

IN THE GRAND COURT OF THE CAYMAN ISLANDS
HOLDEN AT GEORGE TOWN, GRAND CAYMAN
CAUSE NO: 195/2000

C.J. 1

Walt, J.C.

5-07-00

BETWEEN: QUARRY PRODUCTS LTD

PLAINTIFF

AND: AUSTIN INTERNATIONAL INC.

RESPONDENT

APPEARANCES:

Robert Jones and Thomas Lowe, for the Plaintiff
Alistair Walters, for the Defendant

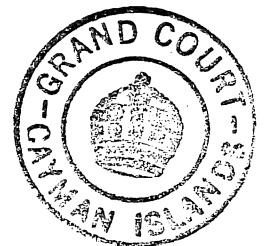
1st June, 2000

BEFORE MR. JUSTICE SANDERSON

REASONS FOR JUDGMENT

This is an application by Quarry Products to strike out the winding up petition filed by Austin International Inc. on March 21st 2000. Extensive affidavit material, authorities and written submissions were filed on behalf of both parties. Many issues of law and facts were raised.

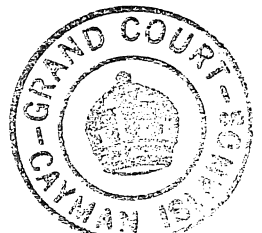
Austin International Inc. (Austin) sold and delivered various products to Quarry Products Ltd (the Company) between December 1998 and July 1999. It is undisputed that the Company did not pay for products billed in the amount of US \$325,886.65 and so Austin made a statutory demand and then filed a winding up Petition.



The Company claims that it is not indebted to Austin because Austin failed to provide ammonium nitrate (A.N) which was of explosive grade. The Company has now refused to pay two invoices of \$33,568.44 for what it alleges was non explosive grade A.N. The Company has also refused to pay invoices of US\$292,318.21 for other products, which were not defective in any way, on the basis that the Company claims that it has either a set-off or alternatively a cross claim for damages, arising from Austin's alleged failure to provide explosive grade A.N., over the period of December 1998 to July 1999. The Company calculates or estimates its damages to exceed the amount claimed by Austin.

The Company's main submission is that the petition should be set aside because the debt is disputed on substantial grounds. It concedes that it is for the Company to demonstrate that the petition is disputed on substantial grounds and submits that it will only fail to do so if the court is unable to conclude that the dispute was not put forward in good faith by the Company or it has no rationale prospect of success. It submits that if the Company has a genuine cross-claim it is just as if it was a disputed debt. In support of these propositions the Company relies upon the following authorities: *Gold Hill Mines* (1883) 23 Ch D, *Mann v Goldstein* [1968] 1 WLR 1091 @1098-9, *Stonegate v Gregory* [1980] Ch 576 at 580, *Re a Company* [1993] BCLC 59, *Re Bayoil* [1999] 1 WLR 147 at 150., *Re a Company* [1992] 1 WLR 351 and *Re Portman Provincial Cinemas* [1999] 1 WLR 157 at 159.

Mr. Walters, for Austin, agreed that only in exceptional circumstances should the court hear argument about disputed debts but that it was proper for a judge to examine the evidence to consider whether or not there was a bona fide dispute on substantial grounds. He also submitted

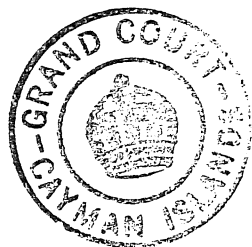


that where there exists an undisputed debt and cross claim, the court has discretion whether to dismiss the petition or make a winding up order. He said that except in special circumstances a winding up order will not be made where there is a serious, genuine cross claim or one of substance which the Company has been unable to litigate. He relied upon the following authorities, *Application to Wind Up Companies, Derek French*, at 206-234, , *Banco Economico S.A. v. Allied Leasing and Finance Corporation* [1998] CILR 292 at 303, *In the Matter of Cayman Islands Television and Video Production Company Limited* (trading as CITV-33) 1992-1993 CILR 332 at 336, 5-10), *Re Bayoil SA* [1999] 1 BCLC 62 CA, *Greenacre Publishing Group v The Manson Group* [2000] [BCC 11, *Re L.H.F. Wools Ltd* [1969] 3 All ER 882, *Re FSA Business Software Ltd* [1990] BCLC 825 and *Re a Company* (No 006273 of 19920).

The Company advances two alternative positions. It first says that the petitioner does not have locus standi to file the petition because it is a disputed debt and relies upon Mann and Another v Goldstein and Another [1968] 1 WLR 1091. At page 1098-99 Ungoed-Thomas J. states;

“ I would prefer to rest the jurisdiction directly on the comparatively simple propositions that a creditor’s position can only be presented by a creditor, that the winding up jurisdiction is not for the purpose of deciding a disputed debt (that is disputed on substantial and not insubstantial grounds), since, until a creditor is established as a creditor he is not entitled to present the petition and has no locus standi in the companies court; and that therefore, to invoke the winding-up jurisdiction when the debt is disputed (that-is, on substantial grounds) or after it becomes clear that it is so disputed is an abuse of process of the court...

So, in my view, when a petitioning creditor’s debt is disputed on some such substantial ground this court should restrain the prosecution of the petition as an abuse of the process of the court even though it should appear to the court that the company is insolvent.”



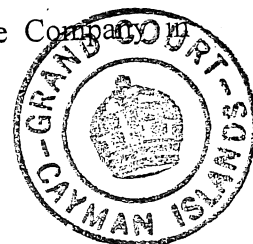
These propositions are not disputed by Austin and they have been applied in the Cayman Islands recently. However, Austin says that the debt here is not disputed and that it is entitled to proceed with its petition. The Company acknowledges that it has not paid previous invoices totaling \$325,886,65US and that only \$33,568.44US of these invoices relate to A.N. that was allegedly not of explosive grade. The balance of \$292,318.21US was for other products which were admittedly suitable but not paid for. The Company claims that the damages it has suffered as a result of Austin's alleged failure to provide explosive grade Ammonium Nitrate exceed the amount of the undisputed debt. It argues therefore that the debt is a disputed debt on the basis of equitable set-off and relies upon the decision in British Anzani (Felixstowe) Ltd v International Marine Management (U.K.) Ltd [1979] 2 All E.R. 1063. The judgment of Forbes J. summarised in the report's headnote as follows;

“an unliquidated demand could give rise to an equitable set-off against a claim for debt...”

However the defendant would have to show that its counterclaim was so directly or clearly connected with the plaintiff's claim as to go to the foundation of that claim...

It was not essential for the application of that doctrine for the claim and counterclaim to arise out of the same contract; it was sufficient if the defendant's counterclaim arose out of a transaction so closely connected with the lease that it would be manifestly unjust not to allow a set-off.”

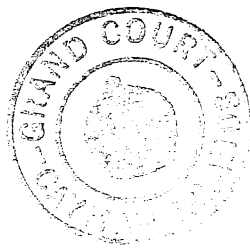
The Company submits that its counterclaim for damages for the alleged breach of contract in supplying non explosive grade A.N. is so closely connected with Austin's claim for the other unpaid goods that it is entitled to claim it as a set-off against Austin's claim. I accept the companies submission on this issue. Austin began supplying products to the Company



December 1998. Some of those products were intended to be explosive grade A.N. and others were not. All the products were invoiced and were paid for initially. In August 1999 the Company says it concluded that the A.N. was not of explosive quality and thereafter it did not pay any outstanding invoices, with included both A.N. and other products. I conclude that the Company's counterclaim is so closely connected with Austin's claim that it goes to the foundation of that claim. If I am incorrect in this conclusion, the Company has alternatively submitted that if it is not entitled to dispute the debt claim on the basis of equitable set-off it is nevertheless entitled to strike the petition on the basis that it has a counterclaim which exceeds the amount of the debt.

The general test to be applied in such cases have been recently examined by the English Court of Appeal In re Bayoil S.A. 1 W.L.R. 147, where an initial arbitration award had been issued against a company and the company's counterclaim for damages remained unresolved. The creditor issued a statutory demand and no payment being made it filed a petition in the Companies Court seeking an order that the company be wound up. Although the Company did not dispute the debt it applied to have the petition dismissed on the basis that it had a genuine or serious counterclaim which exceeded the amount of the debt and which it had been unable to liquidate. The court held that in such circumstances it would, in the absence of any special circumstances exercise its discretion by dismissing or staying the petition. In his reasons for judgment Nourse L.J. reviewed the leading authorities . He stated at p. 154;

There is no reported decision since *In re L.H.F. Wools Ltd* [1970] Ch 27 in which the practice in cross-claim cases has been considered by this court. The headnote in that case, in paragraph (2) of the holding, at P. 28, reads:



“That the judge erred in the exercise of his discretion because he had given insufficient weight to (a) the modern practice that where a company had a genuine and serious cross-claim against the petitioning creditor which it had not reasonably been able to litigate, the petition should usually be dismissed or stayed...”

Mr. Russen has submitted that that is an incorrect statement of that part of the decision. I disagree. The correct view is that the practice in cross-claim cases was established by the actual decision in *In re Portman Provincial Cinemas Ltd* [1999] 1 W.L.R. 157. In *In re L.H.F. Wools Ltd* [1970] Ch. 27 Harman L.J., with whose judgment Danckwerts L.J. agreed, recognised and affirmed its existence. So too did Edmund Davies L.J., his only reservation being that there was still a residual distention in the court and that the petition ought not to be rejected out of hand. The reservation was clearly correct. It is met by the exception for special circumstances....

Thus in the Privy Council case of *Malayan Plant (pte) Ltd. v. Moscow Narodny Bank Ltd* [1980] M.L.J. 53 (a disputed debt case) Lord Edmund-Davies, in delivering the judgment of the Board, said at p.55:

“There is no distinction in principle between a cross-claim of substance (such as in the *Wools* case) and a serious dispute regarding the indebtedness imputed against a company, which has long been held to constitute a proper ground on which to reject a winding up petition.”

In the present case Judge Roger Cooke, recognising the inadequacy of the report of *In re Portman Provincial Cinemas Ltd* in the Solicitors' Journal (108 S.J. 581), suggested to counsel that it might be useful to try to get hold of a transcript of the judgments in that case. The attempts of counsel to do so were unsuccessful. So he also had to consider *In re L.H.F. Wools Ltd* [1970] Ch. 27 without that assistance. In the circumstances it is not surprising that he adopted the approach of Warner J. in *In re F.S.A. Business Software Ltd* [1990] B.C.L.C. 825. However, for the reasons stated, that approach was incorrect. Having held that the company had a genuine and serious counterclaim in the arbitration, which it had been unable to litigate, in an amount exceeding the amount of Seawind's debt, the judge ought to have asked himself whether there were special circumstances which made it inappropriate for the petition to be dismissed or stayed.”

Ward L.J. gave concurring reasons and at p. 156 concluded ; “



“Secondly I am satisfied that, when subjecting *In re Portman Provincial Cinemas Ltd* [1991] 1 W.R.L. 157 and *In re L.H.F. Wools Ltd* [1970] Ch. 27 to close analysis, such as Nourse L.J. has subjected them to, there is authority of this court, from which we should not depart, that the practice is not to allow the winding up where there is a genuine cross-claim except in special circumstances.

Thirdly, were the matter before me de novo, I would arrive at the same conclusion. The practice in the disputed debt case is well established. I appreciate that in that case the petition is dismissed because the petitioner cannot properly claim to be a creditor. That said, there seems to me to be little practice difference between the disputed debt and a cross-claim which does not constitute a set-off properly so called. In this regard I am fortified by the opinion of Lord Edmund-Davies in *Malayan Plant (Pte) Ltd v. Moscow Narodny Bank Ltd* [1980] M.L.J. 53, 55:

“There is no distinction in principle between a cross-claim of substance (such as in the *Wools* case) and a serious dispute regarding the indebtedness imputed against a company, which has long been held to constitute a proper ground on which to reject a winding up petition.”

Fourthly, a winding up order is a draconian order. If wrongly made, the company has little commercial prospect of reviving itself and recovering its former position. If there is any doubt about the claim or the cross-claim, that seems to me to require that the court's should proceed cautiously.

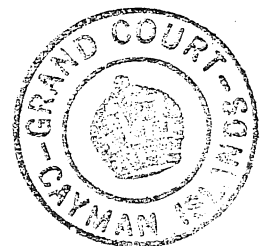
Whether the Company is entitled to dispute the debt either on the basis of equitable set-off or cross-claim will depend firstly on whether or not the dispute is bona fide and on substantial grounds or whether or not the counterclaim is genuine and serious. I agree with Ward L.J.'s observation that there is little practical difference between a disputed debt (a bona fide dispute on substantial grounds) and a cross-claim (genuine and serious cross-claim). The question to be answered here is whether the Company has demonstrated that it has a dispute on substantial grounds or alternatively a genuine and serious cross-claim.



This has been a difficult question. The Company says that immediately after using Austin's A.N. it observed a deterioration in the performance of the explosives. It claims that the blasting with the A.N. from Austin, resulted in approximately 25% of the blasted rock being oversized boulders. This was up from a historical figure of 5%. The oversized boulders then have to be re-blasted to be useful and the re-blasting process is expensive.

The Company claims to have noticed the change in performance in January 1999, which was shortly after it switched to Austin's A.N. and that in February 1999 it pointed out the increase in the amount of large boulders, to the representatives of Austin. It says it did not conclude in February or thereafter that the increase in boulder size blasted rocks was due to the change to Austin's supplied A.N.

In August 1999 the Company received a shipment of A.N. from Austin which had been supplied from a Costa Rican supplier. The Company says that the explosive performance of this A.N. was as before and that the percentage of boulders after explosion went from 25% back to 5%. The Company claims it was then that it realized that the A.N. it had previously been receiving from Austin was not explosive grade. It did not pay any invoices after August 1999, which included invoices that had been sent out in July of 1999. The Company says it orally complained about the poor performance of the A.N. explosives in October 1999 and advised Austin that it would not pay any invoices until the problem had been resolved between the parties. Austin issued a statutory demand on February 23rd, 2000 and on March 10th, 2000 the Company's attorney replied in writing, stating in part, that at least part of the \$325,886.65 was disputed.



The Company retained and filed a report from CANMET (Canadian Centre for Mineral and Energy Technology.) It described the differences in characteristic and performances between the A.N. shipped from Costa Rica and the A.N. shipped from Tampa. It described the higher absorption and greater explosion velocity obtained from the Costa Rican samples and counsel argued that these differences were significant and showed that the product supplied by Austin - from it Tampa source - were not of explosive grade. The report itself, however, did not state that the A.N. supplied from the Tampa source was not of explosive grade quality .

Austin argued that the Company did not at any time prior to the filing of the winding up petition ever state either orally or in writing that the A.N. supplied was not of explosive grade. Rather it promised it would make payments in due course and only when the winding up petition was filed did it invent this story about non explosive grade A.N. The Company provided a report from Universal Tech Corporation which compared the performance of the two types of A.N. prills, the high density (non explosive grade) and the low density (explosive grade). It observed that there were differences in the explosive performance that were greater than the differences observed in tests performed by CANMET. That is, the two samples Universal tested showed a more significant difference than the two samples tested by CANMET. Tech Corporation also concluded;

1. That both samples tested by CANMET achieved greater than 5.8 % absorption rate, which was the minimum required to achieve explosive grade A.N.;
2. That if the Company had received fertilizer grade A.N. as opposed to explosive grade A.N. there was a strong probability that the company could have experienced



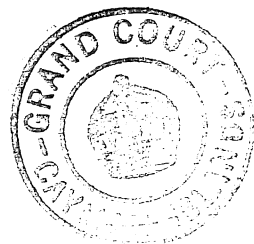
complete detonation failures in some boreholes.
(apparently none were reported);

3. If non explosive grade A.N. had been supplied, post blast fumes generated during the blasts should have been heavy and concentrated in orange NOx fumes, (there was no evidence of this).

Finally, Austin relied upon the exclusion clause which was printed on the packaging of the A.N. and on the reverse side of the invoices submitted, which excluded any warranties as to merchantability or fitness for a particular purpose.

The evidence before the court on several of the issues mentioned above was contradicted between the parties. Primarily, the Company says (and has filed supporting affidavits), that it made Austin aware of its complaints and insisted on something being done about them before they would pay the invoices. Austin says that the complaint was never made and is now just a stall. On the material before the court, can it be concluded that this is a bona fide dispute on substantial grounds or alternatively is it a genuine and serious counterclaim? In making that determination I am guided by the judgment of Graham J. in this Court in *Banco Economico v Allied Leasing* 1998 CILR p. 292 (affirmed on Appeal), at page 303.

“ I conclude, therefore, that the real test is whether the debt is disputed on substantial grounds. I am required to assess the “substantiality” of the alleged dispute on all the available evidence, as to what the parties have said and done and what they have not said or done, as I find it to be. It is in this context that the court takes heed of the warning from Chadwick, J., in *In re a Company* (No 006685 of 1996) (4) ([1997] BCC at 835), quoting Oliver, L.J. in *Re Claybridge Shipping Co. S.A.* (2) that it is “only too easy for an unwilling debtor to raise a cloud of objections on affidavits” and so seek to avoid the resolution of the issues raised in the petition. The court is entitled and indeed bound to weigh the evidence to see whether there is really



any substance in the dispute raised by the company or whether it is in reality contrived. In other words, as illustrated by the more pithy comments of Lord Denning, M.R. in *Re Claybridge Shipping Co. S.A.* ([1997] 1 BCLC at 575): “If [the defence] is obviously a ‘put-up job’ – or if it is so insubstantial that a Queen’s Bench master would only give conditional leave to defend-then I should think the petition to wind up should stand.”

I am also mindful of Ward L.J.’s caution in *In re Bayoil* supra, that if there is any doubt about the claim or the cross-claim, then the court should proceed with caution.

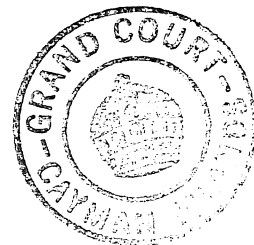
In, *In Re A Company* No 0012209 1991 1 W.L.R. p. 351 Hoffman J. said at p. 354

“In order to say that the respondent company is entitled to present a winding up petition I must come to the conclusion that that argument is either not put forward in good faith or that it has really no rational prospect of success. In my view it is not possible on the affidavit evidence to come to that conclusion. There is in my judgment a triable issue on that question, and if that is right then the whole question of whether the application for interim payment, which forms the basis of the statutory demand, was in accordance with the contract is something which is disputed and would have to be tried....

But if, as in this case, it appears that the defence has a prospect of success and the company is solvent, then I think that the court should give the company the benefit of the doubt and not do anything which would encourage the use of the Companies Court as an alternative to the R.S. C., Ord. 14 procedure.”

This approach was followed by Jonathan Parker, J. in *McDonalds’ Restaurant Ltd v Urbandivide Co. Ltd* 1994, 1 BCLC 306. After quoting the above passage he stated at page 317;

“The only question, based upon Hoffman J’s formulation of the test which has to be applied, is whether there is a defence which has a prospect of success....



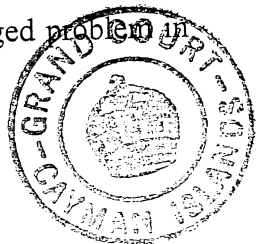
In my judgment, it is that distinction between a set-off and counterclaim which lies at the basis of the authorities to which Mr. Burroughs has referred. In my judgment, the evidence in this case, as it appears on the material before me, reveals quite clearly an arguable defence by way of set-off. I do not have to go any further at this stage, in the context of the present application; nor, indeed, am I in any position to do so. Nor do I express any view at all as to whether such a defence may prove successful. But, in my judgment; the evidence which has been filed on this application indicates clearly the existence of a real and genuine and arguable dispute.”

Finally, Harman L.J. in *In re Portman Provincial Cinemas Ltd*, supra, stated at p.161;

“ I do not think that on this proceeding we are entitled to adjudicate upon that matter. I do not think we ought to reject out of hand statements on oath by Mr. Hymanson and Mr. Waller which, unsatisfactory as they may be, do yet set up affirmatively this story. There is nobody, of course, to contradict them. I think we must take it that there is at least a chance that the judge will believe that story and will agree that there was such a bargain made, and, moreover, that it was an inherent part of the sale agreement. What has given me pause is the question of the uncertainty of the agreement. It is said that this is not an agreement which in law could ever be enforced. I have felt during the hearing that there is a great deal of force in that.

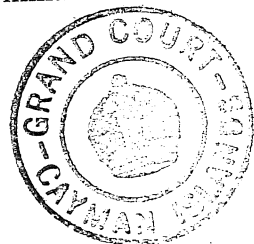
There is then this question of ostensible authority, and about that I do not think we are in a position to say anything because it needs a careful perusal of all the documents and the cross-examination no doubt of more than one of the deponents before the court can come to any conclusion on that part. Therefore, I have had grave doubts about this matter but I have come to the conclusion on the whole that it cannot be said that the story was so vague and the likelihood of success so slight that we can say there was no substance in the cross-claim. I think the judge was right to say that the matter ought to go to trial, and therefore according to the modern practice the petition should be dismissed, and I would so hold.”

In the case at Bar I have doubts that Company's set-off or counterclaim will succeed. I am suspicious of the fact that from the time the Company became aware of this alleged problem



January , 1999 that it did not conclude the problem was caused by the new supply of A.N.. It is an expericed operator with twenty years of blasting at this quarry. When it changed suppliers for the explosive A.N., it says it suffered and immediate five fold increase in large boulder production but it did not conclude that this was caused by the A.N. It had no other explanation . If it was the A.N. that was causing this problem or indeed if there was such a problem it is difficult to understand why it was not discovered until August, 1999. It is equally difficult to understand why the Company would not have put its objection and complaints in writing. It says it made oral complaints in October 1999 but that is denied. One would expect that a Company would report its complaint in writing and it is difficult to understand why this was not done. This is even more surprising after this statutory demand was made. I would have expected an immediate reply from the Company to the effect that the Company was not indebted to Austin because of its failure to supply explosive grade A.N., and that this issue has been previously mentioned and remained unresolved. Finally, the report of CANMET does not say that the A.N. was not of explosive grade. If it were NOT of explosive grade I would expect the experts retained by the Company to so state.

In summary, the position of the Company certainly does have some of the elements of a "put-up job" ,to use the words of Lord Denning. However, to conclude that it is a put-up job or that the set-off or cross-claim has no prospect of success I would have to disbelieve affidavits filed on behalf of the Company. I am suspicious of certain aspect of those affidavits but based upon the authorities referred to above I do not think it appropriate to make that determination at this stage of the proceedings. I seriously considered the possibility of staying the petition on terms; namely, that the Company pay into Court the amount of \$325,886.65 pending determination of



the Company's set-off or alternatively cross-claim. In his submission Mr. Lowe indicated that the Company had the ability and indeed would pay the Company's claim if the Petition were not stayed. However, I felt constrained by the authorities referred to above from so ordering. Following the guidelines in these cases I have concluded as follows:

1. Because I have doubt about the claim or cross-claim I should proceed with caution, (in *Re Bayoil*, supra);
2. Although I am suspicious of the companies claim I cannot conclude that it has no rationale prospect of success; (*Re A Company 1992, McDonald's Restaurants Ltd v Urbandivide Co Ltd*. supra) and
3. that there is at least a chance that the trial judge will believe the evidence on behalf of the Company (*In RePortman Provincial Cinemas Ltd*, supra),

Accordingly I do not believe it is appropriate to allow the winding up petition to proceed.

Regarding Austin's position on the exclusion clause and adopting the same reasoning and approach as described above in these reasons, I am satisfied that the Company has raised a bona fide dispute on substantial grounds or that its counterclaim is genuine and serious. I will not deal with the full arguments by counsel except to say that I do not think that the issues raised were capable of being resolved in Austin's favour at this stage.

Accordingly, I allow the application and order that the Petition be stayed pending resolution of the companies claim.

Dated this 5th day of July, 2000.

DB Sanderson
Dale Sanderson
Judge of the Grand Court

