

Petitioner
Mary-Lou Gallegos
First Affidavit
[] of [] 2003

IN THE GRAND COURT OF THE CAYMAN ISLANDS

488
CAUSE NO: OF 2003

IN THE MATTER OF THE COMPANIES LAW (2003 REVISION)

AND IN THE MATTER OF THE INSURANCE LAW (2001 REVISION)

AND IN THE MATTER OF PEGASUS INSURANCE COMPANY



PETITION

TO: HER MAJESTY'S GRAND COURT OF THE CAYMAN ISLANDS

The Humble Petition of THE CAYMAN ISLANDS MONETARY AUTHORITY
(hereinafter called "the Petitioner")

SHOWETH as follows:

1. Pegasus Insurance Company (the "Company") was incorporated as an exempted company on December 17, 1985. The Company was formed to write professional liability insurance on a direct basis, for members of the Podiatric Risk Management Society in Michigan, USA.
2. The Company was granted an Unrestricted Class "B" Insurer's Licence with effect from January 2, 1986. The license was subsequently suspended on September 12, 2000.

3. The registered office of the Company is IAS (Cayman) Ltd., formerly Mutual Risk Management (Cayman) Ltd ("MRM"), P.O. Box 1363 GT, 5th Fl, Genesis Building, Grand Cayman, Cayman Islands.
4. From incorporation until November 7 1994 the Company was managed by HSBC Financial Services (Cayman) Limited. The Cayman Islands Monetary Authority (the "Authority") approved a change in manager to Willis Corroon Management (Cayman) Ltd. on November 7 1994, and then to MRM on November 30 1998. On July 30, 2001 MRM notified the Authority of their immediate resignation as managers. Since that time, the Company has not had an insurance manager.
5. At the time of licensing, the authorised share capital of the Company was US\$900,000 comprising of 100 Ordinary Shares of US\$1.00 each, 44,935,000 Class A Redeemable Preference Shares of US\$0.01 each, 60,000 Class B Redeemable Preference Shares of US\$0.01 each and 44,995,000 Nominal Shares of US\$0.01 each. The 100 Ordinary Shares were issued to Mercury Incorporated, a Cayman Islands exempt company jointly owned by Steven Lademan and Dr. J. W. Willoughby. Mr. Lademan and Dr. J.W. Willoughby, of East Lansing, Michigan, were the directors of the Company.
6. The Company's audited financial statements as at December 31, 1998 reveal that the authorised, issued and fully paid share capital of the Company was as follows:

Authorised:

- 44,790,000 Class A shares of \$0.01 each
- 240,000 Class B shares of \$0.01 each
- 44,970,000 Class C shares of \$0.01 each

Issued and fully paid:

- 1,200,408 Class A shares
- 228,000 Class B shares
- 217,500 Class C shares

The number of issued and fully paid shares is consistent with the Register of Members and Shareholders of the Company.

7. On January 6, 2000, the shareholders of the Company entered a share purchase agreement with American Safety Group ("ASG") to purchase the shares in the Company for \$1,850,000.
8. Following the acquisition, Mr. Lademan and Dr. Willoughby resigned as directors and were replaced by David Volz Brueggen, of Elmhurst, Illinois, Lloyd Allan Fox, of Atlanta, Georgia, Thomas William Mueller, of Louisville, Kentucky, and Frederick Charles Treadway, Indianapolis, Indiana
9. On April 24, 2000 ASG advised the Authority that it had initiated legal action in the United States District Court for the Northern District of Georgia to rescind the acquisition of the Company on the basis that the former shareholders had not accurately disclosed the Company's claims experience and had incurred claim losses significantly in excess of the amounts reported in their claims records and their financial statements. ASG also became aware that there had been material adverse changes in the business affairs and formed a view that the former shareholders had misrepresented the financial condition of the acquired companies.
10. As a result of this litigation, ASG discontinued to assist in maintaining the business of the Company as of April 14, 2000 and the directors of the Company resigned. Since that time, both ASG and Steve Lademan have refused to acknowledge the existence of the Company or to accept fiduciary responsibility for the Company.
11. The most recent audited financial statements for the year ended December 31, 1998 were signed off by KPMG. Audited financial statements for the years ended December 31, 1999, 2000, 2001 and 2002 are outstanding.
12. On July 31, 2000 the Authority completed its inspection on the Company, during which the following issues were identified:

- a. Pegasus did not have a shareholder or director.
 - b. MRM continued to be contacted by doctors, lawyers and judges looking for a resolution of claim settlements.
 - c. MRM were not managing the Company on a daily basis.
 - d. Pegasus was unable to be audited due to the lack of financial information.
 - e. The Company appeared insolvent.
 - f. Creditor of the Company would not come forward as it was not in their benefit to make any claims against the Company.
13. On September 12, 2000, as a result of the concerns by the Authority that the Company was carrying on business in a manner detrimental to the interests of its creditors and policyholders, and pursuant to the then Section 11(1) of the Insurance Law (1999 Revision), the Company's license was suspended.
14. At that time, the power to suspend the Company's operations was the strictest enforcement action available to the Authority. On January 10, 2002, Section 11 of the Insurance Law was repealed and substituted with new provisions that expanded the actions that could be taken against licensees, including the appointment of controllers and liquidators. Until such time, however, the Company remained in suspension.
15. On December 13, 2002 the Governor in Council, upon the recommendation of the Authority, appointed Messrs. Christopher D. Johnson and J.I. Nicholas Freeland of PricewaterhouseCoopers (the "Controllers") under Section 11(1)(vii) of the Insurance Law (2001 Revision) (the "Law") to assume control of the Company.
16. On January 13, 2003 and April 4 2003, respectively, pursuant to Section 11(3) of the Law and the terms and conditions of the Controllers' appointment, the Controllers submitted an interim report and an addendum to the interim report of its findings into the affairs of the Company ("Interim Report").
17. In the Interim Report, the Controllers identified a number of regulatory issues, as follows:

- a. The Company is insolvent. According to the Interim Report, the estimated total assets of the Company as at March 31, 2003 were \$284,543 and the estimated total liabilities were \$2,785,643.
 - b. The Company's insurance claims continue to accrue and remain unaddressed.
 - c. The Company is in default of its net worth requirements under Section 4(10) of the Law. As at December 31, 2000, the Company's net worth was a deficit of \$475,618. As at March 31, 2003 this deficit position had increased to \$2,501,110.
 - d. Since April 2000, the Company has been without management or directors. The Controllers are of the opinion that the directors have abandoned their fiduciary duties to act honestly, in the utmost good faith and for the benefit of the Company. The failure of the directors to fulfil their ongoing fiduciary, statutory and financial obligations has resulted in the carrying on of the business in a manner detrimental to the public interest and to the interests of its creditors.
 - e. The Company is in breach of Section 59 of the Companies Law (2003 Revision) whereas it has failed to maintain proper books of account. Certain significant records that would have been expected to be maintained in the ordinary course of business have not been made available to the Insurance Manager.
 - f. The Company is non-compliant with Section 9(3) of the Law whereas it has failed to prepare annual accounts and to have such accounts audited by an independent auditor, for the years ended December 31, 1999, 2000, 2001 and 2002. In addition, the Company failed to provide a certificate of compliance as required under the Law.
18. Based on the above, the Controllers have recommended that the Company be wound up.
19. Pursuant to Section 11(4)(d) of the Law, the Petitioner applies under Section 94 of the Companies Law (2003 Revision) for the Company to be wound up by the Court on the grounds that it is just and equitable for the following reasons:

- (1) Based on the information currently available, the Controllers believe that the Company is insolvent.
- (2) The Company has no directors or shareholders.
- (3) The Company has no insurance manager.
- (4) The Company's insurance claims continue to accrue and remain unaddressed.
- (5) It is expedient in the public interest that the Company be wound up.

YOUR PETITIONER THEREFORE HUMBLY PRAYS as follows: -

- (a) That Pegasus Insurance Company be wound up by the Court subject to the provisions of the Companies Law (2003 Revision);
- (b) That Messrs. J.I. Nicholas Freeland and Christopher Johnson of PricewaterhouseCoopers be appointed as Joint Official Liquidators of the Company, and that the Joint Official Liquidators be authorised to do any acts or things jointly and severally considered by them to be necessary or desirable in connection with the liquidation of the Company and the winding up of its affairs;
- (c) That the Joint Official Liquidators shall not be required to give security for their appointment;
- (d) That the Petitioner be at liberty to apply to the Court at any time, *inter alia*, for the removal of the Joint Official Liquidators;
- (e) That the Joint Official Liquidators be authorised to exercise jointly and severally all the powers set out in Section 109 of the Companies Law (2003 Revision) without further sanction or intervention of this Honourable Court;
- (f) That the Joint Official Liquidators do file with the Clerk of the Court a report in writing of the position of and the progress made with the winding up of the Company and with the realisation of the assets thereof and as to any other matters connected to

the winding up of the Company, every six calendar months or as the Court may from time to time direct;


- (g) That the Joint Official Liquidators engage attorneys in the Cayman Islands satisfactory to the Petitioner to assist with the winding up of the Company;
- (h) That, save as aforesaid, the Joint Official Liquidators be at liberty to employ attorneys, counsel and professional advisors whether in the Cayman Islands or elsewhere as they may consider necessary to advise and assist them in performance of their duties and on such terms as they may think fit;
- (i) That the Joint Official Liquidators be at liberty to and do pay themselves, their agents, employees, attorneys, solicitors and whomsoever else they may employ or instruct, remuneration and costs in priority to all other debts of the Company pursuant to Section 123 of the Companies Law (2003 Revision), and:
 - (i) The Joint Official Liquidators be entitled to remuneration of their usual and customary fees;
 - (ii) The Joint Official Liquidators be at liberty to pay their agents, employees, attorneys, solicitors and whomsoever else they employ or instruct either weekly or monthly or at such intervals as they consider appropriate;
 - (iii) The Joint Official Liquidators be at liberty to meet all disbursements reasonably incurred in connection with the performance of their duties;
 - (iv) Provided however that all payments made pursuant to paragraph (i)(i)-(iii) above shall be subject to approval by the Creditors or the Creditors Committee, should one be appointed, at a minimum on a quarterly basis. For any payment not approved by the Creditors or the Creditors Committee, the Joint Official Liquidators will seek Court approval, and if not approved by

the Court, they will repay the amount not approved within 7 days of the Court's determination.

- (j) The Joint Official Liquidators shall provide to the Petitioner copies of all reports filed with this Court and/or sent to creditors or contributories of the Company.
- (k) The Joint Official Liquidators shall serve on the Petitioner copies of all applications made to this Court for directions or other relief and any evidence in support thereof, such service to be within a reasonable time of date of the hearing of any such applications.
- (m) That the costs of this Petition be paid out of the assets of the Company as an expense of the liquidation.
- (n) That the costs of the Petitioner be costs of winding up.
- (o) Such other orders and directions may be made as the Court thinks fit.

AND YOUR PETITIONER will ever pray etc.

DATED this 21st day of July 2003.



Simone Tomkins
Legal Counsel for the
Cayman Islands Monetary Authority

INDORSEMENT

This Petition having been presented to the Grand Court of the Cayman Islands on the [] day of [] 2003 will be heard by the Grand Court of the Cayman Islands:

DATE:

TIME:

(or as soon thereafter as the amended petition can be heard).

**This petition is filed by the Legal Division of the Cayman Islands Monetary Authority,
whose address for service is 80e Shedden Road, Elizabethan Square, PO Box 10052 APO,
Grand Cayman, Cayman Islands.**