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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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**DECLARATION OF DAN YORAM SCHWARZMANN 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**

DAN YORAM SCHWARZMANN, pursuant to 28 U.S.C. § 1746, hereby declares under penalty of perjury as follows:

1. I am Dan Yoram Schwarzmans of the London office of PricewaterhouseCoopers LLP (“PwC”), and together with Mark Charles Batten, also of the London office of PwC, I am authorized by the High Court of Justice of England and Wales (the “English Court”) to act as foreign representative of Highlands Insurance Company (U.K.) Limited (in administration) (“HIC UK” or the “Company”) in connection with the administration of the Company pursuant to the U.K. Insolvency Act 1986 (the “UK Insolvency Act”) and this Chapter 15 case.

2. I submit this declaration 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.

BACKGROUND

The English Proceeding and the Chapter 15 Case

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

4. 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”).¹

5. On October 25, 2007, the directors of the Company filed an application with the English Court requesting the appointment of the Administrators as the joint administrators of the Company.

6. 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 Mr. Batten and me (together, the “Administrators”) as the joint administrators of the Company to manage its affairs, business and property (the “Administration Order”).

7. Pursuant to the Administration Order, the English Court authorized the Administrators to commence this Chapter 15 case.

The Scheme of Arrangement

8. 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.

¹ Upon information and belief, 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 became 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.

9. 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. In the absence of the Scheme of Arrangement, I would not expect the claims against the Company to mature and crystallize for a number of years. As such, I 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.

10. 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 grant 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.

11. 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 to the Motion as Exhibit A.

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

13. On May 1, 2009, Mr. Batten and I 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 to the Motion as Exhibit B.

The Settlement Agreement

14. Upon information and belief, 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. Upon information and belief, 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. Upon information and belief, 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 a quota share reinsurance treaty pursuant to which HIC US reinsured the Company in respect of 100% of the transferred business.

17. Upon information and belief, 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.

22. Following commencement of the trial (the “Texas Litigation”), proceedings were discontinued pending settlement of the dispute between HIC US and the Company.

23. 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.

24. Given the uncertainty surrounding the Texas Litigation and its outcome, the Company ceased paying claims in August 2006.

25. 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.

26. On May 9, 2008, the Special Deputy Receiver, acting on behalf of HIC US, and I, in my capacity as Administrator and on behalf of the Company, 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 to the Motion as Exhibit C.

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

28. The Settlement Amount (as defined in the Motion), 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.

29. A key benefit of the Settlement Agreement is that it provides certainty to the Company, HIC US and Section 51 Direct Policyholders/Claimants² 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.

30. As a result of the Settlement Agreement, creditors holding claims under the Section 51 Policies should now be able to avoid the potential cost and uncertainty of claiming against two estates where the liability of both is in dispute.

31. 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.

32. I 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 Policyholder/Claimants to pursue HIC US should be immaterial.

² 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.

33. In the event that Mr. Batten and I determine that it is not possible to pay all Scheme Creditors in full, an event which I 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.

Approval of the Scheme of Arrangement

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

35. I 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, Mr. Batten and I will promptly cause a notice to be filed with this Court and attach a certified copy of such order thereto.

36. Within 7 days of the Effective Date, Mr. Batten and I 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.

37. 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.

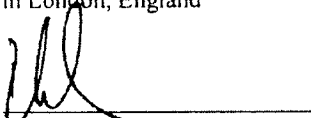
38. Mr. Batten and I will also cause notices of the Effective Date to be placed in *Insurance Day*, in the U.K., *Business Insurance*, in the U.S., *NRC Handelsblad*, in The Netherlands and the international editions of each of the *Financial Times* and the *Wall Street Journal*. Such notices also will be posted on the Company's website at www.ukhighlands.co.uk.

39. The relief sought in the Motion is necessary to effectuate the terms of the Settlement Agreement and thereby obtain for the Company the Settlement Amount, which will make it more likely that it will be possible to pay the claims of all 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, in accordance with the Scheme of Arrangement.

40. If the relief sought in the Motion is not granted in substantially the form set forth in the Proposed Order, attached as Exhibit D to the Motion, the Scheme of Arrangement may not become effective, the Settlement Amount will not be paid and the likelihood of full payment to Scheme Creditors will clearly reduce. Moreover, additional resources of the Company will need to be utilized to reach an alternative resolution of the Texas Litigation and the underlying dispute with respect to the Section 51 Transfers and pursuing an alternative Scheme of Arrangement.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on this 30th day of June, 2009
in London, England



Dan Yoram Schwarzmann