WFUM (the "WFUM Pools"). The other participants in the WFUM Pools were the Scheme Companies, including Sovereign Marine and its two solvent subsidiaries, Sovereign Insurance (UK) Limited and Greyfriars Insurance Company Limited, which account for approximately 50% of the WFUM Pool liabilities. Sovereign Marine, its subsidiaries and the other Scheme Companies decided to promote schemes of arrangement to present a unified resolution of WFUM Pools. The related scheme of arrangement for Sovereign Marine will be implemented through amendment of the Original Scheme. The Scheme Administrators believe that this will create significant benefits to Scheme Creditors, principal among these being: (i) acceleration and increase of the dividends to be paid by Sovereign Marine; (ii) valuation and settlement of Scheme Claims under the Scheme much earlier than would be the case in the normal course of run-off; (iii) realization of the value embedded in Sovereign Insurance (UK) Limited and Greyfriars Insurance Company Limited for the benefit of its Scheme Creditors; and (iv) avoidance of the fragmentation of the WFUM Pools and the

associated costs and disruption which would result. Such costs and disruption would affect both the Scheme Companies and Scheme Creditors.

5. The Scheme Administrators have a duty to close the Sovereign Marine estate and distribute its assets to creditors at a time when the ultimate Payment Percentage is expected to be maximized. The most efficient method would be to participate in a unified resolution of the WFUM Pool. There would be many difficulties for policyholders, reinsurers, and all of the Scheme Companies should the WFUM Pools fragment, including the duplication of effort and increased costs to all parties, and the likely reduction in Sovereign Marine's ultimate dividend. If the WFUM Pools remain unified, claims handling and reinsurance collection can remain cohesive and costs can be minimized and shared between the Scheme Companies in the WFUM Pools. For the above reasons, the Amended Scheme and the Scheme of Arrangement for the other WFUM Pools participants provide that the Scheme Creditors of each scheme of arrangement must abide the terms of the other Scheme of Arrangement.

6. The Amended Scheme was overwhelmingly approved by Sovereign Marine's Scheme Creditors on October 27, 2006 (96.46% by value and 95.72% by number voting in favor of the Amended Scheme) and sanctioned by the High Court on September 17, 2007.

7. In order to ensure that the Amended Scheme is given full force and effect in the United States in the same manner as the Original Scheme, the Scheme Administrators seek to have the Permanent Injunction Order modified so that all of its provisions will encompass the changes made by the Amended Scheme. As set forth below, the relief sought by the Scheme Administrators in modifying the Permanent Injunction Order meets the requirements of section 304 of the Bankruptcy Code and is consistent with precedent in this Court in the ancillary proceedings of other insurance companies that operated in the London insurance market. The Scheme Administrators believe that amending the Permanent Injunction Order to support the Amended Scheme will best assure the economical and expeditious administration of Sovereign

Marine's estate, and respectfully request that such relief be granted in aid of the Amended Scheme.

JURISDICTION & VENUE

8. This Court has jurisdiction over this matter 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 matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). Venue is properly located in this District pursuant to 28 U.S.C. § 1410.

BACKGROUND

9. The Court is respectfully referred to the Petition under section 304 of the Bankruptcy Code dated July 11, 1997, a copy of which is annexed hereto as Exhibit D (the "Petition"), for a summary of the history and business of Sovereign Marine. The Board of Directors of Sovereign Marine filed a winding-up petition in the High Court on July 11, 1997. On the same date, the High Court appointed Anthony James McMahon and Philip Wedgwood Wallace to act as the Joint Provisional Liquidators of Sovereign Marine.

The Original Scheme of Arrangement

10. The Original Scheme was sanctioned by the High Court on December 20, 1999. Anthony James McMahon and Philip Wedgwood Wallace were appointed as the Scheme Administrators pursuant to the Original Scheme. John Mitchell Wardrop replaced Philip Wedgwood Wallace as a Scheme Administrator on May 21, 2002. Michael Steven Walker replaced Anthony James McMahon on February 19, 2007.

11. The Original Scheme is what is commonly referred to as a "reserving" or "run-off" scheme of arrangement. In summary, the Original Scheme provides for Scheme

Claims to be processed and established by the Scheme Administrators (the "Established Scheme Liabilities"), as would be the case in a solvent run-off of an insurance company.

12. If a claim is disputed, it could be litigated to establish its value, following notice and the expiration of a stay. The Scheme Administrators have resolved claims against Sovereign Marine so that it has not been necessary to resort to litigation to establish the value of any such claims. As provided in the Original Scheme, Scheme Creditors are only paid a percentage of such Established Scheme Liabilities, which was set initially by the Scheme Administrators and has been increased regularly as the Original Scheme progressed. The current payment percentage is 40%.

13. Certain Scheme Creditors are protected under the Policyholders Protection Act 1975 (the "PPA"), which calls for benefits to be provided through a fund now known as the Financial Services Compensation Scheme ("FSC") (such Scheme Creditors are referred to herein as "Protected Policyholders"). The Original Scheme provided that Protected Policyholders may receive an additional percentage of their claims from the FSCS, according to the statutory level of compensation provided for under the PPA. Such Protected Policyholders would then assign their rights to further payments from Sovereign Marine to the FSCS. The FSCS has agreed to the amendment of the Original Scheme and to be bound by and to continue to participate in the Amended Scheme amended, subject to the approval of Scheme Creditors, so as to take the form of the Amended Scheme. The basis for participation of the FSCS in the Amended Scheme will not differ substantially from its participation in the Original Scheme, as far as the exercise of its compensation functions are concerned and thus there should be not substantive difference in so far as Protected Policyholders should continue to receive the Protected Percentage of their Scheme Claims after they have fallen due for payment in the ordinary course of business. However, Protected Policyholders will no longer receive payments from Sovereign Marine; instead, once a present obligation of Sovereign Marine to pay an ascertained sum of money has

been established in respect of a Protected Scheme Claim and the FSCS has accepted it is eligible for protection, the FSCS will pay the Protected Percentage of the Scheme Claim – being an Agreed Protected Claim – to the Protected Policyholder.

14. Pursuant to the Original Scheme, the Creditors' Committee was formed to represent the interests of all Scheme Creditors. Since the implementation of the Original Scheme, the Creditors' Committee has met regularly to monitor its progress. The Creditors' Committee will continue to represent the interests of Scheme Creditors to monitor the progress of the Amended Scheme.

15. Many Scheme Creditors are located in the United States and Sovereign Marine has reinsurance recoverables due from reinsurers in the United States. Therefore, on behalf of Sovereign Marine and in support of the Original Scheme, the Joint Provisional Liquidators sought and obtained from this Court injunctive relief under section 304 of the Bankruptcy Code in the form of the Permanent Injunction Order. The effect of the Permanent Injunction Order, *inter alia*, was to make the provisions of the Original Scheme enforceable in the United States. The Permanent Injunction Order also provided that all persons were enjoined from taking action against Sovereign Marine or its property except as provided in the Original Scheme.

Progress Made under the Original Scheme

16. Since the Original Scheme became effective, significant progress has been made by the Scheme Administrators in resolving Scheme Claims. In addition, the Scheme Administrators have now collected U.S. \$247 million of Sovereign Marine's assets, which represents over 80% of Sovereign Marine's total realizable assets of U.S. \$306 million. A substantial proportion of Sovereign Marine's remaining realizable assets represent its investments in its subsidiaries, Sovereign Insurance (UK) Limited and Greyfriars Insurance Company Limited. The residual value of these investments will be realized following

implementation of the Amended Scheme. The bulk of the remaining assets are reinsurance claims which the Scheme Administrators will pursue under the Amended Scheme through the application of setoff. Participation in the collective schemes of arrangement for the WFUM Participants will aid the Scheme Administrator's efforts to collect Sovereign Marine's reinsurance receivables.

The Amended Scheme

17. Upon their appointment, the Joint Provisional Liquidators were required to assess whether a scheme of arrangement would be in the best interests of creditors. That was the basis upon which the Original Scheme was proposed, and it is now the basis upon which the Scheme Administrators have proposed the Amended Scheme. This development was considered possible at the time the Original Scheme was proposed and made possible through the inclusion of Section 9.3.4 of the Original Scheme which provides that "[t]he provisions of Special Resolution to commence the procedures for the closure of the Scheme shall take effect forthwith upon its being duly passed in accordance with the provisions of the Scheme." To facilitate this possibility, the Permanent Injunction Order defines the Original Scheme as "including, without limitations, any amendment or modification thereof, any procedures implemented in furtherance of [a resolution to terminate the Original Scheme by estimating outstanding claims] and any further schemes of arrangement implemented in accordance with the terms of the [Original Scheme]." *See Exhibit A at pg. 2.* Notwithstanding the prior enforcement of the Amended Scheme, the Scheme Administrator concluded it would be appropriate to provide further notice. In this regard, the Permanent Injunction Order provides that "this Court shall retain jurisdiction with respect to the enforcement, amendment or modification of this Order, and requests for any additional relief in this or any subsequent section 304 cases related to this case." *See Exhibit A at p. 9.*

18. The Scheme Administrators now believe that the likely costs of collecting Sovereign Marine's remaining assets in the case of continued run-off under the Original Scheme would outweigh the recoveries. The Scheme Administrators, with the support of the Creditors' Committee, now have proposed the Amended Scheme, which is a further scheme of arrangement between Sovereign Marine and its Scheme Creditors under section 425 of the Companies Act. The purpose of the Amended Scheme is to achieve an early closure of Sovereign Marine's run-off by making certain amendments to the Original Scheme. A copy of the Amended Scheme is attached hereto as Exhibit B.

19. The Scheme Administrators are of the view that it is not cost-effective, or in the best interests of creditors, to continue with the Original Scheme in its present form. As discussed above, the Amended Scheme will have the effect of estimating and crystallizing all of Sovereign Marine's contingent and unliquidated liabilities apart from the Protected Scheme Claims of Sovereign Marine's Protected Policyholders. The Scheme Administrators estimate that the Amended scheme will result in a higher ultimate payment percentage for Sovereign Marine's Scheme Creditors than if the Original Scheme were not amended and Sovereign Marine's liabilities are run-off in the normal course. The majority of Sovereign Marine's and its subsidiaries' liabilities (approximately 95%) arise from participation in the WFUM Pools. Sovereign Marine and its subsidiaries account for approximately 50% of the WFUM Pools liabilities. The Scheme Administrators have determined that it would be more costly and difficult to close Sovereign Marine and its subsidiaries without the other Scheme Companies also closing their involvement in the WFUM Pools at the same time. With this in mind, for the last three years, Sovereign Marine and the other Scheme Companies have been working together towards this common objective.

20. The provisions of the Amended Scheme will modify the procedures for resolving disputed Scheme Claims by introducing a valuation process for future and contingent

claims of Scheme Creditors that have not matured into Established Scheme Liabilities as of the effective date of the Amended Scheme. In order for a Scheme Creditor to qualify for payment or set-off of such claims under the Amended Scheme, the Scheme Creditor must notify the Scheme Administrators of those claims prior to a claims bar date (the "Bar Date"). Once notified, the Scheme Manager, on behalf of the Scheme Administrators, and the Scheme Creditor will seek to reach agreement as to the amount of the claim. If an agreement on the claim can not be reached within six months of the Bar Date, the claim will be referred to the Scheme Adjudicator, who is appointed under the Amended Scheme, for determination.

21. In order to facilitate the resolution of disputed claims, the Amended Scheme will implement an estimation methodology of actuarially-based principles and assumptions that will be used in valuing the contingent and future claims of Scheme Creditors. The establishment of Scheme Creditors' claims pursuant to this expedited procedure will enable Sovereign Marine's run-off to be concluded more quickly, and for Scheme Creditors to receive distributions (including any final or "ultimate" distribution) significantly earlier than the projected final payment date under the Original Scheme.

22. Like the Original Scheme, many schemes of arrangement for London market insurers (for example the KWELM Companies, Andrew Weir Insurance Company Limited, Bryanston Insurance Company Limited, Fremont Insurance Company Limited and North Atlantic Insurance Company Limited) either contemplated earlier closure mechanisms that could be proposed by the respective scheme administrators and agreed by the general body of scheme creditors or, in the nature of "cut off" schemes, incorporated closure provisions from the very beginning. Many schemes of arrangement for London Market insurers (for example Anglo American Insurance Company Limited, the KWELM Companies, North Atlantic Insurance Company, Stockholm Re (Bermuda) Ltd., Black Sea and Baltic Insurance Company Limited and Municipal General Insurance Limited) have obtained relief in support of their cut-off or closing

schemes from the United States Bankruptcy Courts under section 304 of the Bankruptcy Code and all of which were subject to schemes of arrangement incorporating the independent adjudicator process.

Steps Taken by the Scheme Administrators to Identify Scheme Creditors & Parties in Interest

23. In preparation for the Original Scheme, the Joint Provisional Liquidators researched Sovereign Marine's records to ascertain the name and address of each of Sovereign Marine's policyholders who had made a claim. Also identified were those parties not named in a policy, but who had submitted claims. Where a policy existed without a policyholder name or address, the relevant broker's contact details were extracted. All such information was compiled into a list (the "Address List") that also contains contact information for agents, brokers and other entities that represented policyholders, as well as reinsurers and brokers involved with insurance and reinsurance business placed with Sovereign Marine. Since its creation, the Scheme Manager has maintained the Address List so that it is the most comprehensive list of known or potential Scheme Creditors. The Address List currently contains approximately 3,200 entries for U.S.-based potentially interested parties.

Notification to the Scheme Creditors of the Amended Scheme

24. The High Court issued an Order, dated June 27, 2006 (the "Meeting Order"), authorizing the Scheme Administrators to conduct the meeting of Scheme Creditors on October 27, 2007 (the "Meeting"). In a letter dated July 31, 2006, the Scheme Administrators notified Scheme Creditors of the High Court's authorization for the Scheme Administrator to convene the Meeting to consider and, if found appropriate, to approve the Amended Scheme (the "Notice Letter"). The Notice Letter stated that information on the Amended Scheme and the Scheme Documents were or would be made available on the WFUM Pool's website at www.wfumpools.com, and also provided additional contact methods to obtain information.

Enclosed with the Notice Letter was a copy of the Scheme Document in electronic form, a paper copy of the Notice covering the meeting, a map stating the meeting location and description of the voting process. The Notice Letter was sent to each of the parties whose names and addresses are recorded on the Address List.

25. In addition, between July 31, 2006 and September 10, 2006, the Scheme Administrators published notice of their intention to convene the meeting to consider the Amended Scheme in *The Financial Times* (London and Global editions), *Insurance Day* (London), *The Wall Street Journal* (New York and European editions), *Business Insurance* and the *London Gazette*. These publication notices provided details on obtaining information on the Amended Scheme, including copies of all relevant documentation, either via Sovereign Marine's website or from the Scheme Administrators.

Notification to Scheme Creditors of Relief Sought from the U.S. Court

26. Pursuant to this Court's September 20, 2007 Order Specifying Form and Manner of Service of Notice (the "Notice Order"), United States Scheme Creditors will be sent a copy of the Notice of the Motion that contains a description of the relief now sought (the "Notice"), which was approved by this Court in the Notice Order. Also pursuant to the Notice Order, the Scheme Administrators will publish a copy of the Notice in *Insurance Day*, *The New York Times* (National Edition), *The Wall Street Journal* (National Edition) and in *Business Insurance* on October 1, 2007.

Timetable for Implementation of the Bar Date

27. The Amended Scheme was sanctioned by the High Court on September 17, 2007, and the Scheme Administrators now seek to modify the Permanent Injunction Order previously entered by this Court.

28. The Scheme Administrators intend to deliver a copy of the High Court's sanctioning order to the Registrar so that the Amended Scheme will become effective shortly

thereafter. The Bar Date will be approximately one hundred and eighty days after the effective date of the Amended Scheme. Therefore, in order for the Scheme Administrators to provide sufficient notice of the Bar Date, including publication in numerous United States and English publications and posting on the WFUM Pools' website, and to allow parties in interest sufficient time to submit information on their claims, it is the Scheme Administrators' desire to finalize all court procedures related to the Amended Scheme as soon as possible.

RELIEF SOUGHT

29. By this Motion, the Scheme Administrators seek the entry of an Order, substantially in the form annexed hereto as Exhibit C, modifying the Permanent Injunction Order to encompass the Amended Scheme, in order to aid in enforcement of the Amended Scheme in the United States. As discussed above, the relief sought by the Scheme Administrators is consistent with the terms of the Permanent Injunction Order, which states that it applies to any amendment or modification of the Original Scheme, including the manner of terminating the Original Scheme that is provided for in the Amended Scheme. *See Exhibit A at p. 2.* In addition, the Permanent Injunction Order also states that "this Court shall retain jurisdiction with respect to the enforcement, amendment or modification of this Order, and requests for any additional relief in this or any subsequent section 304 cases related to this case." *See Exhibit A at p. 9.*

30. As demonstrated in the accompanying Memorandum of Law, the relief sought by the Scheme Administrators is consistent not only with the terms of the Permanent Injunction Order, but also with the factors stated in section 304 of the Bankruptcy Code. The Scheme Administrators submit that amending the Permanent Injunction Order to provide that its provisions cover the Amended Scheme will facilitate the expeditious administration of Sovereign Marine's estate for the ultimate benefit of the Scheme Creditors.

31. As noted previously, many Scheme Creditors are located in the United States and Sovereign Marine continues to have assets located in the United States. Therefore, the Scheme Administrators have been advised, and believe it is both necessary and prudent, to obtain permanent injunctive relief under section 304 of the Bankruptcy Code in support of the Amended Scheme. As with the Permanent Injunction Order, an order in the form requested will protect the property of Sovereign Marine from individual attack from Scheme Creditors, centralize the resolution of claims through the Amended Scheme and facilitate the orderly closure of Sovereign Marine's run-off for the benefit of the general body of Scheme Creditors. Failing the issuance of the requested relief, the Scheme Administrators fear that the remaining assets of Sovereign Marine's estate may be pieced out prematurely to individual creditors and that the orderly determination of claims and the fair distribution of assets will be disturbed. Furthermore, the Scheme Administrators are informed and believe that granting the permanent injunctive relief sought herein, which will enforce the Amended Scheme in the United States will best assure an economical and expeditious administration of Sovereign Marine's estate, consistent with:

- a. just treatment of all holders of claims against or interests in Sovereign Marine;
- b. protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in the foreign proceeding;
- c. prevention of preferential or fraudulent dispositions of Sovereign Marine's property;
- d. distribution of Sovereign Marine's property substantially in accordance with the order prescribed by the Bankruptcy Code; and
- e. comity.

CONCLUSION

Wherefore, the Scheme Administrators respectfully request that this Court enter an Order, substantially in the form annexed hereto as Exhibit C and grant such other relief as is appropriate in the circumstances requested hereon just and proper.

Dated: New York, New York
September 21, 2007

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