BRITISH VIRGIN ISLANDS

IN THE COURT OF APPEAL

CIVIL APPEAL NO.10 OF 2002

BETWEEN:

SPARKASSE BREGENZ BANK AG

Appellant

and

In The Matter of ASSOCIATED CAPITAL CORPORATION

Respondent

Before:

His Lordship, The Hon. Sir Dennis Byron — Chief Justice
His Lordship, The Hon. Mr. Albert Redhead — Justice of Appeal
His Lordship, The Hon. Mr. Ephraim Georges — Justice of Appeal [Ag.]

Appearances:

Mr. S. Moverley Smith, QC for the Appellant
Ms. N. David for the Respondent

2003: January 16;
June 18.

JUDGMENT

[1] BYRON, C.J.: Matthew J dismissed a petition to wind up Capital [the respondent] for an alleged unpaid debt of US$430,322.12 to Sparkasse [the appellant]. He concluded that there was a genuine and substantial dispute as to whether the debt was in fact due, and that under the terms of the contract between the parties, a Court in Austria had exclusive jurisdiction to resolve any possible legal dispute arising out of the agreement. It was his order that a winding up order could not be made until the Court in Austria had resolved the dispute as to whether the debt was due.

The Grounds of Appeal

[2] The grounds of appeal could be briefly expressed. Sparkasse contended that by failing to lead evidence of Austrian Law, Capital became incapable of discharging its burden of proving that there was a substantial dispute of the debt under Austrian Law; and that although there was a clause in the contract providing that an Austrian Court had exclusive jurisdiction the Court in BVI was obliged to evaluate the validity of the claims of the parties. It also contended that the Judge having found that quantum was disputed should have rejected the opposition to the petition on that ground.

The Settled Law

[3] The law governing the making of winding up orders is well settled and could easily be set out at this stage. The Court will order a winding up for failure to pay a due and undisputed debt over the statutory limit, without other evidence of insolvency. If the debt is disputed, the reason given must be substantial and it is not enough for a thoroughly bad reason to be put forward honestly. [1] But if the dispute is simply as to the amount of the debt and there is evidence of insolvency the company could be wound up. [2] To fall within the principle, the dispute must be genuine in both a subjective and objective sense. That means that the reason for not paying the debt must be honestly believed to exist and must be based on substantial or reasonable grounds. Substantial means having substance and not frivolous, which disputes the Court should ignore. There must be so much doubt and question about the liability to pay the debt that the Court sees that there is a question to be decided. The onus is on the company to bring forward a prima facie case which satisfies the Court that there is something which ought to be tried

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[1] Re **Taylor's Industrial Flooring Ltd**. (1990) BCC 44.

[2] **Tweeds Garages Ltd**.(1961) 1Ch.406

either before the Court itself or in an action or by some other proceeding.[3] A creditor who has served a statutory notice on the company is not entitled to a winding up order if the company bona fide disputes the debt and there is no evidence of the insolvency of the company. [4] If the existence of the debt on which the winding up petition is founded is disputed on grounds showing a substantial defence requiring investigation, the petitioner would not have established that he was a creditor and thus would not be entitled to present the petition, accordingly the presentation of such a petition would be an abuse of the process of the Court.[5] The process of the Companies Court could not be used in cases where there were issues of disputed fact. Such questions must be resolved in actions. A debt disputed on genuine and substantial grounds could not support a winding up petition. Invoking the process of the Court in relation to a debt which was known to be disputed on genuine and substantial grounds was an abuse of the process of the Court.[6]

The Proper Forum

[4] I think that I should dispose of the argument relating to adducing evidence of Austrian Law and the obligation of the Court to determine the validity of the claims. The agreement between the parties clearly mandated that the agreement is subject to the law of Austria and that the Court responsible for the bank's headquarters in Vienna has exclusive jurisdiction over any possible legal dispute arising out of the agreement. This provision is unambiguous. Austrian Law would be relevant to resolve the questions that were raised by the parties. It is not necessary to rely on Austrian Law to determine whether there was a dispute. One can conclude that a dispute exists without knowing how the dispute would be resolved. The learned trial Judge concluded that there were disputes of both a factual and legal nature and it is not for this Court to resolve those disputes. He

[3] Palmers Company Law Vol. 3 Para 15.214
[4] In re **London and Paris Banking Corporation** (1874) LR 19 Eq. 444
[5] **Mann v Goldstein** (1968) 2 All ER 769
[6] Re **Ringinfo Ltd** (2002) 1BCLC 210

concluded that the dispute between the parties should be settled in accordance with the terms of the agreement before it could be said that there was a debt which could ground a winding up order. The principles outlined above, clearly indicate that it was his duty to determine whether there is a genuine and substantial dispute as to whether there is a debt. None of the jurisprudence indicates that it was his duty to resolve the dispute. I reject the contention that the failure to lead Austrian Law in evidence was an error or impacted on the burden of proof. The questions that the judge was required to answer, and those that he did answer did not require any knowledge of Austrian Law. If he had attempted to resolve the dispute he would have been improperly encroaching on, and usurping a jurisdiction which the parties had conferred on the Austrian Court.

[5] There is authority for the proposition that a winding up order should not be made where the company is claiming that it has a genuine and substantial dispute with the creditor to the extent or in excess of the alleged debt, and that dispute is to be determined by another Court or tribunal. This was so even where the creditor had established its debt to the extent that it was entitled to levy execution, and the company's claim was by way of a cross-claim which had not as yet been adjudicated. This gives effect to the rationale that a winding up order could sound the death knell of a company and it would be unlikely that a liquidator would prosecute the company's claims with the diligence and efficiency of the directors. I think that the learned trial judge was correct to conclude that a possible legal dispute between the parties as to the existence of the debt should be resolved in the correct forum as a condition precedent to commencing the winding up proceedings in these Courts.[7]

The Sparkasse Claim

[6] Sparkasse is a bank operating in Austria, and offered its customers a service enabling them to place orders for the sale and purchase of options and other

[7] Re **Bayoil SA, Seawind Tankers Corp v Bayoil SA** (1999) 1 BCLC 62

securities on foreign exchanges. Capital is a BVI corporation engaged in the business of investing in various financial markets. The EUREX derivatives exchange is one of the world's largest markets for trading and clearing of futures and options in shares, stock indices, bonds and money market instruments. Capital wished to trade in DAX options on the German EUREX exchange and entered into a written customer agreement with Sparkasse. The EUREX exchange is only open to a restricted number of institutions termed in the rules governing trading on the exchange as "Clearing Members". These are the only persons entitled to enter into exchange transactions. Sparkasse was not any material time a Clearing Member of the EUREX exchange.

[7] Pursuant to the customer agreement Sparkasse undertook orders from Capital in relation to the purchase and sale of DAX options and in order to effect the transactions entered into mirror agreements with a Clearing Member, Commerzbank, which in turn entered into identical transactions with EUREX in accordance with the EUREX rules.

[8] Sparkasse alleged that by September 2001 significant arrears had accrued on the account and in October made a demand in the sum of US$ 420,000.00. The money was not paid and the winding up petition was issued.

The Dispute

[9] Capital challenged the petition on the ground that there is a dispute that the debt is owed.

[10] There was a factual challenge to the assertion that there was a negative trading balance. Mr. Hodyjas the representative of Capital, gave evidence on affidavit that all options are settled on a monthly basis and that a settlement had taken place on the 21st September 2001. He was summoned to a meeting at the offices of Sparkasse in Bregenz, Austria on 24th September, 2001 to discuss the effect of

the events of September 11th 2001 in the U.S.A. on the stock market. At that meeting Sparkasse demanded that Capital deposit US $420,000.00 or all the Company's options then open would be closed. On 26th September 2001, he was summoned to another meeting where he was again asked to ensure that the deposit was made. He stated that he explained that Capital could not make the deposit because there was no basis upon which Sparkasse could legitimately make such a demand. On 5th October 2002 Capital was served with a demand for the payment of $430, 322.15. Since then efforts have been made to settle the dispute. He said that at a meeting on 8th October, he was presented with a blank promissory note but he refused to sign it, after his request to have his lawyer present and to be given information as to how the sum was computed were denied. According to him it was at that time that he was told that contrary to the EUREX rules Sparkasse did not maintain the infrastructure necessary to ensure that the Margin was properly calculated and maintained. Despite his requests he has never been provided with specific information as how the sum claimed became due.

[11] I must confess some surprise, when even during argument on appeal counsel for Sparkasse maintained that the assertion that the trading account showed a negative balance in the sum claimed contained in the statutory demand should be accepted, that the burden of proof was on Capital to show that there was a dispute, and that Mr Hodyjas' assertions should not be believed.

The Genuine Dispute

[12] This chronology was not contradicted and is evidence that supports the finding of the trial judge there was a genuine dispute, in a subjective sense, before the winding up petition was presented on 31st January 2002. Both parties knew that Capital was denying liability to pay this sum for reasons it openly advanced. The affidavits reveal a question of fact to be resolved. It is clear that not every factual dispute could constitute a substantial dispute as to whether the debt existed. In

this case, however, as I understand the evidence, Sparkasse has never produced any information showing what, if any, funds it disbursed. Consequently Capital does not know if there is a negative balance, when it was created, or whether it was created in accordance with its instructions. In my view, if a creditor refuses to disclose information about the circumstances under which the alleged debt was incurred that creates a substantial issue to be resolved.

[13] Sparkasse submitted that since Capital alleged a conflict on the issue of how much was due, that was evidence to support the conclusion that there was a debt and which was a basis for the winding up order to be made. It is true as shown above that the law is that if there was a debt in excess of the statutory sum, the Court could wind up the company even if there was a dispute as the exact amount of liability. I see this as being different to the facts in instant case. Capital is saying, we do not admit liability, because we do not know what caused the negative balance on our account, but if Sparkasse did pay money on our behalf we may be liable but we don't know how much they might have paid. I do not think that is an assertion of debt with a dispute as to quantum. It is a complete denial of liability.

[14] There was also a legal challenge. Capital contends that the agreement between Capital and Sparkasse included the EUREX rules and that Sparkasse was in breach of the rules by failing to make provisions for Margin.

[15] The EUREX rules make provision for "Margin". Under these rules the Clearing Member is required to ensure that the investor maintains funds in its accounts at a level that covers and exceeds the value of the options to be traded. The rules prescribe the method of calculation and require that this be done on a daily basis.

[16] Capital asserts that Sparkasse was in breach of its obligations under the arrangement because it failed to give notice at any time that its security was equal to or fell below the Margin that was required to be maintained in order to cover its transactions.

[17] Sparkasse argued that it was not a member of EUREX and denied that these rules affected its relationship with Capital. Its argument was that the rules were to protect the Clearing Member to ensure that it always had the funds to pay to the exchange. The rules were not for the benefit of the investor, and so Sparkasse had no obligations to keep a margin if it was willing to take the resulting risks in carrying out the instructions of its customers. It contended that the trading debt could not be discharged because of a failure to obtain security for it.

[18] This raises a legal question as to what were the terms of the contract by which the relationship was governed. Engilsh translations of the agreement between the parties and the EUREX rules were tendered in evidence. The question to be determined, as to what were the terms of the contract, was without doubt a possible legal dispute. The agreement put this within the exclusive jurisdiction of the Austrian Court. I think I could do no better than to adopt the conclusion of the learned trial Judge:

> "it is not for this Court to determine whether there is any provision in the Agreement that enables the Company to be "left –off" its indebtedness to the Petitioner or to say whether or not the petitioners a member of EUREX or bound by its rules. The Agreement is governed by Austrian law and there is also an exclusive jurisdictional clause. The Petitioner must do as was done in Re Bayoil[8] and go to the correct forum to determine the debt and if necessary then present a petition for an undisputed debt."

[19] I would dismiss the appeal with costs in the sum of $9333.33.

Sir Dennis Byron
Chief Justice

I concur.

Albert Redhead
Justice of Appeal

I concur.

Ephraim Georges
Justice of Appeal [Ag.]

[8] (1999) 1 BCLC 62