In The Supreme Court of Bermuda

COMMERCIAL COURT

COMPANIES (WINDING-UP)

2011: Nos. 370

IN THE MATTER OF THE COMPANIES ACT 1981

AND IN THE MATTER OF SECTIONS 33 AND 35 OF
THE INSURANCE ACT 1978

AND IN THE MATTER OF THE SOUTH OF ENGLAND PROTECTION AND INDEMNITY ASSOCIATION (BERMUDA) LIMITED

THE BERMUDA MONETARY AUTHORITY

Petitioner

-v-

THE SOUTH OF ENGLAND PROTECTION AND INDEMNITY ASSOCIATION (BERMUDA) LIMITED

Respondent

REASONS FOR WINDING-UP ORDER
(In Court)

Date of Hearing: November 18, 22, 2011
Date of Reasons: November 30, 2011

Mr. John Riihiluoma and Ms. Jennifer Fraser, Appleby, for the Petitioner
Mr. Rod S. Attride-Stirling and Ms. Kehinde George, Attride-Stirling & Woloniecki, for the Company[1].
Mr. Delroy Duncan, Trott & Duncan, for the Joint Provisional Liquidators.
Mr. Kevin Taylor, Marshall Diel & Myers, for Islamic Republic of Iran Shipping Lines, A Supporting Creditor

Introductory

1. In opposing the immediate winding-up order sought by the Petitioner /regulator and recommended by the Joint Provisional Liquidators ("JPLs") in relation to a public interest petition, the Company effectively took on the Herculean task of persuading the Court to second-guess the professional judgment of both the Bermuda Monetary Authority ("BMA") and the JPLs as to how the public interest would best be served.

2. Having been satisfied that the facts and matters upon which the Petition was based warranted the JPLs' appointment on October 12, 2011, the Court had accordingly already made an interlocutory finding that there was a *prima facie* case for winding-up. And since the Petition was presented by the BMA, the Petition could not be attacked on *locus* grounds, as in the case of a creditor's or contributory's petition. While most objective and informed observers would have rightly expected a winding-up order to have been made on November 18, 2011, Mr. Attride-Stirling's forceful and persuasive submissions caused me to pursue a fuller enquiry than initially appeared justified.

3. The Petitioner's case was simple: the Company was an insurer operating a P & I Club on a mutual basis, was hopelessly insolvent (in Insurance Act 1978 and Companies Act 1981 terms), had a history of regulatory delinquency and should be wound-up on public interest grounds. The Company's case sought to suggest that the true picture was more complicated. The Company's management had relevant business expertise, and had admittedly failed to focus adequately on the administrative dimensions of its operations. Appreciating the seriousness of its current regulatory position, it had reassessed its financial position and could, if allowed the chance to audit its latest accounts, establish its

[1] Attride-Stirling & Woloniecki were not the Company's corporate attorneys at any time material to the present Judgment.

current solvency. It was implied that neither the BMA nor the JPLs had adequately grasped the commercial realities of the P& I Club environment, and that, in particular, the power under the Company's Rules to cancel insurance liabilities owed to members who did not respond to supplementary calls had not been taken into account.

4. More broadly, Mr. Attride-Stirling articulated his clients' concerns that they could not understand why there was such unseemly haste to liquidate an insurer in a major insurance domicile in circumstances where: (a) the JPLs in his clients' view had a conflict; (b) a person formerly seconded by KPMG to the BMA was the key BMA officer behind the liquidation recommendation, and (c) there were credible grounds for believing the Company could be saved. While the conflict complaints were not in any way substantiated, it seemed important to avoid an appearance of injustice by rejecting the opposition to the Petition out of hand.

5. I accordingly adjourned at the end of a full day's hearing on November 18, 2011 and granted leave to the Company to adduce further evidence in support of its somewhat implausible, but potentially significant submission that, in part because of the Rules, the Company's true financial position was not as hopeless as the current statutory financial statements revealed. The Company duly filed evidence exhibiting draft financial statements according to which it was demonstrably solvent, on Tuesday November 22, 2011, when the hearing resumed. However the BMA's counsel also put further material before the Court which arguably demonstrated that, in addition to insurance solvency and accounting concerns, the Company's entire corporate administration from inception had been conducted in a manner which was inconsistent with the letter and/or the spirit of the Bye-Laws and/or the Companies Act 1981.

6. Although Mr. Attride-Stirling was unable to fully respond to this new frontier of regulatory attack and the Court could not fairly make any conclusive findings on the validity of the new complaints, I took the view that the cumulative weight of the regulatory concerns had passed a tipping point and that a winding-up order had to be made.

7. I now give short reasons for that decision.

Key allegations in Petition

8. It was not or could not be disputed that:

    (a) the Company was licensed as a Class 2 Mutual Insurer as of February 19, 2004 and that each member's liability was limited according its Memorandum of

Association to the amount of any premiums owed by such member to the Company at the commencement of the winding-up (paragraphs 3 and 7(ii));

(b) the Company had failed to meet statutory solvency margins and liquidity ratios and has failed to comply with Conditions imposed by the BMA;

(c) the Company had failed to meet statutory filing deadlines for 2009 and 2010;

(d) the Company was insolvent under the Insurance Act and the Companies Act 1981 according to its last statutory financial statements.

9. The crucial grounds of the Petition were set out in the concluding paragraphs as follows:

"*9. In these circumstances the Company is unable to pay its debts, as that expression is used in sections 33 and 35 of the Act and in section 162 of the Companies Act 1981; and*

10. It is in the public interest and just and equitable that the Company should be wound-up." [emphasis added]

The Court's statutory jurisdiction

10. Section 35 of the Insurance Act 1978 provides as follows:

"***Winding up on petition of Authority***

35. (1) The Authority may present a petition for the winding up, in accordance with the Companies Act 1981, of an insurer, being a company which may be wound up under that Act, on the ground—

(a) that the insurer is unable to pay its debts within the meaning of sections 161 and 162 of the Companies Act 1981; or

(b) that the insurer has failed to satisfy an obligation to which it is or was subject by virtue of this Act; or

(c) that the insurer has failed to satisfy the obligation imposed upon it by section 15 as to the preparation of accounts or to produce or file statutory financial statements in accordance with section 17, and that the Authority is unable to ascertain its financial position.

(2)In any proceedings on a petition to wind up an insurer presented by the Authority under subsection (1), evidence that the insurer was insolvent—

(a) at the close of the period to which the statutory financial statements last prepared under section 15 relate; or

(b) at any date specified in a direction under section 27(2),
shall be evidence that the insurer continues to be unable to pay its debts, unless the contrary is proved.

(3)If, in the case of an insurer, being a company which may be wound up under the Companies Act 1981, it appears to the Authority that it is expedient in the public interest that the insurer should be wound up, it may, unless the insurer is already being wound up by the Court, present a petition for it to be so wound up if the Court thinks it just and equitable for it to be so wound up.

(4)Where a petition for the winding up of an insurer is presented by a person other than the Authority, a copy of the petition shall be served on the Authority, and it shall be entitled to be heard on the petition."

11. The relevant provisions of sections 161 and 162 of the Companies Act read as follows:

"***Circumstances in which company may be wound up by the Court***
161 In addition to any other provision in this or any other Act prescribing for the winding up of a company a company may be wound up by the Court if —...

(e) the company is unable to pay its debts…

Definition of inability to pay debts
162 A company shall be deemed to be unable to pay its debts —

...

(c) if it is proved to the satisfaction of the Court that the company is unable to pay its debts; in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company."

12. Accordingly, Petition alleged the following legally discrete grounds for winding up under the Insurance Act:

(a) failure to comply with an obligation to which the Company was subject (section 35(1)(b));

(b) financial statement filing defaults (section 35(1)(c));

(c) insolvency;

(d) public interest.

13. In substance a winding-up order was sought in the public interest based primarily on insolvency, but taking into account the other free-standing bases for winding-up as well. The Court's jurisdiction under section 35 did not crucially depend on proof of insolvency; it was sufficient for the BMA to demonstrate that one or more of other winding-up grounds were made out. The Company had no basis for challenging the existence of grounds for winding-up the Company under section 35(1) (b) and/ or (c).

Findings: insolvency

14. As at the date of the hearing of the Petition, I had little difficulty in finding that the Company was insolvent in statutory terms, having regard to the admitted insolvency of the Company according to last statutory financial statements filed and the presumption that they reflect the continuing position: Insurance Act 1978, section 35(2).

15. Although there was evidence in the form of management accounts suggesting that the current position was that the Company was clearly solvent, I was unable to attach much weight to this evidence (a) in the face of the BMA's insistence that the Company ought to be wound-up immediately; and (b) in light of the Company's admittedly poor history of financial administration. The evidence showed that the Company commenced operations in or about 2004 but that it did not and was unable to file audited returns for 2006, 2007 and 2008 (and eventually obtained an exemption from filing these statements).

16. Its 2009, Ernst and Young audited, financial statements completed in 2011 contained a going concern qualification; the June 8, 2011 Aon actuarial report for year end 2009 did not anticipate major revisions to reserves. The JPLs expressed doubts about the methodology being used by the Company to dramatically reduce its reserves and return the Company to solvency. The Company countered that if reserves were properly updated and audited and the powers to make calls on members and to cancel policies of defaulting members were allowed to run their course, this would effectively resolve all solvency concerns.

17. The implication that the BMA, the JPLs, Aon and Ernst & Young had all failed to accurately assess the true financial position, which explicitly or implicitly underpinned

the application to adjourn the Petition, was simply not credible. The weight to be attached to the Company's assessment of its own position was only undermined by the apparently desultory state of its corporate administration record.

Findings: public interest

18. Insurance and reinsurance form the centre-piece of Bermuda's offshore industry which generates over 80% of the country's foreign exchange earnings. The integrity of Bermuda's insurance regulatory system is as important to Bermuda's national interest as are dykes to coastal areas of the Netherlands. It is a notorious fact that the Bermuda regulatory model is more collaborative than adversarial and that the BMA is quicker to resort to the velvet glove rather than a mailed fist in responding to regulatory challenges. The history of the Company's dealings with the manifestly patient BMA makes good this point.

19. When the BMA exceptionally invites the Court to immediately wind up a trading company in the public interest, the Court must have compelling reasons to reject that natural inference that such application is made (a) in good faith, and (b) based on sound objective regulatory grounds. On the other hand, the Court must be careful to ensure that the legitimate expectations of persons who establish entities in Bermuda are not ignored. The reasons advanced by the JPLs for ending the uncertainty about the Company's status which I found to be dispositive were:

    (a) the Company's inability to fund reinsurance;

    (b) the concerns expressed by members of the Club about the status of their insurance cover, and the risk that significant losses may occur which the Company cannot pay in circumstances where members believe they have effective cover;

    (c) the absence of reliable information about the Company's current financial position (and the resultant improbability of any expeditious return to a viable position).

20. The BMA quite understandably adopted these concerns and added more of their own. Over the course of the adjournment, the corporate books and records of the Company were examined. These revealed that Limestone Nominees Ltd. was the sole shareholder of the Company from inception and had duly at the Statutory Meeting on February 19, 2004 adopted the Bye-Laws and appointed various directors. Thereafter, however, the

general meetings of the Company were only ever attended by directors, the majority of whom (at least) were employed by the Managers. Although the Bye-Laws unarguably contemplated that directors would automatically become members, it was far from clear that the scheme of the Company's constitution contemplated that the Managers would (through their employees acting as directors of the Company) control the Company at both director and member level with no formal involvement on the part of ship owner insureds. The mutual insurance structure is clearly a distinctive one in company law and corporate governance terms; it was suggested in the course of argument that only around 20 such entities exist in Bermuda. *Prima facie*, however, the legal structure in this case appears to have envisaged that insured members would be registered members who would control the Company at member level.

21. The Memorandum of Association pleaded in paragraph 7 of the Petition clearly signified that the members were contemplated as being the ship owner insureds:

> "*…The liability of every member of the Company to contribute to the assets of the Company, in the event of it being wound-up shall be limited to the premiums or any unpaid premiums or undischarged portion thereof due to the Company on the date of the commencement of the winding-up from such member.*"

22. Moreover, the Memorandum's above-cited provisions merely reflects what appears to be a mandatory statutory requirement:

> "***Liability of members on a winding up***
> *154 (1) Section 7(3) shall not apply to mutual companies and the liability of a member of such a company in the event of it being wound up shall be limited to the premiums or any unpaid premiums or undischarged portion thereof due to the company on the date of the commencement of the winding up from such member.*
>
> *(2) For the purposes of this section "premiums" means the premiums, including retrospective premium adjustments or calls payable for insurance issued or effected by a mutual company to, for or on behalf of each member of the company and any capital contribution or other such assessment that is due under the bye-laws or any other contractual obligation with a member of the company.*"

23. Consistently with the quoted provisions, a sample certificate of insurance placed before the Court by the BMA's counsel stated as follows:

"*This is to certify that the ship(s) named herein is/are entered into the South of England Protection and Indemnity Association (Bermuda) Limited on the terms and conditions contained herein and in accordance with the Memorandum and Bye-Laws and Rules from time to time in force and any special terms specified herein.*"

24. Without deciding whether Mr. Riihiluoma was right in colourfully characterising the governing principles of the Bye-Laws as "*of the members, by the members and for the members*", the unique internal management processes apparently employed by the Company did nothing to diminish the primary insurance regulatory concerns. On the contrary it fortified the sense that, no matter how commercially inspired the Company's management might be, the BMA had fairly formed the judgment that the cumulative effects of years of administrative neglect made a winding-up order necessary in the public interest.

Conclusion

25. For the above reasons, I ordered on November 22, 2011 that the Company should be wound-up and confirmed the appointment of Michael Morrison and Charles Thresh of KPMG Bermuda as Joint Provisional Liquidators.

Dated this 30th day of November, 2011_____
KAWALEY J