Cayman Court exercises its just and equitable jurisdiction to wind up a captive insurance company

In a recent judgment in the matter of Virginia Solution SPC Ltd, the Grand Court of the Cayman Islands ordered that a captive insurance company of two substantial Virginia based not-for-profit health care systems be wound up on the just and equitable ground on the basis that (i) the Company was a corporate quasi-partnership and (ii) the relationship of mutual trust and confidence between the two members had irretrievably broken down.

Where a company is a "quasi-partnership" it is just and equitable to take into consideration the legitimate expectations of members about how the company will be run, even though those expectations are not expressed in the company's constitution or the Companies Act. The Court's power to grant equitable relief is therefore enhanced where it is satisfied that the subject company is a quasi-partnership, as recently confirmed by the Privy Council in *Chu (Respondent) v Lau (Appellant)* [2020] UKPC 24, a decision handed down in October 2020 on appeal from the BVI.

Following a two-week trial, including six full days of cross-examination, the Court found that the breakdown in the relationship was entirely due to the stance taken by the Respondent, Augusta Health Care Inc., which the Court found had acted in bad faith in refusing to follow the Actuary's advice with respect to the amount of dividends to be declared as part of a documented plan devised in 2017 to drive Valley Health System, the member with a 69{92e447aa5ae4509d19f58c4a2ed7ec0dbb286610ae15b33d823e9409689b2d4a} economic interest in the Company, out of the captive in order to remain as the "last man standing" and receive a financial windfall.

The plan was reduced to writing in a six-page internal document prepared by Augusta's CEO, who was one of two directors on the Company's Board, in October 2017 and produced on discovery titled the "Confidential Debrief" which the Court found "*laid bare the insincerity of Ms Mannix's evidence-in-chief that Augusta "was not guided by greed" but was acting consistently with the Company's conservative principles when deciding to approve dividends*". Contrary to the position which three of Augusta senior executives had advanced in evidence under oath, the Court found that all of Augusta's decisions with respect to dividends after March 2017 were driven by Augusta's decision not to deal with a US$6 million portion of the Company's retained earnings in accordance with the contractual Dividend Policy, which the members had affirmed as recently as February 2017. Augusta did so in order to leverage Valley Health into receiving a greater share of those retained earnings than Augusta was otherwise entitled to receive under the Dividend Policy. The Court found that Augusta did so in bad faith and in doing so impeded Valley Health's legitimate expectation that dividends would be declared in good faith having regard to the advice of the Actuary and in accordance with the long standing Dividend Policy.

The decision is understood to be the first occasion on which the Cayman court has exercised its just and equitable jurisdiction to wind up a captive insurance company thereby confirming the well-established principle that the Court's just and equitable jurisdiction is wide and untrammelled and that the Court will intervene where it is equitable to do so.

Liam Faulkner of Campbells acted for the successful Petitioner, Valley Health System, instructing Robert Levy QC of XXIV Old Buildings to appear at trial.

Background

The Company was established in 2004 as a segregated portfolio company in the Cayman Islands by a select group of five Virginia based not-for-profit healthcare systems, including Valley Health and Augusta, to operate as a group captive insurance company. At all times the Company had only one segregated portfolio, namely Segregated Portfolio A, through which the Company conducted its insurance business which was confined to issuing certain indemnity policies of insurance to its members.

Prior to establishing the Company, the founding members agreed certain founding principles including (i) that each member would be able to nominate one director to the Company's Board and that it would be "one member, one vote" at both Board and Shareholder level regardless of the amount of capital contributed by each member to the Company and (ii) that dividends would be declared by the Board out of the assets of Segregated Portfolio A based on the capital needs and profitability of the Portfolio with any dividends to be allocated between members in accordance with an agreed dividend formula which was 50{92e447aa5ae4509d19f58c4a2ed7ec0dbb286610ae15b33d823e9409689b2d4a} capital weighted and 50{92e447aa5ae4509d19f58c4a2ed7ec0dbb286610ae15b33d823e9409689b2d4a} loss weighted, which was subsequently documented as a Dividend Policy annexed to a Participation Agreement from 2009 onwards.

By 2016 three of the founding five members had departed the Company due to the changing landscape of the US healthcare sector. It was common ground that the Company had operated without conflict until around March 2017 when Augusta asserted that approximately US$6.3m of the Company's retained earnings should be distributed in a manner other than in accordance with the Company's Dividend Policy because, Augusta asserted, that portion of retained earnings notionally derived from investment income of loss reserves applied by the Company against certain claims of the three departed members who were no longer entitled to share in any dividend declared. However, one of the issues with Augusta's proposed approach was that the members had agreed that any dividend of retained earnings must be declared in accordance with the Dividend Policy, which did not identify retained earnings by source. The Dividend Policy could only be varied by the unanimous agreement of all members, and Valley Health did not consider Augusta's proposal to be reasonable or appropriate.

In response to Valley Health declining Augusta's demands, Augusta and its nominee director to the Company's Board, its CEO Ms Mannix, refused to approve dividends in the amount recommended by the Actuary and instead implemented a documented plan to wear down Valley Health in order to force it to either accede to Augusta's demands (which had no contractual foundation) or withdraw from the Company. Following three years of dispute and impasse on dividends, Valley Health presented a winding up petition on 15 January 2020 seeking an order that the Company be wound up on just and equitable grounds on the basis that the Company was a corporate quasi-partnership and that the relationship of mutual trust and confidence between the two members had irretrievably broken down.

The crux of Augusta's Defence was that:

- The Company was not a quasi-partnership;
- The relationship of trust and confidence between the members had not irretrievably broken down, that the impasse which had existed since March 2017 (i.e. a period of some three years) was not an impasse but instead constituted "*intermittent disagreements*" between the two members which were capable of resolution (presumably if, and only if, Valley Health capitulated to Augusta's demands);
- If the Court found that the Company was a quasi-partnership and that there was an irretrievable breakdown in mutual trust and confidence (which it did) then Augusta alleged that Valley Health did not have "clean hands"; and lastly
- Valley Health had an alternative remedy in that it could simply voluntarily withdraw from the Company. No attempt was made to explain why that was said to be a more attractive remedy for Valley Health than a winding up order such that Valley Health was acting unreasonably in failing to pursue it.

The Court's findings

In a detailed and well-reasoned Judgment, Ramsay-Hale J found against Augusta on each of the above issues. In particular Ramsay-Hale J held that:

- There had been an irretrievable breakdown in the relationship between Valley Health and Augusta: *185 of the Judgment*;
- There was no question that Augusta's stance on the question of the so called "departed member retained earnings" (a concept which simply did not exist in the Company's constitutional documents) caused Valley Health to lose all confidence that Augusta was willing to comply with the spirit and intent of the Dividend Policy as the means of taking the retained earnings out of the Portfolio: *185 of the Judgment*;
- Augusta's opposition to the payment of dividends in accordance with the Actuary's recommendation went beyond an "*intermittent disagreement*". It was the playing out of a policy adopted by Ms Mannix/Augusta to drive Valley Health out of the Company and remain "the last man standing": *187 of the Judgment*;
- Valley Health was correct to apprehend that their "partner" (as Valley Health and Augusta each referred to each other as) was not acting in good faith and was instead seeking to use its veto power to force Valley Health into capitulating on the matter of the so called departed member retained earnings if Valley Health wished to have dividends declared in accordance with the Actuary's recommendation: *188 of the Judgment*;
- The document entitled "Confidential Debrief", which was written by Ms Mannix in October 2017, made it quite clear that the posture adopted by Augusta was intended to exert what Ms Mannix herself described as "leverage": *189 of the Judgment*;
- What Augusta proposed – a 50:50 split based on shareholding in the Company – was unprincipled and proposed simply because Augusta did not think it was fair for Valley Health to get the larger share of what might be the earnings of capital left behind by departed members. Augusta's later attempt to force agreement on a split according to each Member's equity in the Portfolio on the basis of precedent, by holding the $6 million hostage, was also unprincipled: *190 of the Judgment*;
- It was not possible for Augusta to argue, as it sought to do, that it was unaware when it affirmed the Dividend Policy in the Fourth Participation Agreement in February 2017 that the departed members had left capital behind. Augusta was well aware of the fact: *190 of the Judgment*;

- Ms Mannix must be taken to have understood that whatever profits there were in the Portfolio, however derived, represented Retained Earnings which had to be declared and allocated according to the Dividend Policy per the contractual arrangement with Valley Health. The evidence admitted no other conclusion: *194 of the Judgment*;
- Whilst it had been framed by Augusta as an issue for the Court to decide, the Confidential Debrief demonstrated that Augusta, like Valley Health, considered there to be an irrecoverable loss of trust and confidence between the Members: *197 of the Judgment*;
- It was plain on the evidence that Augusta decided to stand still, develop its Plan B and wait for Valley Health to withdraw: *201 of the Judgment*;
- Given Augusta's conduct and the contents of Ms Mannix's Confidential Debrief, it was difficult really to see what there was between the parties on the Petition as they were in "violent agreement" that they do not get on and do not trust each other to manage the affairs of the Company: *202 of the Judgment*;
- It was plain from the evidence that the question of whether there had been a breakdown in the relationship of trust and confidence between the Members, though denied by Augusta in its Defence, was never seriously in issue: *206 of the Judgment*;
- It was plain that Augusta considered that it and Valley Health were partners in a Company which had been built on a relationship of mutual trust: *206 of the Judgment*;
- The evidence that the Company was established as a quasi-partnership by its founding members, of whom Valley Health and Augusta are the last two to remain, was overwhelming: *213 of the Judgment*;
- It was a paradigm case of quasi-partnership: *215 of the Judgment*;
- The evidence clearly demonstrated that Augusta was acting in bad faith in refusing to follow the Actuary's advice with respect to the amount to be declared and Augusta had decided to "stand still" and approve dividends at the historic level in the hope that Valley Health would capitulate to its demands, contrary to the Dividend Policy, or withdraw: *216 of the Judgment*;
- Valley Health had a reasonable expectation that Augusta would approve the dividends as recommended by the Actuary. The practice of declaring dividends when and in the sum advised by the Actuary was well-established: *219 of the Judgment*;
- The $6 million was not being retained in the Company by Augusta to hedge against risk; it was being held until Valley Health agreed to the allocation proposed by Augusta or walked away: *221 of the Judgment*;
- It would be inequitable to allow Augusta to rely on strict contractual rights in order to deprive Valley Health of its proper share of the Retained Earnings because Augusta did not think it was fair that Valley Health should get the lion's share, which is all it amounted to: *221 of the Judgment*;
- The Judge was simply at a loss to understand Augusta's position that it was not fair that Valley Health should be rewarded for its huge investment in the Company and for remaining in the Company for the long-term: *223 of the Judgment*;
- The loss of confidence was clearly not attributable to Valley Health's conduct: *228 of the Judgment*;
- The suggestion of partisanship or mala fides on the part of the Actuary was not borne out by the evidence; the Actuary was, as Ms Mannix described him, "Switzerland", meaning he was neutral: *233-234 of the Judgment*;
- The Confidential Debrief laid bare the "*insincerity*" of Ms Mannix's evidence-in-chief that Augusta "*was not guided by greed*" but was acting consistently with the Company's conservative principles when deciding to approve dividends at the historical level and consistently with the Dividend Policy: *234 of the Judgment*;
- All of Augusta' decisions with respect to dividends after March 2017 were driven by Augusta's decision that it

would not deal with the $6 million in so called departed member retained earnings under the Dividend Policy: *234 of the Judgment*;

- Ms Mannix had not ring-fenced the $6 million because she was, as she stated in her affidavit, making decisions which took "*into account projected future activities, changes in membership and confidence level*": *235 of the Judgment*;
- Augusta made many other allegations against Valley Health which were intended to show that Valley Health did not file the Petition with clean hands. The Judge did not consider those allegations to be relevant or arguable: *238 of the Judgment*;
- The breakdown in trust and confidence was entirely due to the stance taken by Augusta: *239 of the Judgment*;
- In circumstances where the Judge had found that there was an irretrievable breakdown in mutual trust and confidence, it was not necessary to embark upon any inquiry as to whether at the time of trial there existed a functional deadlock at the Board and shareholder level given the observations of Lord Briggs in *Chu v Lau* at paras 15-17: *244 of the Judgment*;
- The breakdown in the relationship between Valley Health and Augusta was demonstrably irretrievable: *246 of the Judgment*; and
- The fact that there is an alternative remedy does not preclude the making of a winding up order unless the petitioner is acting unreasonably in not pursuing that remedy. A voluntary withdrawal as an alternative remedy would be massively to Valley Health's detriment whilst being of massive benefit to Augusta. Ordering Valley Health to withdraw would be to permit Augusta to profit from its own misconduct and would be an inequitable outcome for Valley Health: *254 of the Judgment*.

Alex Lawson and Chris Kennedy of Alvarez & Marsal were appointed by the Court as joint official liquidators of the Company by order dated 11 February 2022.

A copy of the Court's judgment can be accessed here: Virginia Solution SPC Ltd.

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