

New Hampshire Insurance Company

Appellant

v.

Magellan Reinsurance Company Limited

Respondent

FROM

**THE COURT OF APPEAL OF
THE TURKS AND CAICOS ISLANDS**

JUDGMENT OF THE LORDS OF THE JUDICIAL
COMMITTEE OF THE PRIVY COUNCIL

Delivered the 15th July 2009

Present at the hearing:-

Lord Phillips of Matravvers
Lord Brown of Eaton-under-Heywood
Lord Mance

*[Delivered by **Lord Mance**]*

1. The issue on this appeal is whether New Hampshire Insurance Company (“New Hampshire”) has locus standi to present a winding up petition in respect of its reinsurers, Magellan Reinsurance Company Limited (“Magellan”). Under the Turks and Caicos Islands Companies Ordinance, that issue depends upon whether New Hampshire was a “creditor” of Magellan. This in turn depends upon whether Magellan’s breach of a reinsurance obligation to pay monies into a trust account held by Texas Commerce Bank constituted New Hampshire a creditor of Magellan. There has been no extension of any right to petition to contingent creditors or creditors with unliquidated claims. (Turks and

Caicos law remains in this respect as English law was at the time of the decision in *Re Pen-y-Van Colliery Company* (1877) 6 Ch D 477.)

2. Magellan reinsured New Hampshire with effect from 1 October 1995 under a reinsurance agreement dated 17 January 1997 in respect of a book of vehicle service contract reimbursement policies administered by Warrantech Automotive, Inc. New Hampshire appears to have been fronting, since (in return for overriding commission) it ceded 100% of the risk to Magellan for 100% of the premium, and Magellan and Warrantech's sub-agents, Automotive Financial Group, have at least a "shared ultimate ownership".

3. Articles VII and VIII of the reinsurance provided:

"ARTICLE VII – REPORTS AND REMITTANCES

A. The company shall provide monthly accounts and reports within 60 days from the end of each month and shall render to the Reinsurer, on a calendar monthly basis within 60 days from the end of each calendar month, an account current showing the following:

1. Gross Written Premiums
2. Ceding Commission
3. Losses Paid
4. Loss Expense Paid
5. Unearned Premium Reserves
6. Outstanding Loss Reserves

B. The Company shall credit the Reinsurer with the Gross Written Premiums less the Ceding commission and Loss and Loss Expenses paid. The company will remit the balance within 45 days of receipt from Warrantech. The Reinsurer will pay any amounts due within 45 days after receiving the account current.

ARTICLE VIII – TRUST ACCOUNT

The reinsurer will provide the Company with a Trust Agreement acceptable to the Company and its regulatory authorities. The Reinsurer shall be required to deposit an amount equal to 100% of the total unearned premium reserve plus the outstanding loss reserves as determined by the Company at the end of each calendar quarter."

Article IV defines "Unearned Premium Reserve" as "the premium represented by the unexpired portion of the Policies in force as of

any specified date, as determined by the Company [i.e. New Hampshire]” and “Outstanding Loss Reserves” as “losses reported to the Company which have been reserved but are unpaid at any specified date”.

4. A trust agreement between Magellan as Grantor, New Hampshire as Beneficiary and Texas Commerce Bank, NA as Trustee was entered into dated 11 April 1997. It provided inter alia:

“Section I. Deposit of Assets to the Trust Account

(a) The Grantor shall establish the Trust Account and the Trustee shall administer the Trust account in its name as Trustee for the Beneficiary. The Trust Account shall be subject to withdrawal by the Beneficiary solely as provided herein.

.....

Section 2. Withdrawal of Assets from the trust Account

(a) Without notice to the Grantor, the Beneficiary shall have the right, at any time and from time to time, to withdraw from the Trust Account, upon written notice to the Trustee (the “Withdrawal Notice”), such Assets as are specified in such Withdrawal Notice. The Withdrawal Notice may designate a third party (the “Designee”) (to whom Assets specified therein shall be delivered and may condition delivery of such Assets to such Designee upon receipt, and deposit to the Trust Account, of other Assets specified in such Withdrawal Notice. The Beneficiary need present no statement or document in addition to a Withdrawal Notice in order to withdraw any Assets; nor is said right of withdrawal or any other provision of this Agreement subject to any conditions or qualifications not contained in this Agreement.

(b) Upon receipt of a Withdrawal Notice, the Trustee shall immediately take any and all steps necessary to transfer the Assets specified in such Withdrawal Notice and shall deliver such assets to or for the account of the Beneficiary or such Designee as specified in such Withdrawal Notice.

(c) Subject to paragraph (2) of this Section 2 and to Section 4 of this Agreement, in the absence of a Withdrawal Notice the Trustee shall allow no substitution or withdrawal of any Asset from the Trust Account.

(d) The Trustee shall have no responsibility whatsoever to determine that any Assets withdrawn from the Trust Account pursuant to this Section 2 will be used or applied in the manner contemplated by Section 3 of this Agreement.

Section 3. Application of Assets

The Beneficiary hereby covenants to the Grantor that it shall use and apply any withdrawn Assets, without diminution because of the insolvency of the Beneficiary or the Grantor, for the following purposes only

(i) to pay or reimburse the Beneficiary for the Grantor's share under the Reinsurance Agreements regarding any losses and allocated loss expenses paid by the Beneficiary but not recovered from the Grantor, or for unearned premiums due to the Beneficiary, if not otherwise paid by the Grantor in accordance with the terms of the Reinsurance Agreements,

(ii) to make payment to the Grantor of any amounts held in the Trust Account that exceed 102% of the actual amount required to fund the Grantor's entire Obligations (as hereinafter defined), and

(iii) where the Beneficiary has received a Termination Notice (as hereinafter defined) pursuant to Section 10 of this Agreement and where the Grantor's entire Obligations remain unliquidated and undischarged ten days prior to the Termination Date (as hereinafter defined), to withdraw amounts equal to such Obligations and deposit such amounts in a separate account, in the name of the Beneficiary, in any United States bank or trust company, apart from its other assets, in trust for the uses and purposes specified in subparagraphs (i) and (ii) of this Section as may remain executory after such withdrawal and for any period after such Termination date. For the purposes of this subparagraph (iii), the phrase "the Trust Account" in subparagraph (ii) of this Section shall be deemed to read "the separate account" established pursuant to this subparagraph (iii).

Section 4. Redemption, Investment and Substitution of Assets

(a) The Trustee shall surrender for payment all maturing Assets and all Assets called for redemption and deposit the principal amount of the proceeds of any such payment to the Trust Account.

(b) From time to time, at the written order and direction of the Beneficiary, the Trustee shall invest Assets in the Trust Account in Eligible Securities.

(c) From time to time, subject to the prior written approval of the Beneficiary, the Grantor may direct the Trustee to substitute Eligible Securities for other Eligible Securities held in the Trust Account at such time. The Trustee shall have no responsibility whatsoever to determine the value of such substituted securities or that such substituted securities constitute Eligible Securities.

...

Section 5. The Income Account

All payments of interest and dividends actually received in respect of Assets in the Trusts Account shall be deposited by the Trustee subject to deduction of the Trustee's compensation and expenses as provided in Section 8 of the Agreement, in a separate account (the "Income Account") established and maintained by the Grantor at an office of the Trustee in Dallas. The Grantor shall have the right to withdraw funds from the Income Account at any time.

Section 6. Right to Vote Assets

The Trustee shall forward all annual and interim stockholder reports and all proxies and proxy materials relating to the Assets in the Trust Account to the Grantor. The Grantor shall have the full and unqualified right to vote any Assets in the Trust Account.

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Section 10. Termination of the Trust Account

(a) The Trust Account and this Agreement, except for the indemnities provided herein, may be terminated only after (i) the Grantor or the Beneficiary has given the Trustee written notice of its intention to terminate the Trust Account (the "Notice of Intention"), and (ii) the Trustee has given the Grantor and the Beneficiary the written notice specified in paragraph (b) of this Section 10. The Notice of Intention shall specify the date on which the notifying Party intends the Trust Account to terminate (the "Proposed Date").

(b) within ten Business Days following receipt by the Trustee of the Notice of Intention, the Trustee shall give written notification (the "Termination Notice") to the Beneficiary and the Grantor of the date (the "Termination Date") on which the Trust Account shall terminate. The Termination Date shall be (a) the Proposed Date (or if not a Business Day, the next Business Day thereafter), if the Proposed Date is at least 30 days but no more than 45 days subsequent to the date the Termination Notice is given; (b) 30 days subsequent to the date the Termination Notice is given (or if not a Business Day, the next Business Day thereafter), if the Proposed Date is fewer than 30 days subsequent to the date the Termination Notice is given; or (c) 45 days subsequent to the date the Termination Notice is given (or if not a Business Day, the next Business Day thereafter), if the Proposed Date is more than 45 days subsequent to the date the Termination Notice is given.

(c) On the Termination Date, upon receipt of written approval of the Beneficiary, the Trustee shall transfer to the Grantor any Assets remaining in the Trust Account, at which time all liability of the Trustee with respect to such Assets shall cease.

Section 11. Definitions.

...

The term "Obligations" shall mean, with respect to the Reinsurance Agreements, (a) losses and allocated loss expenses paid by the Beneficiary, but not recovered from the Grantor; (b) reserves for losses reported and outstanding, (c) reserves for losses incurred but not reported; (d) reserves for allocated loss expenses and (c) reserves for unearned premiums."

5. Monies were paid (in practice directly by New Hampshire) into the trust account, which had in it in excess of US\$2.5 million by the end of 2001. In April 2002 New Hampshire made a series of withdrawals, effectively emptying the account, in order, it explained, to cover unpaid losses due for settlement under the reinsurance. Correspondence ensued about the whole balance of account between the parties, with New Hampshire maintaining that Magellan was obliged to replenish the trust account and Magellan denying this and maintaining that New Hampshire's withdrawals included unsubstantiated claims.

6. On 30 September 2003 New Hampshire served a statutory demand asserting that Magellan had on 30 April 2002 incurred a debt of US\$1,400.459.45, consisting of a "shortfall in payment to trust account

required pursuant to reinsurance agreement of 17th January 1997”. the petition presented on 16 August 2004 referred to this demand and repeated that Magellan “is indebted to the Petitioner in the sum of US\$1,400.459.45 being the shortfall in a trust account pursuant to a reinsurance contract dated 17th January 1997”.

7. The petition came before the Chief Justice, who had to determine not only whether New Hampshire had locus standi, but also, if it had, whether there was a bona fide dispute as to the alleged shortfall and whether Magellan was unable to pay its debts as they fell due. He held that New Hampshire had locus standi, on the basis that Magellan had agreed to pay into the trust account a sum determined by New Hampshire, which New Hampshire was entitled to withdraw without notice and in respect of which New Hampshire had an equitable interest. Having heard cross-examination on affidavits, he went on to conclude that “a significant sum is due and owing by [Magellan] to the Trust account, and that the inspection of the records relating to the sample claims comes nowhere near to establishing otherwise”, and that there was “no bona fide dispute as to whether any sum is owing”. He further concluded that Magellan was “unable to pay its debts as they fall due in the ordinary course of business”, satisfying the criterion for winding up in s.93 of the Companies Ordinance.

8. The Court of Appeal allowed the appeal, holding that New Hampshire was not a creditor, first because the sum outstanding was not and never had been payable to it, and, secondly and more fundamentally, because “an obligation to provide security for a debt which may become payable” was not itself a debt. It added that “If there is a debt which has or may [sic - as noted above, the Turks and Caicos Companies Ordinance does not in fact refer to contingent creditors] become due directly from Magellan to New Hampshire, then that debt itself could in principle found a Petition, but that is not, for whatever reason, how New Hampshire puts its case”.

9. Mr David Marks QC for New Hampshire put the appeal before the Board on two main bases. First, the petition related to an obligation to pay into the trust account sums which were alleged and as a matter of fact proved to the Chief Justice’s satisfaction to be payable under the reinsurance. Second, and in any event, any sums payable into the trust account belonged in equity to New Hampshire, who could and should be treated accordingly as a creditor in respect of their payment into that account.

10. The first argument fails in the Board’s submission upon an analysis of articles VII and VIII of the reinsurance agreement and of the issue determined by the Chief Justice. Under article VII the primary expectation

was that any sums due either way after netting premiums against claims would be settled direct between the parties. The trust account to be established under article VIII was to hold unearned premium plus outstanding loss reserves (the latter by definition in article IV meaning losses reserved, but as yet unpaid). In the event that the primary payment mechanism provided by article VII did not for some reason operate, the trust account was however available for New Hampshire to draw on under the terms of section 3(i) of the trust agreement. On this basis, New Hampshire withdrew sums from the trust account in April 2002.

11. The fact that this put the trust account into deficit under article VIII does not demonstrate that New Hampshire was entitled to recover any further sums from Magellan under article VII of the reinsurance. The withdrawals made in April 2002 may have covered all claims actually payable at that date. It is true that, in the correspondence mentioned in paragraph 5 above, New Hampshire were asserting the contrary. In particular, on 17 December 2002 New Hampshire asserted a total shortfall in the trust account of US\$1,400,459.45 “of which \$647,439.34 is immediately due to [New Hampshire] for losses it has previously paid”, and enclosed schedules which indicate the balance of the alleged shortfall to be attributable to unearned premium reserve (US\$840,544.12). (It is unnecessary to examine why the last two figures in total exceed the first.) New Hampshire was thus treating as payable into the trust account under article VIII sums which were payable, contractually, under article VII. However, the figures were in issue, and the Chief Justice was – for whatever reason, as the Court of Appeal observed - asked to do no more than find whether there was a shortfall in the trust account. And this is all he did in paragraphs 14 to 16 of his judgment, when he expressed himself “quite satisfied that a significant sum is due and owing by [Megellan] to the Trust account”. He did not thereby find that there was any amount outstanding under the reinsurance by way of (a) paid claims after deducting earned premiums, as opposed to (b) unearned premium reserve plus outstanding loss reserves.

12. Mr Marks’s second submission thus arises for consideration. Assuming that all that was alleged and established before the Chief Justice was that there was a shortfall in the trust account as at 30 April 2002, did that entitle New Hampshire to petition as a creditor? It was not in dispute before the Board that a winding up petition may be presented by either the purely legal owner of a debt (*Parmalat Capital Finance Ltd. v. Food Holdings Ltd.* [2008] BPIR 641 (PC)) or by the equitable owner of whole or even part of a debt (*Re Steel Wing Company Limited* [1921] 1 Ch 349). In the present case, New Hampshire had a contractual right to have sums paid into the trust account where sums would have been held by Texas Commerce Bank as legal owner on the terms of the trust agreement.

13. Mr Marks submitted that New Hampshire was a creditor in respect of sums payable into the trust account, for one or more of three reasons. First, all sums in the account were held by Texas Commerce Bank as bare trustee for New Hampshire, second, New Hampshire had under section 2 of the trust agreement an unqualified right to withdraw any such sums from the account and/or, third, New Hampshire had under section 3(i) of the trust agreement the right to use any sums so withdrawn to meet losses payable under the reinsurance.

14. Mr Clutterbuck for Magellan submitted that all three reasons should be rejected as a matter of general principle. New Hampshire's contractual right to have sums paid into the trust account did not give it any legal interest in such sums. The only interest which could in equity constitute a person a creditor was an interest entitling that person to insist that a payment be made directly to him by the alleged debtor. Even a beneficiary under a bare trust had no such right, although he could under the principle in *Saunders v. Vautier* (1841) Cr & Ph 240 determine the trust, compel an assignment of any right held by the trustee and then petition. Mr Clutterbuck also referred the Board to *Re The Law Courts Chambers Company Limited* (1889) 61 LT 669. The present case might however be said to present a special feature, not present in any case to which the Board was referred, namely the existence of a contractual relationship entitling the petitioner to payment to the alleged trustee.

15. In the Board's view, it is unnecessary to consider further the position as it might be if the shortfall in payments into the trust account represented sums which, once paid into the trust account, could be said to belong in equity to New Hampshire. Assets in the trust account were not, in the Boards' view, held by Texas Bank Commerce as bare trustee for New Hampshire. The trust account was carefully designed to provide New Hampshire with security in respect of risks not yet run (the premium reserve) and risks not yet crystallised (losses reported and reserved, but not yet paid). Magellan's continuing interest in assets in the account was reflected in the provisions entitling it to receive income and dividends (section 5 of the trust agreement) and any capital gains (sections 4(a), read with 3(ii) and 10(c)), to vote any such assets (section 6) and, on termination after satisfaction of all its reinsurance obligations as defined to receive the balance of any assets remaining in the account (sections 10(c) and 3(iii)). These provisions are inconsistent with any notion that New Hampshire had an unconditional right to assets in the trust account.

16. New Hampshire's right under section 2 to withdraw assets from the trust account on written notice and without presenting any statement or document does not lead to any contrary conclusion. Unless and until such a

notice was given, it could not give New Hampshire any interest in assets in the trust account, and the intention was not that New Hampshire should be able to give notice at will. The bank as trustee was free of any duty to enquire into the legitimacy of any withdrawal. But under section 1(a) the trust account was “subject to withdrawal by the Beneficiary solely as provided herein”, and under section 3 New Hampshire covenanted to use and apply any withdrawn assets “for the following purposes only”. Those were, in summary, to pay or reimburse itself for losses payable under the reinsurance agreement, to pay Magellan any amount held in the trust account in excess of 102% of the actual amount required to fund Magellan’s entire obligations (that is, unpaid losses, loss reserves and unearned premium reserves) or, finally, to constitute another, separate trust account for the first two purposes. The intention was not therefore to give New Hampshire an unconditional right to give notice of withdrawal or unconditional entitlement in respect of any sums withdrawn. On the contrary, it was only entitled to withdraw assets for specific purposes.

17. New Hampshire’s right under section 3(i) to withdraw assets from the trust account in order to pay or reimburse itself for losses payable under the reinsurance agreement is also irrelevant on the facts, when the Chief Justice was not asked to, and did not, find that there were as at 30 April 2002 any unpaid losses due under article VII of the reinsurance agreement. It follows that there is no basis upon which it can be said that New Hampshire would have been entitled in equity to withdraw or have the further sums which the Chief Justice held that Magellan ought contractually to have paid into the trust account in order to secure New Hampshire in respect of rights which New Hampshire might have or acquire.

18. In these circumstances, the Court of Appeal was, in the Board’s view, correct to conclude that there was no basis upon which Magellan’s breach of the reinsurance contract in failing to make payments into the trust account could have constituted New Hampshire a creditor of Magellan, so as to entitle it to petition to wind Magellan up. On the basis on which the matter was put in the petition and determined before the Chief Justice, New Hampshire had at most a claim for damages for breach of contract, which could only have entitled New Hampshire to petition if first converted by judgment, award or agreement into a liquidated claim. The Board will therefore humbly advise Her Majesty that the appeal should be dismissed with costs.