IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

FSD NO: 5 of 2020 (MRHJ)

IN THE MATTER OF THE COMPANIES ACT (2021 Revision)

AND IN THE MATTER OF VIRGINIA SOLUTION SPC LTD

BETWEEN:

VALLEY HEALTH SYSTEM

Petitioner

-and-

AUGUSTA HEALTHCARE, INC.

Respondent

OPEN COURT

Before:	**The Hon. Justice Margaret Ramsay-Hale**
Appearances:	**Mr. Robert Levy QC, instructed by Mr. Liam Faulkner and Ms. Demi McLean of Campbells LLP on behalf of the Petitioner** **Mr. Alex Potts QC, Mr. Jonathon Milne and Mr. Spencer Vickers of Conyers Dill & Pearman LLP on behalf of the Respondent**
Heard:	**9 - 19 March 2021**
Draft Judgment Circulated:	**26 January 2022**
Judgment Delivered:	**10 February 2022**

HEADNOTE

Companies - Winding Up - Just and equitable ground - Two Member Captive Insurance Company - Whether Company a corporate quasi-partnership - Whether legitimate expectation that dividends will be paid according to Participation Agreement - Whether irretrievable breakdown of trust and confidence between Members - Clean Hands - Whether functional deadlock of Company - s 92(e) Companies Act (2021 Revision) - Chu v Lau (JCPC)

JUDGMENT

Introduction

1. Following the 2003 collapse and bankruptcy of Reciprocal of America, a Virginia based professional liability insurer, five Virginia based not-for-profit healthcare systems, including Valley Health System ("Valley Health") and Augusta Healthcare Inc ("Augusta") (together, the "Members"), established Virginia Solution SPC Ltd. (the "Company") in the Cayman Islands to operate as a group captive insurance company to meet their insurance needs.

2. The Company was established in 2004 as an exempted segregated portfolio company with six segregated portfolios. Only one, Segregated Portfolio A (the "Portfolio"), was activated at the time the Company was founded and it is the Portfolio through which the Company conducts its insurance business, which is confined to issuing divers indemnity policies of insurance to its Members only.

3. The Company became a two member captive in 2014, with Valley Health and Augusta being the two remaining Members. The Company operated without conflict until 2017 when the previously constructive relationship between Valley Health and Augusta broke down over the payment of retained earnings out of the assets of the Portfolio.

4. As part of the Participation Agreement made with Company, the Members agreed that the undistributed profits in the Portfolio would be taken out of the Company by way of dividends which would be declared and allocated in accordance with a Dividend Policy which was adopted by the founding Members in 2004 and formally approved by the Board in 2009. The Dividend Policy requires the Board to declare dividends with the advice of the Company's Actuary, who is responsible for determining the excess funding in the Portfolio which is available for distribution to members, and to allocate the dividends according to a blended equity and claims experience formula. This formula was unanimously approved by the Members in 2009 and again in 2017 by Valley Health and Augusta, in a restated and amended Participation Agreement.

5. The Company proved to be very profitable, and by the end of 2016, the retained earnings in the Portfolio - that is to say, profits not returned to the Members by way of dividends which had been invested - had reached circa $24 million. In 2016, Valley Health and Augusta both accepted the advice of the Actuary that, for commercial reasons, no dividends be declared but they asked that a dividend distribution plan be developed for 2017 in order to get the retained earnings out of the Company.

6. A plan was developed, but Augusta refused to approve the dividend recommended by the Actuary, having formed the view that some $6.3 million of the retained earnings should not be allocated according to the dividend formula, but shared equally between Valley Health and

Augusta. In the ensuing years, Augusta and its appointee to the Company's Board, refused to agree to a distribution of retained earnings in the amount recommended by the Company's Actuary, unless Valley Health agreed to allocate that $6.3 million as Augusta proposed.

7. The on-going failure to reach a resolution on this issue prompted Valley Health to present this Petition on 15 January 2020 for the dissolution of the Company on the basis that it is just and equitable to do so, as there has been an irretrievable breakdown in trust and confidence between Valley Health and Augusta.

8. Valley Health's position is, in summary, that the Company was established and continues to operate as a corporate quasi-partnership and that it has a legitimate expectation that the Company's affairs will be conducted in a way that maintains mutual trust and confidence as in a partnership firm. In particular, Valley Health asserts that is has a legitimate expectation that dividends will be declared and paid in accordance with the Dividend Policy of the Company and that legitimate expectation has been impeded by Augusta.

9. Valley Health says further that it is unjust and inequitable for Augusta to exercise its right not to approve dividends, or to otherwise impede the Board of Directors from approving dividends recommended by the Actuary, in order to obtain a greater share of the retained earnings than it is entitled to receive under the Company's Dividend Policy. It asserts that Augusta's exercise of its veto right for such a collateral purpose is outside of what was reasonably contemplated by Valley Health when it became a member of the Company, which has caused an irretrievable breakdown in mutual trust and confidence.

10. Valley Health also contends that the Company is functionally deadlocked at both Board and shareholder level.

11. Augusta defends the Petition primarily on the ground that the Company is not a quasi-partnership for the reasons, *inter alia,* that the Company's corporate shareholders are large community healthcare systems which are impersonal and to which the personal qualities of trust and confidence cannot be ascribed and that it would be inconsistent with the parties' and the Company's express contractual arrangements, as well as the Company's regulatory status as a licensed insurer, for the Court to super-impose equitable considerations on their legal rights by reference to the concept of a 'quasi-partnership.'

12. Augusta says further that the disagreements between the two members are intermittent and capable of resolution through the divers contractual mechanisms in the Company's governing documents.

13. If the Court finds that the Company was a quasi-partnership and that there was an irretrievable breakdown in mutual trust and confidence, then Augusta contends that Valley Health does not have clean hands.

14. Finally, Augusta asserts that there is no functional deadlock as the Company continues to perform its primary business of insuring its members.

The Law

15. The jurisdiction to wind up a Cayman Islands company on the just and equitable ground is entirely statutory and arises by virtue of section 92(e) of the Companies Act which provides that a company may be wound up by the Court if "*the Court is of the opinion that it is just and equitable that the company should be wound up*".

16. In *ABC Company (SPC) v J & Company Limited* [2012 (1) CILR 300], the Court of Appeal held that it is not possible to wind up an individual portfolio of a segregated portfolio company; the remedy available to the member is to wind up the company "*as a whole*" on the just and equitable ground.

17. Section 223 of the Companies Act applies in the context of a winding up of a segregated portfolio company. Notwithstanding any statutory provision or rule of law to the contrary, in the winding-up of a segregated portfolio company the liquidator shall deal with the company's assets only in accordance with the procedures set out in section 219(6) of the Companies Act.

18. Pursuant to section 95(1) of the **Companies Act** upon hearing the winding up petition the Court may -

(a) dismiss the petition;
(b) adjourn the hearing conditionally or unconditionally;
(c) make a provisional order; or
(d) make any other order that it thinks fit.

19. In the case of a contributory's petition on the ground that it is just and equitable that the company should be wound up, the Court has jurisdiction under section 95(3) of the Companies Act to make the following orders, as an alternative to a winding-up order, namely –

(a) an order regulating the conduct of the company's affairs in the future;
(b) an order requiring the company to refrain from doing or continuing an act complained of by the petitioner or to do an act which the petitioner has complained it has omitted to do;
(c) an order authorizing civil proceedings to be brought in the name and on behalf of the company by the petitioner on such terms as the Court may direct; or
(d) an order providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a reduction of the company's capital accordingly.

20. The statutory formula which provides that the Company "*may be wound up if the Court is of the opinion...'* indicates that the power is discretionary. The authorities establish that the discretion must be exercised judicially, having regard to all the circumstances of the case in light of the established principles by which the discretion is generally to be exercised.

Quasi-Partnership

21. I adopt submissions on the law relating to quasi-partnership made by Mr. Levy QC on behalf of the Petitioner. The first is that if a company is a corporate quasi-partnership, it is appropriate to apply the partnership analogy to that company on the basis that *"in substance it is a partnership in the form or guise of a private company"* per Lord Cozens-Hardy M.R. in *Re Yenidje Tobacco Co Ltd*. [1916] 2 Ch 426.

22. It is not necessary that a company should have been a quasi-partnership company from its formation. It is sufficient if it has become one by the time that events occurred which are claimed to be wrongful.

23. 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.**

24. In the leading case of *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, Lord Wilberforce said at pp.379-380:

> "*The foundation of it all lies in the words 'just and equitable' and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force.*
>
> *The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.*
>
> *That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising*

between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence—this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company- so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves. To refer, as so many of the cases do, to 'quasi partnerships' or 'in substance partnerships' may be convenient but may also be confusing. It may be convenient because it is the law of partnership which has developed the conceptions of probity, good faith and mutual confidence, and the remedies where these are absent, which become relevant once such factors as I have mentioned are found to exist: the words 'just and equitable' sum these up in the law of partnership itself. And in many, but not necessarily all, cases there has been a pre-existing partnership the obligations of which it is reasonable to suppose continue to underlie the new company structure. But the expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations.

A company, however small, however domestic, is a company not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in."

25. In *Chu v Lau* [2020] UKPC 24, the Privy Council confirmed that none of the three indicia of quasi-partnership identified by Lord Wilberforce represent necessary elements of a quasi-partnership, in the sense that the absence of one or more of them is fatal to such a finding. In that case, the trial judge held that it was sufficient that there was a relationship of mutual confidence between the members and an understanding that both members would be involved in the management of the company. The Privy Council's view was that this constituted *"ample evidence"* to support the conclusion that the superimposition of equitable considerations was fully justified.

26. In French on **Applications to Wind Up Companies**, the learned author makes the point that the term is, per Sales J (as he then was)in *Fisher v Cadman* [2005] EWHC 377 (Ch) at para 84, only a *'useful shorthand label'* and that the real question is:

> *"…whether the circumstances surrounding the conduct of the affairs of a particular company are such as to give rise to equitable constraints upon the behaviour of other members going beyond the strict rights and obligations set out in the Companies Act and the articles of association."*

27. Mr. Potts QC submits on behalf of the Respondent that the status of Valley Health and Augusta as large 'not-for-profit' community health systems, with no beneficial owners or shareholders, which employ teams of executive officers and management and have thousands of employees, volunteers, and other consultants or contractors and participate in the affairs of the Company as both (a) shareholders and (b) policyholders for the benefit of numerous affiliated insureds, means their association is very far removed from '*a personal relationship*' between a small number of individuals that would give rise to a relationship of mutual trust and confidence.

28. He submits that it is legally impossible for these large community health care systems to have personal relationships *inter se*. He seeks to draw support for that submission from the decision of the Hong Kong Court of Appeal in *Ng Yat Chi v. Max Share Ltd & Strong Progress* [2001] HKLRD 561 which rejected the notion that a quasi-partnership could exist between a government-owned enterprise and the individual who brought a petition for winding up on the just and equitable basis. Rogers VP said at p.571:

> "*I consider that it is stretching the concept of a quasi-partnership too far to consider that a State could be such a partner. It seems to me impossible for a State to exhibit the qualities of mutual trust and confidence for that to happen for the reason that these are personal qualities and the State is impersonal*."

29. Mr. Potts accepts that a state body or government is not the same as a not-for-profit healthcare system, but he submits that the analogy holds good in this case because these are massive institutions which are impersonal entities similarly incapable of exhibiting 'personal' or 'individual' qualities of trust and confidence. As he put it in his oral submissions, the mere fact that the CEO of one company *"might be buddies"* with the CEOs of other institutions at any given moment is entirely irrelevant. The CEOs come and go, but the institutions persist.

30. I do not find the analogy is apt. I will not venture into a discourse on the political theory of the impersonal state but will say that, when the comment made by Rogers VP is put in its factual context, it does not make good Mr. Potts' submission.

31. In *Ng Yat Chi*, the petition was founded upon the basis that there was a joint venture between Mr Ng and the second respondent, which was a State owned company of the People's Republic of

China. Mr. Ng claimed a special relationship with the persons who controlled the management of the second respondent as well as with the State political leadership.

32. Rogers VP observed that the second respondent was directly answerable to and under the control of the State Council, and the managers of the second respondent with whom Mr. Ng claimed a personal relationship were temporary nominees. They were nominated directly by the second respondent and therefore acting indirectly on behalf of the State Council being put in charge for the time being of the relevant asset. Rogers VP stated:

> *"Although senior political figures in the People's Republic were referred to as being persons with whom Mr Ng had contact and dealings and to whom he could complain,* ***it seems to me to be impossible that <u>there was an entity</u> or person with whom Mr Ng could have formed a permanent personal relationship*** *through the agency of the 2nd respondent which could give rise to personal rights which would bring into play the just and equitable clause. His arrangement could only have been temporary to the extent that his political and other connections remained. But the repose of political power in one or more individuals is only temporary."* [emphasis mine]

33. It was against that factual background that Rogers VP made the statement on which Mr. Potts relies, that *"it was stretching the concept of a quasi-partnership too far to consider that a State could be such a partner."*

34. Nothing in the decision of Rogers VP suggested that such a relationship of trust and confidence could only be between natural persons. That a company could be party to such an understanding was established in *Re A & BC Chewing Gum Ltd; Topps Chewing Gum Inc v Coakley and others* [1975] 1 WLR 579 in which the court held that the relationship between Topps and the Coakleys had been destroyed and could not be restored.

35. Further, as Mr. Levy in his reply pointed out, it is noted in French at in para 8.366 that

> *"A company may be a quasi-partnership company even though members are companies rather than individuals"*

36. Mr. Potts rightly refers to the principles of corporate attribution in his skeleton and acknowledges that personal qualities, qualities such as honesty and integrity (good faith), have been ascribed to companies in other contexts yet he seems to suggest that in this case attribution should be restricted to formal acts of the Company.

37. The principle of attribution was recently revisited by the Cayman Islands Court of Appeal in their decision in *AHAB v SAAD* CICA (Civil) Appeal No: 15 of 2018, which was handed down after this judgment was reserved. The Court made the following observations which are apposite given Mr. Potts' submissions on corporate personality. The discussion on the law starts at para 810 with the

decision of the Court of Appeal in *El Ajou.* At para 814, the Court discusses the following passages from that judgment which are relevant to the issue raised by Mr. Potts:

> "*Secondly, the court emphasised that the directing mind and will of a company has to be considered in relation to the transaction in question. Thus Nourse LJ 783 said:*
>
> *Directing mind and will*
>
> *This doctrine, sometimes known as the alter ego doctrine, has been developed, with no divergence of approach, in both criminal and civil jurisdictions, the authorities in each being cited indifferently in the other. A company having no mind or will of its own, the need for it arises because the criminal law often requires mens rea as a constituent of the crime, the civil law intention or knowledge as an ingredient of the cause of action or defence. In the oft-quoted words of Viscount Haldane LC in Lennards Carrying Co Ltd v Asiatic Petroleum Co Ltd [1915] AC 705 at 713, [1914-1915] All ER Rep 280 at 283:*
>
> > '*My Lords, a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.'*
> >
> > *The doctrine attributes to the company the mind and will of the natural person or persons who manage and control its actions. At that point, in the words of Millett J ([1993] 3 All ER 717 at 740): "<u>Their minds are its minds; their intention its intention; their knowledge its knowledge". It is important to emphasise that management and control is not something to be considered generally or in the round. It is necessary to identify the natural person or persons having management and control in relation to the act or omission in point….'"</u> [Emphasis added]*
>
> *The judgment of Rose LJ was to similar effect784:*
>
> > *There are, it seems to me, two points implicit, if not explicit, in each of these passages. First, the directors of a company are, prima facie, likely to be regarded as its directing mind and will whereas circumstances may confer that status on non-directors. Secondly, a company's directing mind and will may be found in different persons for different activities of the company.*
>
> *And finally Hoffmann LJ785:*

The authorities show clearly that different persons may for different purposes satisfy the requirements of being the company's directing mind and will."

38. Companies act through natural persons who manage and control their actions and through those persons they can create relationships of a personal nature. It follows that there can be a relationship of trust and confidence between the corporate shareholders of a company if one existed between their Chief Executive Officers who were the active and controlling minds of the corporate shareholders, as Valley Health asserts in this case. What is required is evidence of the understanding amongst the members when the Company was established including details of how any 'legitimate expectation' arose.

39. I cannot accede to the submission that because the shareholders are large corporations with no shareholders or beneficial owners, it is impossible for there to be a personal relationship of mutual trust and understanding between them as to how the business of a small captive with five members or, as now, with two members - *"a close company"* as the CEO of Augusta described it - should be run.

40. Perhaps I have misunderstood Mr. Potts' submission as raising a question of law and all he means to contend is that, as a matter of fact, it is not possible to characterise the Company as a quasi-partnership because the relationship between Valley Health and Augusta is a purely commercial one of the sort described in *Re Coroin* on which he relies, defined by their legal and contractual relationships which leave no space for equitable considerations to operate:

> *"In my judgment, there is no room for equitable considerations of this kind in the present case. The company was formed by a group of highly sophisticated and experienced business people and investors with a view to the purchase of a well-known group of hotels for a price running into many hundreds of millions of pounds and to retaining and managing some of those hotels. There was little prior relationship between many of the investors and some were unknown to each other until a few days before the company was formed. More importantly, articles of association and a shareholders agreement were negotiated and drafted, containing lengthy and complex provisions governing their relations with each other and with the company. I find it hard to imagine a case where it would be more inappropriate to overlay on those arrangements equitable considerations of the sort discussed by Lord Wilberforce and Lord Hoffmann* [in O'Neill v Phillips]*",* per Richard Davis J at para 635.

41. In that event, we are *ad idem* on the law and the question for the Court is whether this Company was established or its business conducted on the basis of mutual trust and confidence between the founding members or whether the relationship between the Members is a purely commercial one in which the parties' contractual arrangements set out and define the scope of the parties' rights and obligations within the Company which, Mr. Potts suggests, is run at arm's length by a number of professional and corporate service providers, all of whom are checks and balances in

the corporate structure, as required as a matter of the licensing conditions under the **Insurance Act.**

42. In closing, Mr. Potts challenged Mr. Levy to find a single reported authority where it has ever been found that an international business in the Cayman Islands, structured as a segregated portfolio company, licensed and regulated as a class B insurer, has ever been found to be a quasi-partnership. Mr. Potts says there is no such case and that if the Court were to conclude that the Company was a quasi-partnership, it would be entirely unprecedented and entirely inconsistent with the legal position.

43. I consider that, while there is no precedent for holding that two major companies who are shareholders in a captive insurance company are in a quasi-partnership, the Court should heed Lord Wilberforce's observation that *"the foundation of it all lies in the words 'just and equitable'* and that the Courts should not be too timorous in giving them full force.

The Parties

44. Given Mr. Potts' emphasis on the size and structure of the parties in his submissions, I set out a brief description of both.

45. Both Valley Health and Augusta are reputable, 'not-for-profit', regional community health systems based in the State of Virginia, in the United States, with excellent track records in the delivery of public healthcare in the public interest. Neither entity has been established or operated 'with a view to profit' or with private ownership interests in mind. Neither entity has any private shareholders or private owners both being 'Virginia Nonstock Corporations'.

46. They are both active members and participants in the Virginia Hospital & Healthcare Association ("VHHA"), an alliance of hospitals and health delivery systems in the State of Virginia. The VHHA was formed in 1926 as a trade association of Virginia hospitals, with a vision to make the State of Virginia 'the healthiest state' in the United States of America.

47. Valley Health's annual consolidated revenue is in the region of $1 billion per annum and Augusta Health's annual consolidated revenue is in the region of $350 million per annum.

48. Valley Health is governed by a Board of volunteer Trustees appointed by members of the community which it serves (a diverse group of community leaders, business executives, and physicians). Augusta Health, in turn, is governed by a Board of Directors consisting of volunteers appointed by members of the community which it serves (also a diverse group of community leaders, business executives, and physicians).

The Evidence

49. The evidence on which Valley Health relies is given primarily by Mr. Mark Merrill, the CEO of Valley Health from 2009 to 2019. His affidavit evidence runs to 118 pages and exhibits hundreds of documents. It was referred to by Mr. Potts without irony as Mr. Merrill's *magnum opus.* Mr. Nantz, the current CEO, also gave evidence on behalf of Valley Health as did Mr. Peter Gallagher, Valley Health's CFO.

50. The evidence on behalf of Augusta was given by Ms Mary Mannix, CEO of Augusta since 2009 to the present, Ms Sharon Moore who is the Treasury Director of Augusta and has been associated with the Company since 2004 and Mr. John Katsianis, Augusta's CFO.

51. Mr. Potts made the point in his submissions that Mr. Merrill has no personal knowledge of any of the matters between 2004 and 2009 of which he gives evidence and cautioned the Court that some of the documents to which Mr. Merrill refers and on which he relies are replete with inadmissible opinion evidence as indeed was much of the evidence of Mr. Merrill himself. Mr. Potts made other criticisms of Mr. Merrill's affidavit including that it had been used improperly as a vehicle for legal submissions.

52. I bear his submissions in mind as I begin the resolution of the issues by turning to consider what the evidence discloses about the structure of the Company and its evolution into a two member captive, the way its business was conducted and the events that Valley Health asserts led to the breakdown in the relationship between it and Augusta.

The Company

53. The following facts are largely agreed. The founding members of the Company were Valley Health, Augusta, Rockingham Memorial Hospital, Halifax Regional Hospital, Inc and Martha Jefferson Hospital. The initiative to establish a group captive to cover their insurance needs was spearheaded by the CEO of Valley Health. The hospitals he approached were all members of the VHHA, to which Valley Health and Augusta still belong, and I accept Mr. Merrill's assertion that the CEOs knew each other in a professional capacity as a result of their involvement in that association.

54. In order to assess the feasibility of establishing a captive to meet their insurance needs, they turned to Mr. Mark Cain of IRMS Actuarial Services who can fairly be regarded as the architect of the Captive. Augusta's CEO said this in his Report to the Augusta Board in 2004 recommending Augusta's participation in the proposed group captive,

> "*Mike Halseth, CEO of the Valley Health System (Winchester Hospital and more), has taken the lead on this project. Mike sought and retained the best consultive* (sic) *talent he could find in the form of Mark Cain, FCAS, MAAA, MBA an actuary with the Illinois Hospital Association who has put together many of these hospital shared risk organizations."*

55. Mr. Cain conducted a feasibility study which included the financial projections of how much capital the institutions would have to contribute to the Company to fund their insurance programs. Valley Health was by some distance the largest by coverage size and the initial projections indicated that Valley Health would be required to contribute 49.4% of capital to the captive, an amount nearly equal to the capital projections of the other proposed members of the captive.

56. On or around 13 February 2004, the founding members met with Mr. Cain to discuss the establishment of the Company. An email sent by Mr Cain to the founding members on 13 February 2004 records the agreement that was reached between them at that meeting in respect of how the Company was to operate. Among the things that were agreed are set out as follows:

"Hello everyone,
Thank you again for a very productive meeting. Let me summarize what we agreed to.

1. *The Board will be made up of one member from each institution. The Chairman will rotate periodically. In addition, each Board Member will have one vote.*

2. *Dividends will be declared by the Board based on capital needs and profitability. Profits will be distributed to each member in two ways. One half of the profit will go to each member in proportion to their capital. One half will be distributed to each member based on loss experience. The loss experience formula will have two steps. First, for the period that generated the profits, only those members that have contributed more in premium over that period compared to their incurred losses for that period will be eligible. For the eligible members, the dividend will be in proportion to the amount that the member's premium exceeded their losses.*

I should add that with any new venture, we should not expect to pay dividends for the first five years. In general it will take that long before we establish a track record for our loss experience and can better estimate profits.

3. *New members will be treated like existing members. They will be required to make a capital contribution calculated under the same basis as the existing members. In addition they will pay an amount similar to the existing members' share of the start-up costs.*

4. *If a member leaves the captive their stock will be converted to non-voting stock. The captive will keep their capital for a minimum of five years. After five years, the captive will retain only enough capital to support the outstanding losses for that member.*

One question that comes to mind. Are members that left eligible for dividends? I would suggest that they are not. If they are, it puts the captive in a difficult position in a soft market. That is, a member could leave for a lower premium and still get paid a dividend by the captive. That creates a strong financial incentive to leave.

5. *Future capital needs. The captive will not have an automatic assessment provision. The intent is to run the captive in a conservative manner, and ensure that premiums are adequate and initial capital is sufficient. If additional capital is needed, the captive will need to present a business plan describing the need for the capital and the corrective actions taken to ensure the financial strength.*

As we discussed, this further emphasizes the need for strong Board leadership an involvement. Toward that end, the group agreed that the Board Members must be an officer of each respective hospital.

6. *The group agreed that the capital will be in cash, not debt or a letter of credit. From a timing standpoint, each member will need to submit a capital deposit prior to the start of the captive. The balance will be due when the member starts to purchase insurance from the captive.*

Please let me know if you disagree on any of these points."

57. These principles are characterised by Mr. Merrill as the Company's founding principles, with the first founding principle being that, with respect to governance, each member would have one vote whatever their capital contribution and the second, that the profits made by the captive would be distributed to the members in proportion to the capital they had invested combined with their loss experience.

58. The Company operates Professional and General Liability Insurance Programs as well as a Workers Compensation Program and a Medical Benefits Reimbursement Program (the "Insurance Programs"). It issues indemnity policies to its members on a 'claims made' basis which means that some of the claims made in any given year might relate to acts or omissions that have taken place historically, and some of the claims might not be paid, or even fully crystallise as financial liabilities, until much later into the future.

59. Each member's capital represents the premiums paid in by the member for their insurance policies issued during the life of the Company and is what Valley Health refers to as their 'economic interest' in the Company. When the Company was established, Valley Health had 46.7% of the shares in the Portfolio, Augusta had 7.1%. Valley Health currently has 69% and Augusta 31%.

60. The premiums paid by the Members are invested conservatively. The capital and the investment income which is earned on it, when net of paid losses and loss reserves for claims known and unknown, represents the profits made by the Company in any year. Profits which are not paid out to members are referred to as retained earnings ("Retained Earnings").

61. Whilst it is the Company which issues policies to its Members, the Insurance Programs are administered and managed by Solution Services Corporation ("SSC"), a not for profit Virginia non-stock corporation which was incorporated around the same time as the Company and which employs a number of full time staff. The role of SSC is to administer and operate the Insurance Programs and assist the Members with their duties and obligations as Members of the Company and insureds under the Insurance Programs. It is headed by a CEO whose job it is to manage and oversee the operations of SSC and coordinate activities relating to the operations of the Company. The CEO of SSC at the time of trial was Ms Mary Barrick.

62. Each Member of the Company is issued with one voting share in SSC and has the right to appoint two directors to the SSC Board, one of whom must be the CEO of the member with the effect that directors of the Company also sit on the Board of SSC. There is no contractual relationship between the Company and SSC, consistent with SSC's role to provide services to each of the Members as members of the Company and as insureds.

63. Although there was agreement in 2004 that the profits of the Company would be paid out in dividends to be allocated as one half in proportion to the member's capital and the other half to each member based on their loss experience, a dividend policy was not then formulated and adopted by the Company.

64. Mr. Cain was appointed the Actuary of the Company in 2004 and remains its Actuary.

65. In 2006, Mr Cain submitted to SSC a proposed dividend methodology in response to a request that he describe a dividend formula and demonstrate how it would apply to the Company. In his submission he stated, *inter alia*, that:

> *"I would like to begin by stressing that this document is intended only to define a formula, and that we are not recommending that Virginia Solution consider dividend at this time. When the captive was formed, we stated that in our opinion the Virginia Solution Board should wait at least 5 years before declaring a dividend. We continue to believe that this waiting period is appropriate.*
>
> *However, it is appropriate to establish a policy for dividends at this time. It is important to remember certain core principles in deciding how to craft a dividend formula:*

1. The captive was established to protect its members for the long run. Toward that end the Captive took several steps to enhance longevity. First and foremost the member contributed capital to protect the Captive at 90% probability.
2. The members share in each other's loss experience.
3. In the long run, each member would pay their fair share.
4. The Captive would enforce sound underwriting and risk management principles to minimise losses.

With that in mind, we recommend the following dividend formula:

Step 1 Actuarially determine if the total funding (loss reserves plus capital) exceeds the funding necessary at 90% probability level
Step 2 Declare all or a portion of the excess funds as a dividend
Step 3 Allocate the dividend to each of the members, either as a cash dividend or a credit to future premiums.

It is in step 3 where we typically see diversity. Typically there are two extremes used for the allocation of the dividends to individual members. The first allocates the dividend strictly based. The second allocates the dividend strictly on the loss performance of each member….

In my experience, most programs will recognise both allocation methods have merit, and will give weight to each. This allows the dividend to recognise loss experience, retain the pooling concept and provide for a return on the capital investments.

66. At the Board Meeting on 23 May 2007, the Company unanimously approved the Combination of Capital and Loss Based allocation dividend formula and resolved that *"such formula to be used at such time, if any, the Company declares a dividend."*

67. On the same occasion, the Company also resolved, in light of recent inquiries by other Virginia health systems who expressed an interest in joining the Company, that SSC would work with Mr. Cain to prepare a feasibility study to assess the financial impact the entry of new members might have.

68. In light of the proposal to add new members to the Company, a special committee of SSC was established at the Board Meeting of May 2008 to review the Company's Articles of Association, draft a Shareholders Agreement, review or draft the Company's mission and corporate guiding principles, develop the process and procedures for adding new members and review and revise all other governing documents that may be impacted by the addition of one or more new members.

69. The following comment on the structure of the Company was made by onshore Counsel to the Special Committee of the Board which had been formed in 2008 to consider the entry of new members into the Company:

> "*The structure of the Company's shareholdings and voting rights is a common one in multiowner programs; namely that the shareholders have equal voting rights (because each holds ordinary common shares and each has one vote as a holder of such shares) but different rights regarding value (because each holds a different number of segregated portfolio shares with no voting rights). These types of structures are viewed as beneficial because each shareholder can have an equal right in governance and corporate direction, …*
>
> *"…some actions require unanimous vote. For those actions,* ***even one new member not voting with the founding members could cause a block on actions desirable to and advanced by the founding members. We recommend that these actions be reviewed specifically to confirm that the founding members are comfortable with the unanimous vote required. Most significant among them is the establishment of a dividend formula.*** *This is the means by which the "value" of the Company is distributed on an ongoing basis for the benefit of its founding shareholders. Consequently, we recommend that the dividend policy be reviewed carefully prior to the admission of any new shareholder to ensure that it is reflective of the founding shareholders' intent and agreement."* [emphasis mine]

70. Onshore Counsel went on to recommend that the Company should document in a Participation Agreement the various understandings of the parties that were not already addressed in the Company's governing documents and to adopt corporate policies and procedures as necessary to implement various matters arising from the Participation Agreement such as the Dividend Policy.

Mission and Guiding Principles

71. At the December 2008 meeting of the Board, the Company adopted a statement of Mission and Guiding Principles. The Mission of the Company was *"to provide a stable, long-term solution for the professional and general liability insurance needs of its Members"* which is defined to mean the Company's Members and the Insureds.

72. The Company committed to the following guiding principles:

- **Virginia based**: Members will be Virginia based hospitals. Risks outside of Virginia will only be insured if they are related to the operations of a current Member; so long as the current Member maintains a majority interest in such operations of the consolidated health system and the risk outside the state of Virginia does not create an inordinate risk to the Company or the other Members of the Company.

- **Governance**: Each Member will have one vote on the Board of Directors, regardless of size or capitalisation and will adhere to the highest standards of corporate governance and behaviour**.**

- **Stability**: Members will be committed to participate in spite of competitive pressure for inexpensive insurance. The Company will not follow market cycles, but instead strive to offer predictable, stable pricing.

- **Coverages**: The Company will limit the coverage it offers to those that can be reasonably insured and represent the risk of its Members. Insurance for risks that are highly volatile will not be offered.

- **Capitalisation**: Each Member will contribute capital to effectively fund the Company at the 90% probability level through the five years following initial coverage. The Company has the right to ask for additional capital or surplus up to 100% of the initial capital to fund for adverse loss experience. All new Members will be subject to the same funding requirements as founding Members and capital for new Members will be calculated as if the new Members were Members at the Company inception.

- **Equity**: While losses are pooled amongst the Members, the objective is that in the long run each member will pay its fair share. This is accomplished through experience rating on the front end, and loss-based dividends on the back end.

- **Financial Strength**: The Company's premiums and reserves will be set by the Board based on recommendations of a qualified actuary. The Company will have its books audited each year by an independent auditing firm. The audit shall include a review of the actuarial analysis used to set the reserves. The Company will also follow the rules and regulations promulgated by the Cayman Islands Monetary Authority.

- **Efficiency**: Each service provided will be evaluated for quality and efficiency.

- **Growth**: Growth is not a primary objective of the Company. New Members will only be added if they meet the following criteria: (a) acceptable loss experience; (b) commitment to long term participation; (c) shared values of the existing members; (d) history of strong financial performance; (e) based in Virginia; and (f) operate as a not-for-profit system.

The Participation Agreement

73. The first Participation Agreement, which detailed the agreement made between the Company and its Members relating to the operation of the Company and the Insurance Programs, was adopted by the Board in 2009 subsequent to the review.

74. Ms Mannix and Mr. Merrill were both present at the meeting when the Board approved the Participation Agreement and the Dividend Policy annexed to it as Exhibit 1 as well as divers amendments to the Articles.

75. The Participation Agreement, which was restated and re-amended in 2017, (the "Fourth A & R Participation Agreement") provided at clause 1.3 that if a conflict arose between the provisions of the Participation Agreement and the Articles of the Company, the terms of the Participation Agreement shall prevail and be binding on the Company and the Members.

76. At clause 6.3 **Dividends** it provided that,

> *"Any dividends declared by the Board of Directors pursuant to the Articles of Association are subject to the approval of the Members as provided in the Articles of Association and the approval of the Cayman Islands Monetary Authority and* ***must be declared in accordance with the Policy regarding Dividends attached hereto as Exhibit 1."*** [emphasis mine]

The Dividend Policy

77. The Dividend Policy annexed to the Participation Agreement, then as now, has its own Guiding Principle at paragraph A which provides that:

> *"Because the Company was founded as a long term solution for protection of its members, it is the intention of the Company that capital, when combined with premium, will result in funding for the Company at a 90% confidence level, as determined by the Company's actuary."*

78. Funded, in other words, to the extent that there is a 90% chance, or probability, that the capital, when combined with the premiums paid, will cover all liability.

79. At B (B1 in the 4th Amended and Restated Participation Agreement) it provides as follows:

> *"On an annual basis, the Board of Directors shall review the financial performance of the Company and determine, with the advice of the Actuary (i) whether or not to declare a dividend out of retained earnings based on the dividend formula and process set forth in Paragraph C below; and (ii) the total amount of such dividend. In making such determinations, the Board of Directors shall take into account the extent to which the Company is funded in excess of the 90% confidence level, the historic financial performance of the Company, projected future activities and business of the Company and potential changes in membership. The decision to declare a dividend shall be made by the Board of Directors in its sole discretion and the Board shall not be required to declare a dividend even if the annual review would suggest that amounts are available to distribute as dividends."*

80. The Dividend Policy provides at paragraph C that:

(i) The Company's Actuary shall determine whether the total funding of the Company - loss reserves + capital - exceeds the funding necessary to achieve a 90% confidence level.

(ii) If such excess funding is available, the Board of Directors shall determine whether or not to declare a dividend, and the amount of any such dividend shall not exceed the amount of the excess funding.

(iii) The Board of Directors shall determine whether the dividend shall be paid as a dividend on shares or a credit against future premium payable by each shareholder or its affiliates.

81. It also provides that the dividends, or credit as the case may be, be allocated according to a dividend formula which is set out at paragraph D2.

82. The Dividend Policy provides that half the dividend declared shall be in the same proportion as each Member's capital contribution for Portfolio shares adjusted to recognise the timing of each Member's capital contribution. The time weighted capital element was explained to the Board by the Actuary as follows:

> *"the capital based portion of the dividend takes into account the amount and timing of capital contribution. For example, if a member contributes $1 million of capital 10 years ago it would get 10 years of weight. If a member contributed $1 million of capital 1 year ago it would get one year of weight."*

83. In calculating the dividend based on capital, then, the Members' capital contribution for Portfolio shares is adjusted to recognise when the capital contribution was made.

84. With respect to the loss weighted portion, the Dividend Policy provides that it shall be allocated in the same proportion as each member's "*Positive balances" with* the effect that only those members who have contributed more in premiums than their share of losses and expenses are eligible for a dividend.

Article XIII of the Company's Articles: Dividends

85. The Company's Articles provide as follows:

(i) Subject to any dividend formula adopted by the Board and to the Companies Law, the Company, in general meeting, may by Special Resolution declare dividends, but no dividend shall exceed the amount recommended by the Board: section 13.1 of the Articles; and

(ii) Subject to any dividend formula adopted by the Board, the Directors may, before recommending any dividend, set aside such sums as it deems proper as a reserve or reserves which shall, at the discretion of the Board, be applicable for meeting contingencies, or for equalising dividends or for any other purpose to which the profits of the Company may be properly applied or invested: section 13.2 of the Articles.

86. As there are currently only two members of the Company, a special resolution can only be passed unanimously. As there are only two directors of the Company, the Board can only make a recommendation of an amount to be declared as a dividend unanimously, as an ordinary resolution requires more than 50% of the votes of those entitled to vote.

Capital Rebalancing

87. An understanding of the arrangements made for the capitalisation of the Company is necessary to understand one element of the dispute which is the subject of the Petition.

88. Clause 6.4 of the Participation Agreement, and its later iterations, provides that the capitalisation and funding of the Company shall be reviewed periodically in accordance with the Company's Policy Statement regarding Capital Assessments and Additional Capital Contributions (the "Capital Assessment and Reallocation Policy").

89. Given that the dividend formula rewards the investment of capital over time, the arrangements for assessing each Member's capital contributions - for rebalancing capital in the Company - are central to understanding the dispute.

90. At the Company's Board meeting in November 2010, it was resolved that the Capital Assessment and Reallocation Policy should be revised to (i) ensure that a capital review is performed at least once every three years and (ii) that capital assessments are mandatory, rather than at the Board's discretion. The principal rationale behind these amendments was to ensure regular assessments were carried out and that the reviews were tied to the Company's three-year reinsurance negotiation and renewal cycle.

91. A clear explanation of capital rebalancing was given by Ms Mannix to her Board in a memorandum dated 24 April 2017:

> "*On a periodic basis but no less frequently than every three years, a capital adequacy analysis is performed on the [Company]. The performance standard established by the founding members of Virginia Solution is to fund the [Company] at the 90th percentile confidence level. This means that through the premium paid and capital contributed, there is a 90% chance that the company will have enough reserves to cover its losses. If a member has grown rapidly or experienced an increase in loss reserves, it is very possible that that member may be required to pay in more capital…This is why it is required to do a capital rebalancing analysis periodically. The [Company] has historically run the rebalancing analysis every three years, at the beginning of a new three year reinsurance treaty...*"

92. A failure to rebalance capital would, if there was an increase in a member's loss reserves for example, result in the member having a smaller proportion of capital in the Portfolio relative to other members with implications for the payment out of dividends which rewards capital investment over time.

The Two Member Captive

93. Shortly after Fauquier was admitted as the first non-Founding Member of the Company in June 2010, first two and then three Founding Members announced they were joining a much larger not-for-profit integrated healthcare system and might seek to withdraw from the Company as a result.

94. An *ad hoc* committee of SSC, comprised of Ms Mannix as Chair together with Mr. Merrill and the then CEO of SSC, was set up to to consider policies, practices and the implications of one or more Members departing the Company. The function of the sub-committee, as explained by Ms Mannix, was to "*take a proactive approach to understand the implications for one or more Members leaving Virginia Solution*" and that the sub-committee would be required to "*develop a punch list of all criteria with a model of issues that could arise*" in order to have "*an understanding of possible implications* and then to "*provide a formalized report outlining implications, including a set of recommendations or options*" to the Board of the Company for its consideration at the Board meeting to be held in May 2011.

95. At a meeting of the Committee in January 2011, Ms Mannix inquired about the implications of Valley Health's ownership of the Company increasing above 50% as a result of the member withdrawals and how this would impact the one member one vote Guiding Principle. Onshore Counsel responded that the increase of one member's ownership above 50% did not affect the governance of the Company as "*shareholder vote and ability to appoint directors is on a per capita basis. Secondary shares are owned in proportion to financial interest in the Company and that is how dividends are distributed.*"

96. During a meeting of the Committee held on 14 March 2011, the Actuary advised the Committee, with respect to the financial impact of the departing member, that *"the decline is not as much as expected. The program is designed so they leave their assets behind."* He observed that the remaining members would benefit financially from the departures as *"insurance is driven by investment income"* and the Company would keep the income generated on the premiums and capital of departed members.

97. During this discussion Ms Mannix raised the issue of whether the Company could continue if its largest member Valley Health were to depart. The Minutes record that:

> *"Ms. Mannix questioned how the scenario would change if Valley Health System were to leave and that it would need to be pointed out to the other two Members. Mr. Cain stated that even if VHS left, the program could still work and that five million would probably be*

the minimum to keep the company running. The Company is self-stabilizing at this point. The group concurred that this is good news. Mr. Cain stated that there is still a risk, but only 10 percent. Ms. Mannix stated that this is an excellent analysis to incorporate into the findings. She asked if he could prepare a fourth scenario of VHS leaving. Mr. Merrill agreed, asking to see at what point the company would be in jeopardy. Mr. Cain concluded that you would want to be the last man standing. The Company keeps the interest on the dividends and capital and could very well survive on its own. The Program was strategically set up conservatively."

98. Martha Jefferson and Rockingham withdrew in 2012, Fauquier was expelled in 2013, Halifax withdrew in 2014 and the Company became a two-member captive.

99. The November 2013 meeting was the last attended by Halifax. At the meeting, the Board approved a formal Prospective Member List. Although the Company continued to seek out new members to join the Company, the Board and the two Members considered the implications of a two member captive and whether new rules should be made.

100. Ms Mannix proposed a former Director as a potential 'member at large' but Mr. Merrill demurred, stating:

> *"On a third member, I appreciate your outline of the options. I agree there are pros and cons. One additional concern is that non shareholder director could become a "tiebreaker", which makes me uncomfortable.*
>
> *I am guardedly optimistic that AH and VHS will work for the good of VHS and respective institutions, but there could be a time when we may differ on strategy, adding members etc."*

101. Ms Mannix agreed. They sought recommendations from the Actuary and their onshore legal counsel on the implications arising from a two member captive.

102. During the period of review of the existing governance documents to determine what new rules, if any, should be adopted, onshore Counsel, in a presentation to the Board in November 2014, titled "*Implications of a two member captive*" noted that:

(i) the current governance rules provided for one member one vote with the effect that all actions would require a unanimous vote with each member having a blocking vote. Even if membership were increased to three members, actions requiring a 75% vote would require unanimous support. It was noted that Valley Health had the dominant economic interest in the Company and that the disproportionate impact of the one member one vote policy would become more pronounced with only two members remaining. Ms Robertson's recommendation was that there should be no change to the one member one vote policy because historically the Company's Board and Members had acted by consensus and the Members could rely on the existing arbitration provisions in the event of a serious conflict and that

(ii) in the event that one member withdrew or was expelled from the Company, it was noted that the remaining member would be entitled to all interest and investment earnings on the departing member's capital during the run off period and that the remaining member might decide not to declare dividends during that period in order to keep the profit for itself and obtain a financial windfall. In order to protect the departing member from this type of "unfair treatment" and from forfeiting significant assets and providing a windfall to the remaining member, Ms Robertson raised the option of the Members agreeing that in the event that either member wanted to voluntarily withdraw, or failed to meet the eligibility criteria or had a change of control or in the event of deadlock, there would be either (i) automatic dividends being declared and the crediting of interest to the departing member or (ii) either member would have the ability to put the Company into liquidation, with both members remaining in the Company until dissolution.

103. Onshore counsel also reminded the members of the need to recognize their dual roles and that whilst the members had the right to protect their individual interests at shareholder level, the directors of the Company were required to act in the best interest of the Company at all times.

104. At the Company's November 2014 Board meeting, the Board rejected the proposal that a member who voluntarily withdraws from the Company would have the right to place the Company into voluntary liquidation on the basis that it was a Founding Principle of the Company that the departure of a member should not jeopardize the future of the Company for other members. The scenario which the Board was considering was where a member either wanted to voluntarily withdraw or was required to withdraw due to a change of control or because it no longer met the eligibility criteria.

105. Anticipating that a new member would join the Company, the Members entered into the second Amended and Restated Participation Agreement on 14 November 2014 and agreed to amend the Articles so that actions requiring a 75% vote in the Articles would instead require a two-thirds vote whenever there were less than four members. This was to ensure that no member would have a blocking vote on a Board of three.

106. In 2015 onshore counsel was asked to recommend changes to the governing documents to address what would happen if one of the two remaining members withdrew from the Company in one of two scenarios: (i) a voluntary withdrawal due to change of member control and (ii) an involuntary termination (expulsion) by the Company due to change of control. In early 2015, in the first of two memoranda to Valley Health and Augusta, onshore counsel noted with some prescience that:

"*With a two-member company, if one of the members withdrew ….[t]he remaining member…could have a significant financial windfall due to the operational provisions of the Governing Documents and related policy statements that allow dividends to be declared by the directors (i.e., at that point, the representatives of the remaining member), and because former members are not entitled to interest/investment earnings on funds held in their separate accounts, which could be for a period of up to 20 years at the discretion of the board.*

"With a two-member company, ***these provisions could operate to create an incentive for one member to force another to withdraw (for example, by being uncooperative and blocking actions)****, or by terminating a member that was the subject of a change in control"* characterising such conduct as *"bad behaviour."* [my emphasis]

107. In the second, she made the point again, stating:

"Windfall to Remaining Member. VS historically has been funded and operated in a very conservative manner and currently has significant retained earnings, much of which are attributable to years in which former members participated. With VS' current and expected positive financial position, the remaining member could receive a significant windfall at the expense of the former member. The windfall could result because (i) the remaining member is under no obligation to declare dividends to be credited in part to former members, and consequently could "wait it out," never declaring a dividend until after payment of the former member's separate account, which would then consist only of its paid in capital, with no interest; (ii) even if the remaining member did declare dividends, the interest from the former member's separate account would accrue to the benefit of the current member for a period potentially exceeding twenty years; and (iii) in the right market conditions, the remaining member could negotiate reinsurance for years in which the former member participated, generate a profit on the reinsurance for VS and keep that profit. In short, the Governing Documents contemplated that there would be a number of former members collectively making decisions as to the treatment of a former member, as opposed to one member that could greatly benefit from mistreatment of a former member. The difference in size of the two members adds further potential for unfair results. For example, if Valley were acquired by another organization, Augusta could terminate Valley's membership under the "change in control" provisions even if Valley wanted to continue its participation, with Valley being vulnerable to losing not only its insurance vehicle ***but also its significant share of the surplus of VS and investment earnings on that surplus. The potential for windfall also creates an incentive for one member to "behave badly," for example by blocking actions or not attending meetings, to force the other to conclude it should withdraw. While there is no suggestion that the current participants would deal with one another unfairly, it is impossible to predict who might be representing the members in the future, or how circumstances, corporate or***

other strategic alignments or the financial condition of the members might change." [emphasis mine]

108. Notwithstanding the observations of onshore counsel, Valley Health and Augusta both agreed to continue the one member one vote policy.

109. The Board agreed the new rules for dealing with the expulsion or withdrawal of one of the two remaining members which provided that, if one member withdrew, the Actuary would determine how much capital is needed for the remaining member to continue on. Then, the dividend formula would be applied. The dividends owed to the departing member (less some amount, to be determined) would be put into a separate account. The money in that account would be paid to the departed member in five annual installments, beginning after all of the departing member's claims were closed.

110. These new rules were recorded in the third Amended and Restated Participation Agreement on 11 December 2015.

The Special Rule for Founding Member Retained Earnings

111. By 2016, the accounts of the departed members were settled with the effect that they no longer had any interest in the Company or any right to share in any dividend declared by the Board.

112. The Board resolved to make offers to two health systems to join the Company. By that time, the Retained Earnings in the Company had reached $18 million. The Board Minutes for the November 2016 Board meeting records that the Members were concerned about the potential impact of the entry of new members into the Company, including the possibility that a new member would be entitled to share in the Retained Earnings to which they had not contributed. Consideration was given to divers methods of protecting the existing members' share of the Retained Earnings. The Board ultimately decided that that upon a new member joining, Valley Health's and Augusta's shares in the Portfolio would be converted into Class A Shares and only they would be entitled to participate in distributions of historic Retained Earnings.

113. The decision of the Board is captured in clause 6.8 of the Fourth A & R Participation agreement which introduced for the first time the concept of Founding Member Retained Earnings which provides as follows:

> *"(c) The Founding Members, as the holders of Class A Shares, solely and exclusively shall be entitled to distributions of Founding Member Retained Earnings, as defined in paragraph (e) below. They also shall, along with the holders of Other Shares, have the right to distributions of all retained earnings other than Founding Member Retained Earnings which are declared as dividends or otherwise distributable in accordance with this Agreement and the Dividend Policy.*
>
> *…*

(e) *Founding Member Retained Earnings shall be the retained earnings of the Company as reflected on the Company's audited financial statements prepared for the end of the fiscal year immediately preceding the date of issuance of the first Other Share or Other Shares.*

(f) *Distributions of Founding Member Retained Earnings shall be made as provided in the Dividend Policy."*

114. The Dividend Policy was also amended with Paragraph B2 providing for the *Special Rule for Founding Member Retained Earnings*: that if the Company's funding level was higher than the 90% confidence level, Retained Earnings from years over five years old would automatically be distributed to the Founding Members annually to the extent that a distribution still allowed the 90% confidence level to be maintained, unless both Founding Members agree to forego the distribution.

Events leading to the presentation of the Petition

115. I have set out the events that began in 2017 up until the presentation of the Petition in some detail given that the question of whether Valley Health has come to the Court with "clean hands" has been raised by Augusta in its amended defence to the Petition. The allegations made against Valley Health include assertions that Valley Health acted in breach of its fiduciary duties and the guiding principle of the Company that each member must adhere to the highest standards of corporate governance by:

(i) attempting to accelerate payments out of the Company and exert maximum pressure on Augusta with a view to seeking to obtain an outcome favourable to Valley Health when leaving or dissolving the Company;

(ii) in essence, suborning the CEO of SSC and the Actuary, both ostensibly independent advisers to both members, in order to create pressure on Augusta and Ms Mannix and to withhold important information from them which Valley Health would then deploy when it suited Valley Health's purpose; and

(iii) seeking, since 2017, to advantage Valley Health at the expense of the Company and against the best interests of the Company and/or Augusta and the policies and principles of the Company as illustrated by Mr Merrill's express refusal to rebalance capital so as to arrive at a fair allocation of dividends between the Members *"regardless of what the analysis indicates"* and/or regardless of the expert advice.

116. There is little disagreement as to the events which took place between 2017 and 2019 that led to the presentation of the Petition - they are all heavily documented - though the parties disagree on the emphasis that should be placed on some of the events and the inferences that the Court is entitled to draw.

Events in 2017

117. As stated earlier, in November 2016, the Board of Directors and Members were advised by the Actuary that, as at June 2016, the Company had cumulative Retained Earnings of approximately $18 million after cumulative dividends paid out since 2012 of $9.55 million.

118. As at December 2016, the value of the Retained Earnings had increased to $24.1 million.

119. Notwithstanding the size of the Retained Earnings in the Company, the Actuary recommended that the Board not declare a dividend in 2016 given the development of a new business line, the Medical Benefits Reinsurance Program. Additionally, in circumstances where the Company was seeking to attract new Members, the Actuary considered it would helpful to show the Company's strong financial position as demonstrated by its net equity position.

120. The Board accepted his recommendation but directed the Finance Committee of SSC to develop a plan for distributing the Retained Earnings to Members.

121. The Finance Committee met on 22 March 2017 to develop the plan for consideration by the Members and the Board at their April meeting.

122. The minutes of that meeting are important as what was said there by the Actuary, in many ways, set the stage for the events that later unfolded. The Minutes record that the Actuary observed that the Retained Earnings had to be addressed because the "*number was so big, it seems to be creating its own issues…"* and in particular, the discussions to ring fence those earnings so new members would not share in them and *"the whole concept of the two-member captives."* As Mr. Cain put it:

> *"All of that really stemmed from the fact that the retained earnings had gotten so large….the retained earnings were actually driving the decisions* of the Company."

123. The goal, then, was to drive that number down. The dividend that SSC and the Actuary intended to propose was in the sum of $10 million which would be allocated $1.4 million to Augusta and $8.5 million to Valley Health in accordance with the Dividend Policy.

124. The Actuary noted that the payment of such a large dividend would not be in Augusta's favour as it was coming off of a bad year having suffered big medical benefits losses in the circumstances where the other half of the dividend formula took loss experience into account. If a $10 million dividend were declared and allocated according to the Dividend Policy, Augusta would *"take a hit"* to its income statement which would show a loss of $719,000.

125. As the Actuary noted, however:

> *"The [dividend formula] was done on purpose because, again, one of the tenets of the company is over the long run, everyone pays their fair share. In some respects the*

dividend formula is working exactly as it should. Augusta had a bad year, and now the dividend's going to penalise them for that."

126. Augusta's Treasury Director, Ms Moore, who was present at that meeting, proposed staggering the dividends which would allow time to see whether the losses associated with the new insurance program continued or improved. If they improved, the loss to Augusta would be ameliorated. Valley Health agreed to Ms Moore's proposal, although Mr. Merrill made the point that he would like to see even a small dividend at the April meeting, whether it be $2m or $3m, a proposal with which Ms Moore *"did not disagree."*

127. There was also discussion about capital rebalancing to *"true up"* the relative risk of the two members to 70/30 instead of 80/20. The Actuary noted however, that this would not have any impact on the dividend being proposed because the dividend is determined using account time-weighted capital.

128. The critical moment in the meeting, as the evidence will show, was the moment when the Actuary, *apropos* of nothing, observed that:

> *"The other part about it that I hadn't thought of until recently is one of the reasons we have $27 million worth of equity in the company, $24 million worth of retained earnings, a lot of that frankly has come from the beneficial closing out of [departed members].*

129. He then questioned whether:

> *"… running part of a dividend through the* ***loss based formula,*** *does it make sense to maybe take some of the money and say, okay, not all of that is purely normal dividends earned from profits of the company, a big chunk of it is earned from favourable close out of members that basically left money behind."* [my emphasis].

130. On 29 March 2017, Ms Moore reported back to Ms Mannix after a one-on-one discussion she had with the Actuary concerning the dividend plan:

> *"So, we agreed that the VS board needs to reduce the amount of retained earnings in the company = it's how the company is designed to operate. At the same time, we have to be sensitive to timing of that in consideration of potential negative impact on member financials.*
>
> *I asked Mark how much of the retained earnings is associated with departed members. He didn't know off the top of his head but advised it is easy to get to and is likely significant. He is actually incorporating that information into his presentation for the April VS board meeting. His thought was to carve that amount out and declare a dividend to get it out of the captive. I asked him how that dividend would be allocated b/t the members and his response was: according to the dividend policy allocation = 80%-20% Valley/Augusta or based on % "ownership" in the company. At that point, I pushed back. I*

reminded him that "ownership" in the company is at the shareholder (vote) level = one member/one vote and NOT at the % of paid-in-capital and premium in the SPC A (no vote) level. I asserted that the dividend allocation for departed member retained earnings should be split = 50%/50% b/t the two, remaining members since neither member contributed to those retained earnings = using the 80%/20% allocation is a disproportionate benefit to Valley and that, if the tables were turned or roles reversed, Valley would make the same argument. He said that was a discussion for the members. I stood firm on that one, ***acknowledging the board's desire to preserve the founding members' rights to their retained earnings by its recent action to issue a new share class for incoming members*** *but asserted that the 80/20 allocation should not apply to retained earnings associated with departed members that neither member contributed to. Rather, the "true" % ownership at the shareholder level should drive that or 50%/50%."*

131. Ms Mannix, in her email in response, stated that she thought Ms Moore's rationale was *"incredibly sound and on target"* and that she wished she had been *"smart enough to construct the argument"*.

132. She also wondered "*why Mark defaulted to the dividend policy for other member retained earnings"* to which Ms Moore replied:

> *"I think Mark used the dividend formula b/c it's the only way we have to get money out of the captive currently. The board can take action to change that."*

133. Ms Moore then recommended that Augusta:

> *"1. Wait until the November meeting to re-evaluate the capital rebalance and declare any dividends, if then, to d/t the potential negative impact on Augusta's financials if the health plan experience doesn't improve and*
>
> *2. Discuss how the board treats the allocation of the departed members' retained earnings for purposes of distributing dividends at the April VS board meeting."*

134. Ms Moore followed up with the Actuary on the issue of the extent to which the Retained Earnings represented capital left behind by departed members and asked him to assess how much of the Retained Earnings were attributable to those members.

135. The Actuary, in his response, set out the difficulty he was having in determining what that number might be:

> "*Regarding an amount from departed members, I am struggling to come up with a methodology for calculating an amount. The dividend formula does not allow payments to former members, so there would be no amounts allocated to former members through the dividend policy. From an equity standpoint, they do not have any equity to use.*

I also cannot simply use loss experience because that ignores the significant amount of investment income that has contributed to the retained earnings ($16miliion through 12/31/2016)."

136. Ms Moore pressed and the CEO of SSC responded:

> *"There is no calculation for the departed member portion of retained earnings because the dividend policy is the method (and only method) for moving retained earnings out of the company, and the departed members do not factor into the dividend policy.*
>
> *The prior statements accounting for the retained earnings of members (prior to departure) was done at the request of the members for their own accounting purposes and isn't relevant to the current retained earnings or dividend policy…*
>
> *Just a reminder too, the Board revised the Dividend Policy at the last meeting to specifically and automatically deal with the accumulated retained earnings of the current (Founding) members."*

137. Forwarding that response to Ms Mannix, Ms Moore said:

> *"Mark has looped in Mary B who is resisting coming up with this. It is likely now a discussion that will have to occur b/t you and Mark. Mark and Mary b should be prepared for an impasse on declaring dividends without it unless there is good reason we should except (sic) that."*

138. The distribution of $10 million which represented 47.6% of the $21 million retained earnings for the years 2005-2010 was recommended to the Board and the Members at the April 2017 Board Meeting ("the April 2017 Recommended Dividend").

139. In the Shareholders' meeting Augusta made it plain that they wanted information on how much of the retained earnings were attributable to the departed members and how dividends would be allocated if Augusta had rebalanced capital in 2014 before it would consider a dividend. Valley Health and Augusta acknowledged that they disagreed on the question of whether retained earnings attributable to departed members, however calculated, should be paid otherwise than in accordance with the allocation methodology in the dividend policy.

140. The dividend of $10 million proposed to the Board was approved by Mr. Merrill but was opposed by Ms Mannix on the basis that Augusta did not have sufficient information on which to act. The minutes note than an impasse on the amount and allocation of a dividend was declared by the Directors, and a dividend was declared from the retained earnings for 2004 which was closed.

141. It was agreed at the meeting that the Actuary would perform additional analyses to examine what the impact on the dividend split between the two Members would be at various levels of dividend if Augusta's 2016 loss experience was included or taken out and if it were assumed that a capital

rebalancing had taken place. The Actuary was also asked to determine how much of the Retained Earnings were attributable to the departed members.

142. After the April Board meeting, the Actuary prepared certain hypothetical models based on varying assumptions in order to derive a sum which might represent how much of the Retained Earnings were earnings attributable to the departed members and proposed a figure of approximately $6.3 million.

143. In August 2017, SSC and Actuary made a revised recommendation to the Board and the Members that $18 million be declared as a dividend. This represented 85.7% of the $21 million Retained Earnings for the years 2005 - 2010 ("the August 2017 Recommended Dividend"). The proposal provided for a retrospective rebalancing in 2014 and a rebalancing in 2017, with one dividend in 2017. The CEO of SSC noted:

> *"We believe that this addresses the rebalancing issue by recasting the dividend as if it had occurred in line with board policy."*

144. It was recommended that the August 2017 Recommended Dividend be paid in two tranches: $9 million be paid in November 2017 and a further $9 million be paid in January 2018. The dividend was to be allocated according to the dividend formula.

145. I should note here that there was no contractual basis for rebalancing capital "as if" the capital had been paid in 2014. Ms Mannix's evidence is that the decision was to "defer" rebalancing and she understood the issue could be revisited later, but it is simply impossible to go back in time and pay in capital.

146. Nonetheless, Valley Health approved the August 2017 Recommended Dividend notwithstanding this retrospective rebalancing exercise would have an adverse impact on Valley Health in reducing its proportion of capital in the Portfolio.

147. The August 2017 Recommended Dividend was opposed by Augusta on 30 August 2017. Augusta instead proposed that a dividend of $6 million per annum be declared for three years, which included a progressive annual capital rebalance which would lead to a break even for both members over all three instalments. The delay in distributions was intended to minimise the impact to Augusta's balance sheet as a result of the medical losses it suffered in 2016 and mitigate the impact of its failure to rebalance capital in 2014.

148. On or around 19 September 2017, the CEO of SSC and the Actuary made a third recommendation which was to declare a dividend of $16 million to be paid in 2017 out of Retained Earnings, excluding the $6 million in issue (the **"September 2017 Recommended Dividend"**) which could be left for further discussion.

149. The advice of the Actuary was that the September 2017 Recommended Dividend would result in the least accounting impact on Valley Health and Augusta and was therefore fair to both members.

150. The President of SSC also recommended that an additional special dividend of $6 million be declared to be allocated between Valley Health and Augusta based on their shareholders' equity rather than pursuant to the Dividend Policy (the **"September 2017 Recommended Special Dividend"**).

151. This would result in Augusta receiving $120,000 more than it would otherwise receive if the dividend were declared in accordance with the Dividend Policy. It was suggested that there was a precedent for this, as the capital forfeited by Fauquier was distributed on the basis of shareholder equity and not the Dividend Policy, with the agreement and consent of all members.

152. Notwithstanding Valley Health's position that any dividends must be declared in accordance with the Dividend Policy, in order to reach a compromise, Valley Health confirmed its approval of the September 2017 Recommended Dividend and the September 2017 Recommended Special Dividend.

153. Augusta did not agree and proposed that the $6 million which they considered to represent the departed members retained earnings be distributed between Valley Health and Augusta on a 50/50 basis again on the grounds that: (i) the capital contributed by Valley Health and Augusta did not contribute to the size of these balances; (ii) the premiums paid by Valley Health and Augusta did not contribute to the size of these balances; and (iii) the risks/loss experience of Valley Health and Augusta did contribute to the size of these balances and that the funds were *"windfall funds",* funds that neither Valley Health nor Augusta anticipated. Augusta was adamant that paying out these "departed members retained earnings" according to the Dividend Policy was unacceptable to it.

154. As a result of Augusta's continued objections to the declaration and payment of dividends recommended by the Actuary, the SSC Finance Committee Chair declared an impasse in late September 2017. I note here that Augusta abjures the characterisation of the 'disagreement' on dividends as an impasse - deadlock - and objected in correspondence much the same way as it did in these proceedings when Ms Mannix was giving her evidence. This despite Augusta's position being, as stated by Ms Mannix unequivocally, that:

> *"If we cannot come to some agreement as to an equitable distribution of the departed members retained earnings, then Augusta cannot agree to an extraordinary dividend that we have been discussing."*

155. There was plainly an impasse, and I say so having borne in mind Mr. Potts' numerous cautions on how I should approach the use of language by witnesses and disparity in culture when weighing witness evidence.

156. In order to move matters forward, Valley Health proposed that the Company re-designate the Shares held by Valley Health and Augusta as Class A Shares with the effect that the Founding Members Retained Earnings would be declared and paid in accordance with the Special Rule for Founding Member Retained Earnings which the Company had recently adopted (the **"Founding Member Proposal").**

157. Augusta opposed the Founding Member Proposal and again insisted that the "departed members retained earnings" of $6 million be distributed between Valley Health and Augusta on a 50/50 basis.

158. On 20 November 2017, Valley Health served Augusta with a demand for arbitration pursuant to Article 10 of the Fourth A & R Participation Agreement due to what it termed Augusta's wrongful refusal to approve a dividend in accordance with the Dividends Policy. Although Augusta formally challenged the demand for arbitration on the ground that the relief sought was not available from an arbitrator under Article 10, Augusta confirmed its agreement in principle to a dividend being declared of $17.5 million in accordance with the Dividend Policy, subject to the $6 million carved out for the 'departed members retained earnings'.

159. On 20 December 2017, the Board of the Company authorised a dividend of $17,467,860 in accordance with the Dividend Policy to be declared in two equal instalments for 2017 and 2018 (the **"Authorised December 2017 Dividend"**). The Authorised December 2017 Dividend was allocated between the members in accordance with the allocation methodology set out in the Dividend Policy.

160. However, with respect to the allocation, the Board agreed to assume that Augusta Health had undertaken a capital rebalancing in 2014 and 2017 for the purpose of determining the capital weighted portion of the dividend and agreed to apply the 30 September 2017 and 30 September 2018 loss data, respectively, for the purposes of calculating each member's Positive Balance for the purposes of calculating the loss weighted portion.

161. The Board resolved that the new capital allocation for Portfolio A would be Augusta 31% and Valley Health 69%, effective from 28 November 2017.

Events in 2018

162. In 2018, notwithstanding that significant Retained Earnings were available for distribution and that dividend payments were recommended by the Actuary, issues arose in respect of how much of a dividend should be declared and how the dividends should be allocated.

163. At the 22 May 2018 Board meeting, the Actuary advised that there were Retained Earnings of $10 million. He recommended a distribution of half of the earnings from the years 2005 - 2010 in the amount of $4.1 million.

164. A dividend in the amount recommended by the Actuary was proposed by Mr. Merrill. His proposal was met by a proposal by Mr. Katsianis, the CFO of Augusta, of a much larger $7.1 million dollar special dividend to be allocated according to the shareholding in the Portfolio, 69%/31%, which assumed that the notional capital rebalance which Valley Health had approved in 2017 would be applied.

165. Ultimately, the Board authorised a dividend of $2.4 million in accordance with the Dividend Policy (the **"Authorised May 2018 Dividend"),** which was the minimum amount recommended by the Actuary. The Authorised May 2018 Dividend was allocated between the members in accordance with the dividend formula.

166. Ms Mannix asked that SSC undertake an analysis of the larger dividend proposed Mr. Katsianis.

167. At that May 2018 meeting, Valley Health proposed that it was time to re-examine the allocation of overhead expenses given that the profile of the Company had changed over the years. Mr. Merrill pointed out that there were equal voting rights between the members with respect to the governance of the Company, and thus he felt that certain expenditures such as travel and meeting expenses should be split equally.

168. Notwithstanding that significant Retained Earnings were available for distribution in 2018 and the Actuary recommended that no further earnings be retained for that year, Augusta did not agree to an additional dividend being declared in that year.

Events in 2019

169. This question of whether and by how much the allocation of expenses for the Company and SSC between Valley Health and Augusta should be varied now became *"layered into the conflict",* to borrow a phrase used by from Ms Mannix in a 2019 memo.

170. It is Valley Health's case that efforts were made to break the continuing impasse between the members with respect to the "*departed members' retained earnings*" by the Chief Executive Officer of SSC.

171. Although Augusta in its Defence suggests that the proposals were not made by Ms Barrick independent of any influence by Valley Health, I am content to repeat the averments in the Petition as setting out the facts of the proposals that were made.

172. On 3 January 2019, (the **"SSC CEO 2019 First Compromise Proposal"**) Ms Barrick proposed that

(i) a $5.9 million dividend would be declared and allocated between Valley Health and Augusta based on their equity shareholdings in the Portfolio;

(ii) each member's share of the operating costs for SSC would be changed from 75% for Valley Health and 25% for Augusta to Valley Health bearing a 60% share and Augusta a 40% share; and

(iii) that going forward the Company's operational costs would be borne 55% by Valley Health and 45% by Augusta.

173. The second proposal was advanced on or around 17 January 2019, SSC (the **"SSC CEO 2019 Second Compromise Proposal"**) recommending that,

(i) a $5.9 million dividend would be declared and allocated between Valley Health and Augusta based on their equity shareholdings in the Portfolio;

(ii) there would be a permanent capital rebalance for 2014;

(iii) each member's share of the operating costs for SSC would be changed from 75% for Valley Health and 25% for Augusta to a 60% / 40% share respectively; and

(iv) going forward the Company's operational costs would be borne 55% by Valley Health and 45% by Augusta.

174. On or around 18 January 2019, Valley Health confirmed its agreement to the SSC CEO 2019 Second Compromise Proposal.

175. On or around 18 January 2019, Augusta confirmed its objection to both Proposals. Augusta then made its own proposal (the **"Augusta January 2019 Proposal"**) that:

(i) a $6.3 million dividend would be declared and allocated between Valley Health and Augusta on a 71.8%/28.2% split respectively per their equity in the Portfolio;

(ii) there would be a permanent capital rebalance for 2014 for the purposes of calculating all dividends going forward; and

(iii) each member's share of the operating costs for both SSC and the Company would be changed from 75% for Valley Health and 25% for Augusta to Valley Health bearing a 69% share and Augusta a 31% share.

176. The Augusta January 2019 Proposal was rejected by Valley Health for reasons that:

(a) it was a material departure from the Dividend Policy to the detriment of Valley Health; and

(b) the constitutional documents for the Company provide for operational expenses to be dealt with at a **company** level and not borne directly by the **members**.

177. On or around 8 May 2019, the CEO of SSC made a further proposal (the ***"SSC* CEO 2019 Third Compromise Proposal"**)

(i) a $5,668,965 dividend would be declared and allocated between Valley Health and Augusta based on the Dividend Policy calculated based on the Loss Run as of 31 December 2018;

(ii) Valley Health would agree to a one-off lump sum payment of $250,000 being paid from its dividend proceeds to Augusta in full and final settlement of any issues relating to the Retained Earnings which could be theoretically said to be attributable to the Departed Members;

(iii) there would be a permanent capital rebalance for 2014;

(iv) each member's share of the operating costs for SSC would be changed from 75% for Valley Health and 25% for Augusta to Valley Health bearing a 69% share and Augusta a 31% share;

(v) going forward the Virginia Solution's operational costs would be borne 53% by Valley Health and 47% by Augusta.

178. On or around 8 May 2019, Valley Health confirmed its agreement to the SSC CEO 2019 Third Compromise Proposal.

179. On or around 23 May 2019, Augusta rejected the SSC CEO 2019 Third Compromise Proposal and made what was stated to be its final proposal (the **"Augusta May 2019 Proposal"**). This proposal was in the same terms as the Augusta January 2019 Proposal.

180. On 24 May 2019, the SSC CEO made another attempt at resolving the impasse and made a further proposal (the **"SSC CEO 2019 Fourth Compromise Proposal"**) whereby:

(i) a $5,668,965 dividend would be declared and allocated between Valley Health and Augusta based on the Dividend Policy calculated based on the Loss Run as of 31 December 2018;

(ii) the years 2008 through 2011 would be closed for dividend purposes; and

(iii) Valley Health would agree to a one-off lump sum payment of $250,000 being paid from its dividend proceeds to Augusta in full and final settlement of any issues relating to the Retained Earnings which could be theoretically said to be attributable to the Departed Members.

181. The SSC CEO 2019 Fourth Compromise Proposal was rejected by Augusta. The Board Minutes of June 2019 record that no agreement could be reached because from the perspective of August

Health the allocation of the '*forfeited retained earnings from departed members remained unaddressed.* "

182. On or around 8 November 2019, the Board approved a $3 million dividend, notwithstanding that the Actuary had recommended a dividend of $10,368,921 be declared.

183. The Petition was filed by Valley Health on 15 January 2020.

Findings of fact

184. The anodyne recitation of the events that preceded the presentation of the Petition belies the strain that this failure to agree on the distribution of the so-called departed members retained earnings put on the relationship between Valley Health and Augusta.

185. Having heard and seen the witnesses and considered all the evidence, including the witness statements which stood as their evidence - in - chief and the documents exhibited thereto, I say I am satisfied and find that there has been an irretrievable breakdown in the relationship between Valley Health and Augusta. There is no question that Augusta's stance on the question of the "*departed members retained earnings*" 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 and to consider that it would be impossible to reach agreement with Augusta on the issue of dividends - and latterly, on overhead costs - going forward.

186. I do not accept Mr. Potts' characterisation of the impasse with respect to the "departed members retained earnings" as *"an intermittent disagreement*" between the member representatives of Valley Health and Augusta as shareholders of the Company on the precise timing of potential dividend declarations and payments, and the precise allocation of potential dividend payments as between the two shareholders.

187. It was Augusta which was opposed and its opposition 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".* Augusta refused to retreat from its position that the so-called "departed members retained earnings" should be distributed 50:50 and it made a decision to approve dividends at the historic level of $2 million or so a year, whatever the Actuary's advice to the contrary, in the hope that Valley Health would withdraw.

188. This policy was exposed in the disclosure by Augusta of divers intra-company documents which demonstrated quite forcefully that Valley Health was correct to apprehend that their *"partner"* - as Valley Health and Augusta both referred to each other - was not acting in good faith and was seeking to use its veto power to force Valley Health into capitulating on the matter of the departed members retained earnings if it wished to have dividends declared in accordance with the Actuary's recommendation.

189. The document entitled "*Confidential Debrief*" which was written by Ms Mannix for her team in October 2017, a little over 6 months after the issue of the departed members retained earnings was first raised at the Finance Committee meeting, makes it quite clear that the posture adopted by Augusta was intended to exert what Ms Mannix described as "*leverage*". This leverage was sought to be exercised to gain an additional $3 million in profits for Augusta to which it was not entitled and/or to force Valley Health to withdraw from the Company and gain that windfall identified by onshore Counsel because *"(i) the remaining member is under no obligation to declare dividends to be credited in part to former members, and consequently could "wait it out," never declaring a dividend until after payment of the former member's separate account, which would then consist only of its paid in capital, with no interest": supra* para 102.

190. I say 'not entitled' because it is agreed by Augusta and its advisers that the only way to take Retained Earnings out of the Portfolio is through the Dividend Policy. The Board had in the past by special resolution dealt with the capital left behind by Fauquier according to each Member's equity in the Portfolio, exceptionally and by agreement, but that resolution at least respected the policy to reward Members for their long term investment in the Company. What Augusta proposed - a 50:50 split based on their shareholding in the Company - was unprincipled and proposed simply because Augusta did not think that it was fair for Valley Health to get the larger share of what might be the earnings on capital left behind by departed members. That is not to say that 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 principled. It was not.

191. It is not possible for Augusta to argue, as it has sought to do, that it was unaware, when it affirmed the Dividend Policy in the Fourth Participation Agreement as the means of getting money out of the Portfolio, that the departed members had left capital behind. It was well aware of that fact. Ms Mannix headed the Departing Members Committee and Ms Mannix herself ensured, when Fauquier's departure became imminent, that Fauquier be expelled on the ground of ineligibility so that its capital was forfeit, rather than permitting it to withdraw on the ground of change of ownership which might have allowed a return of its capital.

192. At the time she wrote to Mr. Merrill, who had suggested the latter option:

> "*As a fiduciary of VS, why would we want to decapitalize the organization?...Other than we all love Rodger and Fauquier has been a good partner for the short time they have been in the Captive, why would we not follow the rules and intent of the principles set forth and deviate from that corporate doctrine?"*

193. Ms Mannix's complaint, that the issue of departed members retained earnings should have been 'lifted up' to the Board for discussion when the new rules were being made for the two member captive, intended to convey that there had been a lack of transparency which deprived Augusta of necessary information, rings hollow against the background of Ms Mannix's knowledge that each departing member had left capital behind.

194. Ms Mannix must be taken to have understood that whatever profits there were in the portfolio, however derived, represent Retained Earnings which have to be declared and allocated according to the Dividend Policy per their contractual arrangements with Valley Health. The evidence admits no other conclusion. Thus, in a 6 April 2017 exchange with Ms Moore, Ms Mannix ran through a series of questions and as she sought to find ways, as it appears to me, to bolster what she recognised was a bad argument:

> *"Ok - let me ask the question differently - and remember this is just an internal exercise to strengthen our rationale. What are the hypothetical arguments to objecting to a 50-50 split?*
>
> *Indulge me here. I need your critical thinking on this.*
>
> *Q. What are the reasons not to share RE of departed members equally, 50-50, across the 2 members?*
>
> *A. Because our business model is that RE can only be distributed based on established dividend policy. It's been our practice for almost 15 years.*
>
> *R. Agreed. We do have an established policy that has worked very well for the company. However, when we developed the dividend policy, it did not contemplate how to dispose of the RE of departed members to remaining members.*
>
> *A. Valley Health distributed significantly more capital than Augusta, therefore it is only fair and equitable that we are entitled to a greater proportion of the earnings, which is consistent with the dividend policy.*
>
> *R. Factually that is true (and I got this argument from you). However, the retained earnings of the departed members are based on their capital and their performance, none of that is based on the performance or capital contribution of the remaining members. And since the remaining members are each equal shareholders, the RE related to the departed members should be distributed based on the shareholder model, not the dividend model.*
>
> *A. But VH has been the largest shareholder for the life of the company. We have contributed the largest amount of capital. We initiated the start up of this company. We have paid the largest premiums of any member. We should get some recognition for this.*
>
> *R.????*
>
> *See where I am going with this Sharon? I want to anticipate every possible objection they could have and be prepared with a rational response.… I don't have access to*

the founding principles but is there anything in that document that might strengthen our position?"

195. Advice on that last question was provided by onshore counsel in an email sent to Ms Mannix and others, four days after Ms Mannix's 6 April email to Ms Moore. Counsel stated:

> *"1. VS's retained earnings, under GAAP and historical practices, consist of all of the profits of VS, regardless of the source of the profits. The profits could come from investment earnings, underwriting profits, or from extraordinary or unexpected items.*
>
> *2. There are no provisions in the Articles of Association, Participation Agreement or Dividend Policy (which is incorporated in and made part of the Participation Agreement) that state that such amounts are not part of retained earnings for purposes of the declaration of dividends, or other purposes…"*

196. Yet Ms Mannix in her October 2017 Confidential Debrief was still arguing for some other result.

Loss of Mutual Trust and Confidence

197. Although it has been framed by Augusta as an issue for me to decide, the Confidential Debrief demonstrates that Augusta, like Valley Health, considered there to be an irrecoverable loss of trust and confidence between the Members.

198. In it Ms Mannix made reference to the *"current conflict",* writing:

> *"I also think we are understandably <u>mired in the conflict</u> (and reviewing the actuarial sensitivity analyses) and it is now time for us to "come up for air" and spend more time on our long term play here and our Plan B strategy.*
>
> *Personally, I think <u>a lot of damage has been done in the relationship and that trust has been breached to a degree that it will be hard to get it back</u>. There is an executive in the mix from VH that I do not trust at all, and I do not think my position will change on that moving forward. As for Mark Cain, I think I do need to meet with him one on one to assess his perspective of these business issues more clearly, assess where the relationship is, and <u>gauge whether Augusta can find an acceptable level of trust moving forward</u>.*
>
> *The prospect of VS breaking up was initially intolerable to me. But as I reflect on what has transpired, <u>the lack of trust in the company</u>, and Augusta's strong feeling of not being treated fairly, <u>is it realistic to think we can go on from here and continue to build, develop and strengthen this company?</u> I don't think so.*
>
> *At this point, I would recommend that we spend some time internally on developing an acceptable RE distribution plan. In the meantime, we just move forward and continue to participate in the company as we have historically, and let this play out (rebalance the*

capital, meet with reinsurers, <u>pay out conservative dividends as we have historically done, etc and wait for VH to withdraw."</u> [emphasis mine]

*"…in the meantime, Augusta develops a detailed Plan B for a single member captive and we need to be prepared to activate it. The Plan B should have a timeframe associated with it as well; beginning on the day VH gives notice. I'd like to develop this Plan B **<u>now</u>** because I also am concerned about the SSC corporate office, and if it might eventually implode as a result of this conflict…"*

199. Ms Mannix also set out Augusta's options as she saw them, including conceding the fight over the so-called "*departed members retained earnings*" and moving forward. She assessed the pros and cons as follows:

"a. Pros

i. Allows members to divert energies away from conflict and focus on the future of the company

ii. Allows members to develop and implement a dividend distribution plan

iii. Preserves company for an indeterminate period of time

iv. Avoids arbitration and associated legal fees

b. Cons

i. Requires Augusta Health to forfeit $1.8 million that it believes is rightly belonging to its ownership position in keeping with the founding principles of the company

ii. Concedes an incremental equity position in the company which will impact future dividends

iii. <u>Forfeits all leverage in the relationship</u>

iv. Does not address the underlying issue of distrust and underlying issue of lack of fairness. (In other words, this move is <u>unlikely to resolve the distrust and feelings of bad faith that have developed amongst the partners</u>…)

v. Does <u>not eliminate conflict around dividend distribution plan</u> and an objective discussion amongst the members on what should be the sensible amount of retained earnings "set aside". Valley Health is clearly on a mission to drain the RE out of the company. Keep in mind new doctrine changes still require the retained earnings of the departing member to remain in the company until all departing *members claims are paid off. <u>If AH is the "last man standing", then it could be years and years before VH has access to these funds.</u>"* [emphasis mime]

200. Ms Mannix then went on to consider the pros and cons of Augusta standing still writing this:

> *"a. Pros*
> *i Keeps retained earnings in the company*
> *ii Maintains leverage for Augusta Health to eventually get its fair share of the retained earnings of the departed members*
> *iii Buys time*
> *iv Is compliant with guiding principles of the founding members as well as policies and procedures*
> *b. Cons*
> *i Antagonizes the other member*
> *ii Could lead to arbitration and legal expenses*
> *iii Does not guarantee that Augusta will prevail on the $1.8 million in dispute"*

201. The evidence makes it plain that Augusta decided to stand still, develop their Plan B and wait for Valley Health to withdraw.

202. Given Augusta's conduct and the contents of Ms Mannix's Confidential Debrief, I adopt Mr. Levy's submission that it is difficult really to see what there is between the parties on the Petition as they are in "*violent agreement"* that they do not get on and do not trust each other to manage the affairs of Virginia.

203. Mr. Potts has sought to argue that the lack of trust and confidence was a personal matter between Ms Mannix and Mr. Merrill - undoubtedly "*the executive in the mix from VH"* who she did not trust at all - and not between the corporate members *per se*.

204. Corporations are run by people and, in these two corporations, the people at the helm have lost trust and confidence in each other.

205. On this point, I would refer to Augusta's letter to Valley Health, through offshore Counsel in July 2020, which made a proffer of terms on which Augusta considered it might be able to "repair the relationship" with Valley Health following the appointment of Mr. Nantz in June 2020 as its CEO, further acknowledging, as Mr. Levy submits, that the relationship was broken. Those terms, which included a variation of the existing Participation Agreement, were rejected by Mr. Nantz on behalf of Valley Health on the basis that Valley Health's position had not changed and it still had no trust and confidence in Augusta.

Was the Company a Quasi-Partnership?

206. It is plain from the evidence that the question whether there had been a breakdown in the relationship of been a loss of trust and confidence between the Members, though denied by

Augusta in its Defence, was never seriously in issue. It seems plain too that that Augusta considered that Augusta and Valley Health were partners in a Company which had been established to meet the member's insurance needs over the long term and built on a relationship mutual trust.

207. Mr. Potts argues, however, that the assertions by the various witnesses with respect to "*their subjective, personal emotions",* or "*their individual, personal opinions*" cannot provide any material assistance to the Court in *"its objective assessment of the corporate relationship between Valley Health and Augusta as rational, 'not-for-profit' entities".* In other words, I should discount Ms Mannix's own assertion in the 'Confidential Debrief' that Valley Health and Augusta were partners and give the statements made by the various CEOs of the founding members of the Company, which suggest they were partners, no forensic weight.

208. Among the email exchanges on which Valley Health relies, is a 21 April 2004 email from Chris Lumsden, then CEO of Halifax, to the then CEO of Valley Health where he stated:

> *"[Halifax] is making a formal recommendation to our Board this Monday regarding participation in the proposed Insurance Captive. This proposal is contingent on a number of issues being resolved upfront and others most likely not being resolved until the group is formally together.*
>
> *Financially, the Captive looks long term much more financially attractive to HRHS than the commercial market. However, we recognize that we <u>are taking somewhat of a leap of faith on the project</u> if we don't have every single issue resolved at this time."*

209. Mr. Levy makes the point, which I accept, that taking a leap of faith is more suggestive of a personal relationship between the founding members than a purely commercial one where all matters are negotiated at arm's length and documented before decisions are made.

210. Mr. Lumsden's email prompted Mr. Halseth, then CEO of Valley Health, to say in response:

> *"It looks like this will be a major agenda item for our May 4 VHS Board meeting. The plan is for Mark Cain to be there at the meeting to present information and to answer questions. I do not have a feel, yet, for how this will go, expecting the key questions to be around the issue of whether this <u>expanded development of our self insurance approach (with partners)</u> is the direction VHS should now head"* [emphasis mine]

speaking to Valley Health's decision to move forward with a group captive - with partners- rather than going it alone.

211. The former CEO of Augusta said this:

> *"As a further update from MJH, we spent most of today reviewing the information that we have. We are comfortable <u>with the partners,</u> believe that concept is a good one and will*

recommend participation to our finance committee and board over the next two weeks assuming that we all remain interested and that we can all agree on the details."

212. When Halifax ended its association with the Company, the minutes of the last Board meeting attended by its CEO Chris Lumsden on 13 November 2013, chaired by Ms Mannix record the following resolutions among others that were made:

> *"THAT Chris A. Lumsden was instrumental in the creation of nine guiding principles to fulfill the Virginia Solution mission of serving its member's needs"*

and

> *"THAT Mr. Lumsden nurtured <u>relationships of trust and collaboration</u> amongst all of the member hospitals"* [emphasis mine]

213. The opinions of the member CEO's may not be determinative on their own perhaps, but taken together with all the other evidence relating to the origin and structure of the Company and how the business of the Company was conducted, 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, is overwhelming.

214. The *indicia* of quasi-partnership, independent of the " *personal opinions"* of those who were and are the directing minds and will of the Members, include the fact that

(i) the CEOs of the founding members were all known to each other as the Health systems they ran were part of the VHHA, an association in which Valley Health and Augusta remain active members and participants;

(ii) despite their disparate sizes and projected investments in the Portfolio through which their insurance would be purchased, they agreed that they would be equal shareholders and have an equal voice in the governance of the Company and that their investment in the Portfolio would be reflected in the returns on their capital which would be paid out as dividends;

(iii) at the time the Company was established, the entirety of their agreement was not, as in *Re Coroin,* "*fully negotiated and drafted"* in "*lengthy and complex*" contractual documents. The principles by which the Company would be run were agreed in a meeting and summarised by the Actuary in an email;

(iv) these principles were subsequently *"clarified and refined"* per Mr. Merrill, in 2009 as the Mission and Guiding Principles, in response to the possibility of new members joining the captive;

(v) the criteria for admission which finds expression in the Guiding Principles is *'shared values'* which would not be a usual feature of a purely commercial relationship and is consistent with a Company built on a foundation of trust and confidence;

(vi) significantly, even after the Company became a two-member captive, Valley Health and Augusta agreed not to change the structure of the Company, despite the warning from onshore counsel of the potential for *bad behaviour,* which is consistent with a company whose business is conducted on the basis of mutual trust and confidence.

215. It is, as Mr. Levy says, a paradigm case of quasi-partnership.

Legitimate Expectation

216. I should not think it necessary to address the question of whether Valley Health had a legitimate expectation that dividends would be paid in accordance with the Dividend Policy when the evidence so clearly demonstrates that Augusta was acting in bad faith in refusing to follow the Actuary's advice with respect to the amount to be declared and had decided to "stand still" and approve dividends at the historical level in the hope that Valley Health would capitulate to its demands that the departed members retained earnings be allocated on a 50:50 basis, contrary to that Policy, or withdraw.

217. But I do so find: The payment of dividends to members out of the profit generated by the Portfolio was one of the advantages for establishing a captive insurance company. It was agreed by the members in 2004 that dividends would be declared by the Board based on capital needs and profitability by a formula that would recognise each members' capital contribution. The members had an expectation, based on the Actuary's advice, that once there was sufficient data with respect to the Company's loss experience to permit the Actuary to estimate the company's capital requirements and the profits available for distribution, the Portfolio would start to pay dividends.

218. It was agreed in December 2008 that from May 2009 onwards the Board, on an annual basis, would review retained earnings by policy year by reference to a report prepared by the Actuary, which would serve as the basis for any dividend declaration out of the assets of the Portfolio. Thereafter, the Board approved, and the members executed, the Participation Agreement and the Dividend Policy. From 2011 to 2014, the Board declared dividends based on the recommendation of the Actuary and the capital needs of Portfolio having regard to the criteria set out in the Dividend Policy. On the recommendation of the Actuary, the Board agreed to pause the payment of dividends in 2015 and 2016 for commercial reasons, but the Actuary and SSC were asked to formulate a distribution plan for 2017 to get the retained earnings out of the Portfolio.

219. In the premises, Valley Health had a reasonable expectation that Augusta would approve the dividends as recommended by the Actuary. The understanding between the members from inception was the Actuary would determine if the total funding (loss reserves plus capital) exceeded the funding necessary at 90% probability level, the excess would be returned to the

members as dividends and allocated according to the dividend formula. The practice of declaring dividends when and in the sum advised by the Actuary was well-established.

220. While Mr. Potts is correct that pursuant to the governing documents, the Board is not obliged to blindly follow the recommendation of the Actuary, I accept Mr. Levy's submission that there must be some commercial reason to do so, and not simply a decision *"to slow play dividends to force Valley Health out"* as Mr. Nantz termed Augusta's strategy.

221. The $6 million was not being retained in the Company to hedge against risk; it was being held, as has been said before, until Valley Health agreed to the allocation proposed by Augusta Health or walked away. It would be inequitable to allow Augusta to rely on its 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 would get the lion's share, which is all it amounts to.

222. The irony of this dispute is that the Dividend Policy was, on the evidence, designed to avoid "deadlocks" on getting value out of the Company.

223. It was a policy designed to reward long-term commitment to the Company by weighting the value of the capital invested in the Company by members and the prudent management of risk. I am 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 - which would necessarily, in my view, include the right to benefit in proportion to its investment from the earnings left by those who did not - by having dividends declared and allocated between them as agreed.

224. Mr. Potts submitted, *inter alia*, that the Company is not deadlocked because, to the extent that Valley Health and Augusta had "areas of disagreement" at the commencement date of these proceedings in January 2020 or at the trial itself in March 2021, those areas of disagreement have not distracted from the primary business activities or the ordinary business of the Company and its ordinary business activities, on an agreed basis, including the business of providing insurance, the business of paying insurance claims and the business of procuring reinsurance.

225. That submission, to which I will return, ignores the point that the result of the conducting of the Company's ordinary business has been the creation of retained earnings of $31 million over the years since its inception. It generated profits of $8 million in 2016 alone, the year before the controversy about departed members retained earnings reared its head. These monies have to be removed. It is part of the business model. Augusta accepts it is the business model, as Ms Moore acknowledged in her 29 March 2017 email to Ms Mannix:

> *"So, we agreed that the VS board needs to reduce the amount of retained earnings in the company= it's how the company is designed to operate."*

226. The Business Plan prepared by the Actuary when the Company was being established made the point that the advantage of owning a captive was that the members paid premiums, as they would if they bought insurance in the open market, but with the advantage being that the members earn profits on their premiums which would be invested and build equity in the captive. The Dividend Policy agreed in 2004, formalised in 2009 and amended in 2017, was the agreed way of removing profits from the Company.

227. Although much was said by Augusta and on its behalf about the fact that both health care systems were not-for-profit institutions, the emphasis was misplaced as this Cayman Islands captive insurance company established by those institutions was always intended to return a profit to its members.

Clean Hands

228. This issue arises because, as explained by Lord Briggs in *Lau v Chu* at [64]:

> *"Just and equitable winding-up is a statutory remedy, albeit of an essentially equitable nature. The clean hands doctrine finds appropriate expression in this context by the requirement, expressed in the Ebrahimi case, that the applicant should not have been the sole cause of the breakdown in trust and confidence or of the deadlock: see para 19 above. The Board sees no reason to disturb that well-known, long standing analysis from the highest authority."*

229. Was the loss of confidence attributable to Valley Health's conduct in seeking a mega-dividend just when Augusta was coming off a bad loss year and "*seeking to drain all the retained earnings"* out of Augusta?

230. The answer is clearly no.

231. The Actuary and the CEO of SSC had been asked by the Board to come up with a distribution plan for the Retained Earnings. It was the Actuary, charged by the Company with assessing risk to ensure that the Company is capitalised *"to the 90th percentile"* and with determining how much of the Retained Earnings might be required to meet future risks - determining *the "sensible amount of retained earnings to be set aside"* - who recommended the dividends which were opposed by Augusta.

232. Valley Health was acting on the Actuary's advice as anticipated by the Dividend Policy.

233. In coming to the conclusion that Valley Health was on a mission to drain the Retained Earnings out of the Company, Ms Mannix must have also come to the conclusion that the Actuary, who she had hitherto respected and admired, was now acting in Valley Health's interest and not rendering *bona fide* advice to the members on the amount of Retained Earnings that should be taken out of the Company. The suggestion of partisanship or *mala fides* on the part of the Actuary is not borne out by the evidence. Mr. Potts says the Actuary was not called as a witness so his

bona fides could not be tested on cross-examination but, short of the Actuary having a Perry Mason moment, it is difficult to see how his *viva voce* testimony would add anything.

234. In rejecting the suggestion that the Actuary had aligned himself with Valley Health, I rely on Ms Mannix's own view of the Actuary, before she became convinced that Augusta was entitled to a half share of the "*departed members retained earnings"*, that he was "*Switzerland*", meaning neutral, as this is consistent with his long association with the Company and borne out by his repeated statements, recorded in the Minutes of divers meetings of Board, that any change in policy was a matter for the Members.

235. 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 which provided that the Board "*<u>shall not be required to declare a dividend</u> even if the annual review would suggest that amounts are available to distribute as dividends".* All of Augusta's 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 members retained earnings under the Dividend Policy. Ms. Mannix had not ring-fenced that sum because she was, as she stated in her affidavit, making decisions which took *"into account projected future activities, changes in membership and confidence level".*

236. That was the Actuary's role and he had performed the requisite risk analysis taking all those matters into account on each occasion that he recommended a dividend.

237. The Actuary made the point repeatedly that the size of the Retained Earnings was a problem for the Company as it was driving decisions by the members. The extent to which Augusta's decision-making was being driven by the size of the Retained Earnings is clear from Augusta's decision to pursue Plan B.

238. Augusta made many other allegations against Valley Health which are intended to show that Valley Health did not file the Petition with clean hands. I do not consider those allegations to be relevant and/or arguable with respect to the issue and I do not propose to deal with them.

239. I am satisfied and find that the breakdown in trust and confidence was entirely due to the stance taken by Augusta when it failed to persuade Valley Health and the consultants that the so-called departed members retained earnings should be allocated other than in accordance with the Dividend Policy.

240. Even if Valley Health had been partially to blame by seeking a dividend distribution of $17 million in the circumstances where Augusta would have been disadvantaged, it would not be a bar to a winding up order being made on the just and equitable ground.

241. The principle was elucidated in *Ebrahimi* case and is summarised in *Lau v Chu* at [19]:

"The Ebrahimi case reinforces the principle that an applicant for a just and equitable winding-up is not barred from his remedy merely because the breakdown or deadlock upon which he relies has been caused to some extent by his own fault. As Lord Cross put it, at pp 383-384:

"People do not become partners unless they have confidence in one another and it is of the essence of the relationship that mutual confidence is maintained. If neither has any longer confidence in the other so that they cannot work together in the way originally contemplated then the relationship should be ended— unless, indeed, the party who wishes to end it has been solely responsible for the situation which has arisen.""

242. The evidence shows, however, that the $17 million mega-dividend was ultimately not the matter which caused Augusta to shift gears but rather its desire to improve its earnings by getting a greater share of the $6 million in retained earnings which it maintained had been forfeit by the departed members.

Functional Deadlock

243. As already mentioned above (*supra* para 224) Mr. Potts submits that there was not deadlock *"of the paralysing kind"* as the Company was able to continue with its primary business and conduct its ordinary business activities, on an agreed basis, including the business of providing insurance, the business of paying insurance claims and the business of procuring reinsurance.

244. In the circumstances where I have found that there is an irretrievable breakdown in mutual trust and confidence, I do not think it necessary to embark upon any inquiry as to whether at the time of the trial there existed a functional deadlock at the Board and Shareholder level. It is unnecessary to do so given the observations of Lord Briggs *in Chu v Lau* at paras 15- 17 that:

"15. Secondly, where the company is a corporate quasi-partnership, an irretrievable breakdown in trust and confidence between the participating members may justify a just and equitable winding-up, essentially on the same grounds as would justify the dissolution of a true partnership. This jurisprudence was developed as an aspect of the law of partnership in England in the mid-19th Century, and is exemplified in the following passage from the judgment of Sir John Romilly MR in Harrison v Tennant (1856) 21 Beav 482, at 496-497:

"I do not base my decision upon any particular reported case, but upon the principle that the circumstances under which the parties entered into the partnership have, by matters over which they have no control, materially altered, that these altered circumstances have, combined with the conduct of the parties themselves, produced a mistrust which the Court cannot say is unreasonable; and that, taking all these things together, it is impossible that the partnership can be conducted upon the footing on which it was originally

contemplated, without injury to all these persons concerned, and that taking all these matters together, it makes this a case in which, in my opinion, it is the duty of the Court to pronounce a decree for the dissolution of the partnership."

It is clear, for example from Pease v Hewitt (1862) 31 Beav 22 and Atwood v Maude (1868) LR 3 Ch App 369, at p 373, that a dissolution of a partnership might be ordered even where both parties were to blame for the breakdown in mutual trust and confidence.

16. This ground for the dissolution of a partnership was developed as the basis for the just and equitable winding-up of a company in the UK in the early 20th century, where the relationship between the members approximated to that of partners. Landmark cases include Symington v Symingtons' Quarries Ltd (1905) 8 F121, a decision of the Scottish Court of Session, and in In re Yenidje Tobacco Company Ltd [1916] 2 Ch 426, a decision of the English Court of Appeal. In the latter case, at p 432, speaking of two businessmen holding equal shares in the company who had spectacularly fallen out, Lord Cozens-Hardy MR said:

"If ever there was a case of deadlock I think it exists here; but, whether it exists or not, I think the circumstances are such that we ought to apply, if necessary, the analogy of the partnership law and to say that this company is now in a state which could not have been contemplated by the parties when the company was formed and which ought to be terminated as soon as possible."

17. The important potential distinction between the two types of breakdown case is this. If there is a complete functional deadlock, then a winding-up may be ordered regardless whether the company is a corporate quasi-partnership. But if the company is of that type, then a breakdown of trust and confidence may justify a winding-up even where there may not be a complete functional deadlock. In the former case winding-up is a remedy for paralysis. In the latter it is the response of equity to a state of affairs between individuals who agreed to work together on the basis of mutual trust and confidence where that trust and confidence has completely gone. But of course both may exist together, and a complete breakdown in trust and confidence may well be the cause of functional deadlock, in a two party quasi-partnership like the present."

245. Valley Health need not show there is a functional deadlock as the Company is in a state which could not have been contemplated by the parties when the Company was formed.

246. The breakdown in the relationship between Valley Health and Augusta is demonstrably irretrievable and, in so holding, I am content to adopt Ms Mannix's own assessment that is it not

realistic to think Valley Health and Augusta can go on from here and continue to build, develop and strengthen this Company. The proper exercise of the Court's discretion is to wind it up.

Alternative Remedies

247. The final issue for resolution is, if the Court finds that a case for winding-up the Company on the just and equitable ground has been established, to what extent (if any) do one or more alternative remedies exist which make it unreasonable for Valley Health to continue to seek a winding-up?

248. Valley Health's position is that no alternative remedies exist. Augusta's position is that Valley Health may voluntarily withdraw from the Company pursuant to the provisions for termination of membership in the Fourth A&R Participation Agreement which includes the *"special provisions relating to termination of Membership when there are only two Members"*.

249. The effect of those provisions is that if Valley Health were to withdraw, it would be required to give 180 days' written notice to the Company of an intention to withdraw, following which Augusta would have an additional 90 days to notify Valley Health whether it wishes to dissolve Virginia and wind up its affairs.

250. Augusta has already indicated that it would wish to continue as a single member captive. The effect of that is that the provisions of Clause 7.9 (d) to (m) would govern Valley Health's withdrawal:

(i) Virginia would establish a Separate Account for Valley Health which would be credited with the redemption price for Valley Health's shares in the Company and credited with Valley Health's Share of Retained Earnings as defined in section 7.9(f);

(ii) Such amount would be calculated by the Actuary in the same way in which the Members' Share of Retained Earnings have been calculated in prior years, based on the retained earnings of Company as reflected in the audited financial statement for the previous year such that Valley Health would not be entitled to Retained Earnings generated since the date of the last audited financial statements;

(iii) The balance of the Separate Account would not be paid to Valley Health until 180 days following the closure by the Board of all claims made against Valley Health under the policies issued by the Company and then the balance would only be paid in five equal annual instalments thereafter;

(iv) Notwithstanding that it could take up to 20 years for Valley Health to receive its Separate Account balance, Valley Health would not be entitled to any interest or investment income generated on the Separate Account balance for that period.

251. An analysis of what would happen if Valley Health withdrew, performed by the Actuary at Valley Health's request, showed that if Valley were to voluntarily withdrawal then not only would it not receive any of its share of the assets for 10-15 years but it would also suffer a "hair cut" of around $5.8m or, if the parties agreed to distribute the balance of the retained earnings before withdrawal took effect - which would require Augusta's agreement - a "hair cut" of around $3m. The beneficiary of Valley Health's "hair cut" would be Augusta.

252. This is the windfall which onshore counsel had been at pains to point out could lead to one member behaving badly and which prompted counsel to advocate for changes to the governing documents that would disincentivize "*bad behaviour,*" changes which Valley Health and Augusta rejected at the time on the basis that the Company historically had acted by consensus, that there were arbitration provisions contained in the Governing Documents that could be invoked by either member and because Mr. Merrill had been, as he wrote to Ms Mannix, *"guardedly optimistic that AH and VHS will work for the good of VS and respective institutions".*

253. The effect of the restrictions in Clause 7.9 is that Valley Health cannot take out its allocable share of the assets (and liabilities) of the Company and go elsewhere as a result of the breakdown in trust and confidence between the members.

254. I accept Mr. Levy's submission, in this instance not hyperbolic, that a voluntary withdrawal as an alternative remedy would be massively to Valley Health's detriment while being of massive benefit to Augusta as *"last man standing".* In the circumstances where Augusta had set its face against complying with the documents governing the relationship between it and Valley Health with a view to achieving this benefit for itself, 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.

255. The fact there is an available remedy does not preclude the making of a winding up order unless the petitioner is acting unreasonably in not pursuing that remedy. Valley Health cannot be said to be acting unreasonably in failing to pursue that remedy. On a winding up, as Mr. Levy submits, each member would receive their contractual share of the surplus assets. Any remedy proposed by Augusta which offered less than that would be properly rejected by Valley Health.

Conclusion

256. In his skeleton argument, Mr. Potts submitted that it would require truly exceptional, or truly egregious, circumstances for the Court to take the unprecedented step of ordering the compulsory liquidation of a solvent insurance company, having regard to the public interest and public policy considerations under Cayman Islands law.

257. In my judgment, there are no public interest or public policy considerations relevant to the exercise of my discretion. This is a two member captive insurance company whose members can

purchase insurance on the open market as they did before the captive was established. The members have fallen out and the irretrievable loss of mutual trust and confidence, under Cayman Islands law, justifies the grant to Valley Health of the remedy it seeks and I make an order that the Company and its Segregated Portfolio A be wound up.

258. I appoint Messrs Alex Lawson and Christopher Kennedy of Alvarez & Marsal, who have consented to act, joint liquidators of the Company and its Segregated Portfolio A on the terms set out in the Petition at paragraphs 98 to 103.

259. I will hear Counsel on the form of order and on costs, unless agreed.

260. It only remains for me to thank Counsel and the parties for their patience in awaiting delivery of the judgment.

DATED THIS 10th FEBRUARY, 2022

RAMSAY-HALE J