

In an article published on Insurance Gateway, Donald Dinnie, director at Deneys Reitz Inc, describes the judgment of BMW Financial Services (South Africa) Pty Ltd vs Harding [2007] 4 All SA 716 (C) of the Cape High Court as a “comfort to cell-captive operators” in South Africa due to the fact that there are currently no legislation on cell-captives in the country.

Deneys Reitz set out the case as follows:

BMW Financial Services (“the Financier”) had instituted action against its debtor for delivery of a motor cycle, and payment of damages and other ancillary relief arising from an alleged breach of an instalment sales agreement concluded between the financier and that debtor.

One of the grounds on which the debtor opposed the relief was by way of a special plea arguing that the instalment sales agreement was void from inception because the financier traded as an insurer either on its own or in partnership or joint venture with Guardrisk Insurance Company Limited (“the insurer”) under the name and style of “BMW Insurance” without it or the partnership or joint venture being registered as an insurer in terms of the Short-term Insurance Act of 1998. Allegedly by virtue of that contravention, the instalment sale agreement and the insurance of contract which was concluded in respect of the vehicle were from inception null and void and against public policy.

It was argued [in court] that the instalment sale agreement and the insurance contract were not severable. The court found that contention without merit. The objective evidence was that the instalment sale agreement was concluded between the financier and the debtor and the insurance contract between the insurer and the debtor.

The financier’s principal business was to provide financial services to BMW dealerships. Procuring insurance cover for the vehicles in question was incidental. While the insurance contract was taken out pursuant to the instalment sale agreement, the two contracts are separate and distinct from each other and affected different parties and had different considerations.

The debtor also argued that the financier was estopped from denying that it trades as BMW Insurance.

It was common cause that after conclusion of the instalment sale agreement, the debtor completed the application for insurance. That was submitted to Glenrand MIB (the broker) who administered the scheme of insurance on behalf of the insurer. The broker issued the policy on behalf of the insurer. The debtor accepted the terms and conditions of the policy issued by the insurer and acknowledged receipt of the statutory notice issued in terms of the Short-term Insurance Act. That note furnished information regarding the broker, the insurer, the short-term insurance ombudsman and the Registrar.

No representation was made to the debtor that the financier traded as BMW Insurance.

The court was satisfied that the debtor could not have acted to its prejudice. In any case, the insurer met its obligations in terms of the insurance contract and accordingly, the debtor suffered no financial loss or prejudice.

EVIDENCE BEFORE THE COURT

The evidence before the court was as follows:

- That "BMW Insurance" was not a trading name as alleged by the debtor but rather an insurance product *underwritten* by the insurer and administered on its behalf by the broker.
- That the customer was under no obligation to take the insurance product marketed by the relevant dealership.

The court was required to determine whether the financier traded in partnership or in joint venture with the insurer.

There was a cell captive agreement between the financier and the insurer in terms of which the financier acquired shares of a particular class which regulated the special relationship between the financier and the insurer.

The Registrar of Short-term Insurance imposed certain conditions when registering the cell-captive shareholders of the insurer which included that:

- The insured should be insured with the insurer.
- The risk would be carried by the insurer.
- The risk would not be limited to funds available in the particular cell.
- Benefits would not be withheld due to non-performance of the re-insurers or the cell-captive shareholders. The insurer would then be ultimately liable to the insured in the event of cell-captive having insufficient funds in its cell to meet claims.

Evidence was presented to the court in respect of the structure commonly known as a cell-captive. The structure comprises a special class of ordinary shares in the insurer. Corporate clients wishing to make use of the structure acquire a particular number and class of those shares.

The structure allows the insurer to issue insurance policies to customers of larger corporate clients for a large and secure customer base and to allow those clients to involve themselves in the field of insurance by entitling them to have a say in the administration of the cell-captive and deriving a financial benefit from the cell-captive in the form of a dividend.

THE ROLE OF THE BROKER

The broker was appointed to:

- Administer the relevant cell-captive structure and to issue the policies,
- Collect premiums and process payment of the claims on behalf of the insurer. The premiums would be credited to the respective cell-captive from which the income was generated and expenses would be debited against that account. The balance would be available to meet claims in respect of the particular cell-captive. Any shortfall, whether in respect of the solvency ratio as stipulated by the Short-Term Insurance Act or in respect of claims, had to be made good by the corporate client or failing that, by the insurer.

A dividend is declared by the insurer subject to the profitability of the particular cell-captive. The insurer does not share the profits of cell-captive but receives an income for its administration and for carrying the risk and ultimately bears any losses.

The vehicle used by the parties to achieve the result referred to above was not in the form of a partnership or a joint venture. The structure created a special class of ordinary shares with special rights and obligations set out in agreement between the financier and the insurer and reinforced by conditions of registration imposed by the Registrar of Short-term Insurance.

The court referred to relevant authority to the effect that:

- A company has almost unlimited freedom to create the capital structure it desires.
- SA courts should not likely disregard a company's separate corporate personality but will try to give effect to it and uphold it.
- It is perfectly legitimate for parties to arrange their affairs in such a way to escape prohibitions imposed by statute provided that is not fraudulent.

The financier and the insurer concluded a pro-forma cell-captive shareholder's agreement which was approved and registered by the Registrar of Short-term Insurance. The arrangement had also been investigated by the Financial Services Board which found that the terms of the shareholder's agreement were acceptable.

DEBTOR'S CHALLENGE

The debtor challenged the validity of the shareholder's agreement. The court found that while some of the terms may offend the debtor's sense of proprietary and fairness, that is not sufficient grounds to have it declared against public policy and therefore unenforceable. In the absence of proof to the contrary, the court assumed that the shareholder's agreement correctly reflected the true intention of the parties.

The court was satisfied, having regard to the principles referred to above, and on a proper construction of the cell-captive shareholder's agreement that the intention was *at all times* that the special arrangement would be governed in terms of the shareholder's agreement, as regulated by the Company's Act and not in terms of a partnership agreement. While the terminology of "partnering" may have been used in promotional material that was of no consequence to the true relationship between the parties.

CONCLUSION BY COURT

The court accordingly concluded that the captive shareholder's agreement did not fall foul of the provisions of the Company's Act or the Short-term Insurance Act.

Institutions (which are not insurers) which "team up" with an insurer in providing insurance products should take care to ensure that:

- The institution and the relevant marketing material for the product contain *no* representations that the institution is the underwriter in respect of the product.
- All marketing material and the policy document itself should clearly identify the underwriter.
- The insurance contract should be separate and distinct contract from any other agreements which that institution

concludes with its customers.

- To the extent that the product name contains any reference to insurance or insurer it is made clear that it is the product name and not the trading name of the financial institution.
- In entering into a cell-captive arrangement, an appropriate shareholder agreement is in place.