

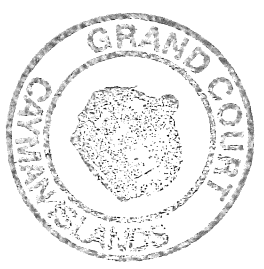
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IN OPEN COURT

IN THE GRAND COURT OF THE CAYMAN ISLANDS
HOLDEN AT GEORGE TOWN, GRAND CAYMAN

CAUSE NO. 7 OF 1998



IN THE MATTER OF THE COMPANIES LAW (Revised)

-and-

IN THE MATTER OF ALLIED LEASING AND FINANCE
CORPORATION

BETWEEN: BANCO ECONOMICO S.A. Petitioner

AND: ALLIED LEASING FINANCE AND CORPORATION
Respondent

Appearances

For the petitioner: Robert Hildyard Q.C.
instructed by Guy Locke and Sara Collins of W.S. Walker & Co.

For the respondent: John Martin Q.C. and Thomas Lowe
instructed by Linda DaCosta of Myers & Albergia

For the Monetary Authority: Stephen Hall-Jones

BEFORE GRAHAM J.

JUDGMENT

1. On the 28th September 1998, after a hearing lasting eleven days, I made an order that Allied Leasing and Finance Corporation, the

respondent, be wound up by the Court subject to the provisions of the Companies Law (1995 Revision). I ordered that joint liquidators be appointed and authorised them to do any acts or things considered by them to be necessary or desirable in connection with the liquidation of a company and the winding up of its affairs. I made other consequential orders, the precise details of which I shall set out at the end of this judgment. I informed the parties that I would in due course deliver written reasons for my decision, it having been opposed by counsel for the respondent on a series of stated grounds. The history of the matter and my reasons for making the order are contained in this judgment.

2. Allied Leasing and Finance Corporation (hereinafter called “the Company”) was incorporated as an exempted company on the 14th March, 1989 under the Companies Law as “Allied Leasing and Investment Corporation”, a company limited by shares. Pursuant to a special resolution of the sole shareholder, Transworld Bank & Trust Company Limited (“Transworld”) dated the 12th June, 1992 the Company changed its name to Allied Leasing and Finance Corporation.

Its registered office is situated at P. O. Box 501 George Town, Grand Cayman. B. W.I.

3. The nominal capital of the company is US\$900,000 divided into 900,000 shares of \$1 each of which 100 of such shares had been issued and are outstanding. The object from which the Company was formed were unlimited in the Memorandum of the Association of the Company.

4. The Company was the wholly owned subsidiary of Transworld, a Cayman Islands Company, holding a "Category B" Banks and Trusts Licence. The register of members of Allied Leasing shows that the sole shareholder is a body incorporated in the British Virgin Islands called White Lightning Inc. ('White Lightning'). White Lightning claims that it is the sole beneficial owner of such shares pursuant to a transfer dated the 14th July, 1994. Cesar Mello, a Brazilian citizen, claims to be the sole beneficial owner and only Director of White Lightning. It appears that that claim is based on the payment of a "modest sum", a topic to which I will return.

The Company has three subsidiary companies:

Allied Investment Fund Ltd. ("AIFL"), Asset Management & Finance International Inc. ("AMFI") and Gulf Canadian International Finance

Company Inc. (“GCFC”), all of whom are incorporated in the British Virgin Islands.

5. Banco Economico S.A. hereinafter called (“the Bank”) is a Brazilian Bank. Under the laws of Brazil it was placed into “intervention” on the 9th August 1995 by the Brazilian Banking Regulator, the Central Bank of Brazil. It is the understanding of the Court, that the Central Bank of Brazil performs a similar function, and has similar regulatory responsibility to that of the Bank of England. The “intervention” was converted into a full liquidation of the bank on the 8th August, 1996 and Flavio Cunha was appointed liquidator with full executive and statutory powers for the carrying out of that function. The allegation put to this Court is that prior to the intervention/liquidation of the Bank it was involved in a number of transactions with the Company which have resulted in the Company being indebted to the Bank in the amount of US\$218,276,794.48. Interest has run on this sum and is running. It is claimed that the Company is unable to pay those amounts despite demand and is consequently indebted to the petitioner in that amount.

6. The Petition for the winding-up was presented to the Court on the 8th January 1998 and the learned judge, the Hon. Mr. Justice Douglas appointed named officers of KPMG Cayman Islands and Getulio Pessoa jointly to act with the KPMG officers as provisional liquidators of the Company. A series of interlocutory matters ensued in the course of which various orders were made for the resolution of this matter. I will deal with those in the course of this judgment.

7. What was sought by the bank was the compulsory winding-up of the Company. The basis for the claim for winding-up was that it was unable to pay its debts. Although there was very serious disagreement between the parties, based on a series of factual and legal issues, it should be pointed out that counsel for the Company now agrees that liquidation of the Company is desirable at some stage as it has not traded for two years and is never going to trade again. This rather Augustinian approach: “Lord grant me chastity but not yet”, has caused the Court some concern. The bank itself, is in liquidation in Brazil due to a demonstrated capital deficiency. It was for that reason that Smellie J, as he then was, inquired of the respondent at the interlocutory stage as to the motive for the opposition to the petition, notwithstanding the fact that

on the Company's case all its identifiable assets were held on behalf of the petitioner. He was then told, by Mr. Martin that it was the Company's case that the value of those assets exceeded the claims contained in the petition and that the Company "should be allowed to realise the surplus for its own account and should be allowed to remain a viable entity" for that purpose. During this hearing I was told that the principal motive for opposition to the petition was the likely "political consequences" to Jose Roberto Azevedo, and others, in the event that this Court were to make findings of dishonesty or fraud against him or them. The petition was in fact opposed in reliance on a series of propositions of law and the general submission that the affidavits filed on behalf of the Company and the disclosed documents demonstrated, a "substantial and bona fide defence" in respect of the matters pleaded in the petition. The change of tack in respect of the motivation of Azevedo et al is very striking. It hardly needs saying that this Court is not remotely interested in, nor concerned with, "political consequences" in Brazil or anywhere else.

8. The Issues

(i) CC 5 account loans

As of the 13th July 1998 the petitioner was "owed" \$US254,006,099.49 including interest. This resulted from advances made on its account No. 19501603. Once the advances were made on the account with the Cayman Islands Banks the money was credited to a "carta circular" five - CCC5 Account in Brazil. This is said to be a special account enabling the introduction of foreign owned capital into Brazilian investments. This introduction of capital is claimed by Azevedo in his affidavit to be with the approval of the Brazilian Government to be secured, inter alia, by unit share certificates called U.P.I.C's. In his affidavit dated the 1st February 1998 (Azevedo 1 para. 3(13) (ii) he claimed that -

"Allied Leasing would issue short term paper in the form of investment certificates or promissory notes to Economico backed or matched by these investments. The overall payment obligations on the paper were made to match the income rights of the investments in terms of maturity dates etc.

The relevant details had to be given to Allied Leasing by Economico. Allied Leasing's repayment obligation

under the original loan made by Economico was

represented by this paper. In fact by the paper

Allied acknowledged its indebtedness in an amount equal to the face value of the relevant paper.

In the case of investment certificates a number of which are exhibited by Mr. Cunha the investor also had a participating interest in the investment fund.

Economico could then sell the paper to foreign investors.

At the end of the life of the paper the investor would be able to redeem it by presenting it at Economico's branch in the Cayman Islands. Economico in turn would pay off the investor by redeeming the underlying investments in Brazil".

Paragraph 19 of Mr. Pessoa's affidavit dated 12th June 1998

demonstrates that, in fact, the loans were simply and repeatedly rolled over as Azevedo was to say.

(iv) "No shortfall in the value of the investment would be laid at the door of the Allied Group. The investment side of the transaction was entirely within Economico's control. It was natural that Economico would take the risk that the investment

would be insufficient to re-pay the loan (which it had made for the sole purpose of funding the investment). It followed and was an important assumption that as long as the loan was reinvested through *Economico* (as it was supposed to be) the investment would always be treated as sufficient to repay the original loan.

This arrangement was clearly agreed between officers of *Economico* including myself and Mr. Donnelly. The Brazilian regulatory authorities were fully aware of the mechanics as they had to be in order to give the approval for the Annex IV fund which was duly given”.

It is appropriate at this stage to point out that it is agreed by all sides that no sales of paper to foreign investors ever took place. In the course of argument, Mr. Martin submitted to me that in effect all arrangements made were designed to deceive the Brazilian regulatory authorities. I note that there is no direct evidence of the approval of the authorities merely Mr. Azevedo's allegation that they did approve of these arrangements. I shall return to Mr. Martin's concession later.

At 3.14 Mr. Azevedo continued -

“Economico and Allied tried to reflect this arrangement at least as far as the Annex IV and CC5 investment were concerned within a written “investment agreement” dated the 14th March 1994 signed with Economico Corretora. I believe that the agreement was substantially extracted from the portfolio agreement. As can be seen Allied Leasing provided Economico with a negative pledge in respect of the investments. By clause 6 Economico agreed to have a recourse to the underlying investments at face value in order to repay its loans. Allied Leasing was therefore entitled to put its investments onto Economico at their nominal face value in discharge of the debt recognised on the commercial paper (investments certificates which were issued) Clause 6 in the agreement was intended to reflect the relationship which had operated between Allied Leasing and Economico. The negative pledge and the fact that Corretora managed the Annex IV investments demonstrates that Economico had effective security over the investments of Allied Leasing.”

At 3.15 -

“Mr. Donnelly telephoned me shortly after we signed the Investment Agreement and sought written confirmation of the sole recourse arrangement from me. I believe he also wanted it confirmed that the same commitment also applied to the debts of Allied relating to all of the other re-finance assets such as the building in Salvador and the aircraft leases. In my letter of the 22nd March 1994, I had no difficulty in giving this confirmation because in doing so I was merely recognising Economico’s understanding of the existing arrangements. What matters above all was the agreement which had already operated between the Allied Group and Economico and represented the clear understanding upon which dealings took place. Insofar as not expressly covered by the Investment Agreement I am in no doubt that those arrangements were intended to operate nevertheless by Economico and Allied Leasing.”

And at 3.16 -

“It follows from the Agreement between Economico and the Allied Companies that investments held by

Economico would have to be redeemed at cost or face value in the event that there was default or a failure in the transaction. As I shall explain below all the relevant investments existed at the time of Economico's intervention. The Annex IV portfolio and the CC5 cash was transferred to Exel. As I have already stated above I have no reason to suppose anything other than that Economico maintained control of the remainder of the assets of the Allied Group."

(ii) "Secured" Advance Loan.

US\$17,617,646 is claimed by the petitioner. The difficulty faced by the Court in respect of this matter is that the key document, a Lease, (See Volume E(4) Tab. 14 p. 25) is governed by Brazilian law, upon which there has been no evidence given, it is highly technical in form and very difficult to understand. The building in respect of which it exists in Salvador Brazil is occupied by the bank and is allegedly not paying rent. It was funded by a series of loans which were eventually taken over by the bank. In Azevedo 1 at paragraph 3.7 the loan amounted at that stage to US\$27m. This was paid for five years by the Company at a sum which came to about US\$10m in round figures. Azevedo's claim is that

the lease entitled *Economico* to a “put” option to Allied Leasing after the period of the lease to buy the building or pay penalties. The Company’s case in a nutshell is that by reason of the operation of the put option and the default clauses in the lease it is owed US\$17,617,646. A set off is then said to arise. On default of purchase under Clauses 35 to 37, a call of a penalty of 10% on principal is called for, together with accelerated receipt of all payments due. The Bank would therefore have to pay the outstanding payments on the lease. Under Clause 37 the Company is entitled to sell the premises at the guaranteed residual value of \$20.25 million. By Clause 37, the Bank must sell the premises to make that obligation. It has not done so. On a rent of \$2,105 million per annum only 4 payments are due plus the 10% penalty. The maximum claim is therefore \$4,0519.00. If that sum is subtracted from the \$17,617,646 the Bank has established, on the balance of probabilities, a deficit of about \$13 million in round figures. This transaction, like all the others, is said to be subject to a back to back/ no risk/ no reward agreement with the bank. The mere fact that a set off can be established does not create a no risk/no reward agreement, nor a course of conduct from which such an agreement may be concluded. The set off can be dealt with by the usual proof of debt procedure. There the complexity of

this matter can properly be dealt with by expert evidence as to Brazilian law if necessary.

(iii) Discounted promissory notes US\$19,356,768.06.

On the face of these notes, which are exhibited, they are payable upon presentation. They have been presented and they have not been paid.

Demand was made at Transworld Bank and Trust Limited, Grand Cayman in accordance with the terms and conditions of the notes. The demand is evidenced by paragraph 7 of the second affidavit of Getulio Silva Pessoa (Pessoa 2). It is alleged by the Company that the promissory notes are also covered by the Investment Agreement and its side letter.

The reason that that argument is hopeless is that, by its terms, it does not apply to investments purchased from other companies. These notes were purchased from the "Allied Investment Fund", a B.V.I. Company.

In the alternative it is alleged that the Court should impute into the arrangement between the parties a course of dealing involving no risk and no reward.

(iv) The Demand Clean Advance

This is said to be a paradigm for the understanding of the true relationship between the Bank and the Company. It is submitted by the Company that the no risk /no reward arrangement arises from the Aratu

aircraft lease and was the foundation of the subsequent “course of dealing” between the parties. There must therefore be a careful analysis of this particular transaction to determine if can properly be described as a no risk/no reward transaction at all. Vide paragraph 12 (v) *infra*.

(v) The Overdraft US\$11,867,176,75

The principal reason of dispute on this matter is that it was claimed on behalf of the Company that the true state of affairs was not revealed by the accounts produced by Mr. Pessoa (vide Volume E(2) Gsp1 Tab.1)

The actual bank statements are set out therein together with a later reconciliation and is prima facie evidence of significant indebtedness on the part of the company to the bank. There was considerable dispute as to what the bank documents demonstrated, but I am quite satisfied, having seen the reconciliation prepared by attorneys for the bank, that by dint of allowances for credits from the Annex IV Investments and other credits that the net debit balance was demonstrated to be

US\$2,223,795.22 as on the 1st January 1995. Accordingly there is prima facie and uncontradicted evidence under this heading of debts in the region of about \$US5,801,978.46 (including interest). No arguable case therefore exists on the evidence and I therefore find the case for the Bank established. I reproduce the reconciliation account at p.15A.

9. The Ground Rules

(i) The reason for my setting out the issues before the Court at this stage of the judgment is so that the various directions and suggestions of Smellie, J and latterly myself, in respect of the conduct of this litigation can be seen in their proper context. If the Bank is able to satisfy the Court that it was a “creditor” within the meaning of the law then a winding up could only be avoided if the company was able to show that there existed a dispute based on “bona fide and substantial grounds”. There would then remain the exercise of the Court’s discretion under Section 63 of the Law. I will deal with the meaning of the phrase “bona fide and substantial grounds” and the question of the burden and standard of proof later in this judgment.



(ii) This matter was originally to be tried by Smellie J. To that end he gave a series of interlocutory Rulings on the 27th February 1998 and a further Ruling on the 2nd July, 1998. I then became seized of the matter.

His first Ruling dealt with the proposed cross-examination of Mr.

Flavio Cunha, the liquidator of the bank in Brazil. He had to deal with a request, be it noted by the Company, to cross-examine Mr. Cunha. Mr.

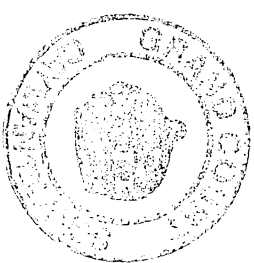
Cunha had made allegations of “systematic fraud” against the directors of the Company in his affidavit. In the event, the Bank agreed not to proceed with those allegations in these proceedings and his Lordship accordingly did not order cross-examination. It is to be noted that there were then in existence proceedings by the Company for the setting aside of the order to appoint provisional liquidators. His Lordship, in the course of his Ruling, and to the surprise of no one who has read these papers, expressed his concern at the “unusual” claim being made by Mr. Azevedo on behalf of the Company in respect of both the alleged “Investment Agreement” and the claim of sole recourse on the part of the Bank. In respect of the investments held on the Bank’s behalf and in respect of the funds used to acquire them: that claim would be against those investments themselves.

He continued :-

“Unusual as it might seem the arrangements become even more remarkable in their aspect - also asserted by the Company - that any losses resulting from the investments were to be for the account of the petitioner but any surplus would be for account of the company”!

And later -

“So it is then that the dispute is joined
whether indebtedness is owed to the petitioner and
if so, by how much.”



His Lordship then quoted, in extenso, the dicta of Lord Templeman in Tay Bok Choon v. Tahansan SDN. BDH [1987] 1 WLR 413. p. c. In delivering the opinion of the judicial committee of the Privy Council on an appeal against a winding-up order which had been ordered to proceed based upon the petition without cross-examination upon the supporting affidavit evidence, Lord Templeman said -

“In civil proceedings the trial judge has no power to dictate to a litigant what evidence he should tender. In winding-up proceedings the trial judge cannot refuse to read affidavits which have been properly sworn, filed and produced to him unless some opposing party has applied for the attendance for cross-examination of the deponent and that application has been granted and the deponent does not attend. The Court cannot give

a direction about evidence unless one of the litigants desires such direction to be made. Of course a judge may indicate to the petitioner that unless he calls oral evidence or applies to cross-examine the deponents of the opposition so as to prove a disputed fact, his petition is likely to fail. The judge may equally indicate to a respondent that unless he calls oral evidence or applies to cross-examine the petitioner's deponent for the purpose of disproving an allegation made by the petitioner, then the petition is likely to succeed. At the end of the day the judge must decide the petition on the evidence before him. If allegations are made in affidavits by the petitioner and those allegations are credibly denied by the respondent's affidavits, then in the absence of oral evidence or cross-examination, the judge must ignore the disputed allegations. The judge must then decide the fate of the petition by consideration of the undisputed facts."

The learned judge commented :-

“The obvious value of that approach is sound in practice and common sense.”

These comments from a Law Lord, dealing with a Privy Council appeal on a similar matter are of great weight, coming as it does from the ultimate Court of Appeal for the Cayman Islands.

And later Smellie J said:-

“The real point is that viewed in its barest form as presented, the petitioner is a creditor’s petition which alleges certain specific indebtedness to be still outstanding. Large though the sums may be, the issue - taken at its simplest - is whether that indebtedness or any significant portion of it is in fact owed. When viewed in that manner, I must agree with Mr. Hildyard that it must be left to the petitioner to assess how to present its evidence in proof. And, if the petitioner chooses to do so by narrowing the issues strictly to those of accounting and contract, it should be allowed to do so, if for no other reason than the

very large costs which are likely to be saved.”

And later:-

“Mr. Martin submits that the issues are to be joined over whether there is any indebtedness owed at all and whether the petitioner holds assets worth in excess of the debt claimed so as to result in a substantial surplus to the Company. It seems that the Company will also be saying that the Unit Shares Certificates, which are said to represent the bulk of the indebtedness claimed in the petition, were in fact equity investments for the amounts they show to have been taken on behalf of the petitioner and so to be set against its claim at face value.”

And later:-

“My decision on the question of cross-examination is intended to strike a balance between the advice given in the cases just discussed with the respective positions of the parties in this case. Although the petitioner must

be restricted to the issues in the petition the case nonetheless is likely to be very complex. On the other hand - and from the Company's point of view - although the issue of indebtedness claimed can and must be dealt with within the context of the petition, the true nature of the relationship between the petitioner and the Company will be relevant to the defence. While it would not be appropriate for me to direct what evidence the parties must rely on, given the promised complexity of the issues in this case, I think it is appropriate to offer advice similar to that of Lord Templeman in the *Tay Bok Choon* case. It does appear that unless oral evidence is called on each side - to bolster to explain the assertions and counter-assertions raised in the petition and affidavit evidence, the issues in this case are unlikely readily to lend themselves to a speedy resolution.

Mr. Azevedo's affidavit in particular contains assertions of fact which are to be amplified by his

evidence beyond whatever might appear from the face of the documentary evidence. A party seeking to rely upon affidavit evidence in those circumstances and in a case of this complexity could well find itself at a disadvantage by not presenting the witnesses for cross-examination.”

In his Ruling dated the 2nd July 1998 his Lordship said:-

“I will now make specific comments which I hope will be of guidance in this matter, having concluded that in the circumstances of this case it would be inappropriate to compel either side to have its witnesses submit to cross-examination. These comments are however aimed at the Company in particular, against the admitted background of it having received the very large sums shown as loans on the books of the petitioner.

The Company seeks to place the onus on the petitioner to explain by reference to underlying documents how it is that these loans remain on its book notwithstanding that the petitioner



never lent any monies to the Allied Group

Companies (to which the Company belongs)

unless the funds were being invested or used

by the petitioner - See paragraph 10 of Mr.

Donnelly's 2nd affidavit; for an example of

how the defence is pleaded. Mr. Donnelly, also

an officer of the company, deposes that without

the benefit of discovery of the underlying

documents from the petitioner, he may not be

able to provide specific explanation why certain

loans still appear on the books of the petitioner.

See in particular paragraphs 10, 11 and 12 of

Donnelly's 2nd affidavit.

The observation I would wish to make is that

given the massive indebtedness here alleged,

the prima facie proof of that indebtedness

being in the records recovered by the duly

appointed liquidator, it would be a remarkable

outcome indeed in this already remarkable

case, that the petition could be staved off by

the evidence of witnesses- untested by cross-examination - that there ought to be in existence of evidence of the redemption of that indebtedness which they have not yet seen. This, I also observe, would be more all the more unlikely because that evidence has neither been the subject of an application for, nor an order for, discovery. No such order has been sought by the Company although its attorneys have written seeking discovery.

As matters stand, the answer to the petition takes a form which is typified by paragraph 10 of Mr. Donnelly's affidavit where he makes the subjective assertion:-

“I am certain that at the time when the promissory notes matured namely 27th November 1995, Economico must have been in possession of some underlying maturing investments which also automatically “matured” with which to pay the promissory notes.”

If the respondent wishes to proceed to defend the petition based on that sort of bald assertion without more and without putting its witnesses up for cross-examination,

I do not consider that this Court should assume the conduct of its case for it, by directing that it presents its witnesses. Indeed the suggestion - in response to my natural query why they should not wish to attend - that they were otherwise engaged - will no doubt be of interest to any judge trying the petition.

In sum my concerns in this regard remain the same as they were on the occasion of my earlier Ruling of 27th February 1998.”

(iii) The matter came before on the 14th April 1998 and the 26th May 1998 in Chambers. I took pains to read the rulings and suggestions made by his Lordship to counsel on behalf of the Company and of the Bank and I raised the question of discovery yet again. No one made any application to me for discovery, despite my heavy hint. I noted that such

an application, if granted, would involve an adjournment and a likely order in respect of the costs thrown away.

(iv) The matter came on before me in open court on the 13th July 1998. The representation of the parties was the same as it had been throughout the course of these proceedings. I began by asking Mr. Martin whether he now wished to apply for discovery. He declined my invitation. It was drawn to my attention that sitting at the back of the Court was Mr. Jose Roberto Azevedo and Mr. William John Donnelly, the key witnesses in respect of the alleged Investment Agreement, the side letter and the alleged course of conduct which I was later invited to rely upon on, as indicating a binding contract between the parties. I was informed by Mr. Hildyard that all the witnesses who were in any sense controversial on his side were present in Court and he was willing to tender them for cross-examination on their affidavits. Again, Mr. Martin informed that he was not going to call his witnesses, who were in fact available, and did not wish to cross-examine any of the witnesses who had deposed to affidavits on behalf of the Bank. The reason he gave, was that without discovery he could not be expected properly to cross-examine tendered witnesses. At that stage I asked counsel for the

petitioner for an assurance from the provisional liquidators that all documents which might assist the Company had been disclosed. I was given that assurance. I am entitled, as I do, to have confidence in assurances given to me by officers of the Court. The provisional liquidators had possession of all the documents within this jurisdiction.

I must also say, with regret, that if discovery was not, in fact, pressed for then the inference must be that Messrs. Donnelly and Azevedo knew quite well that there was, in fact, nothing to be discovered. I am driven to draw that inference. I will refer to the issue again at paragraph (b) page 36 of this judgment.

(v) I was specifically asked by Mr. Martin in the course of his final submissions to me on the 9th day of the hearing to rule as to my understanding of the regime laid down by Smellie J for the resolution of this matter. Mr. Martin posed two questions.

Question 1. Did Smellie J establish a regime for the resolution of “the dispute itself?”

Question 2. Did Smellie J establish a regime “merely for the resolution of the limited question viz. is there a bona fide dispute?”

My answer to those questions are as follows:-

Smellie J sought to make suggestions as to the proper resolution of the issues presented in the petition namely - was it demonstrated that the petitioner was a creditor and had the respondent established a bona fide defence based on substantial grounds? I have therefore not answered the questions in the form presented by Mr. Martin but based on what his Lordship clearly told the parties, and in particular the Company, having regard to the issues they had raised. As to the “dispute itself”. This was whether the Bank could establish its locus standi on the balance of probabilities. It was the Bank’s submission that no substantial bona fide dispute existed on any of the heads of indebtedness. It is my final conclusion that no such case did exist on any of the heads of indebtedness whether the onus of proof was on the Bank or on the Company.

10. The Law

(i) What is the meaning of the “threshold test” as to whether or not the debt is disputed on “bona fide or substantial grounds?”

It is trite law that if the Court is of the view (according to the

appropriate standard of proof) that the debt is disputed on substantial grounds the petitioner is not a creditor within the meaning of Section 95 of the Companies Law. Case after case was cited to me, but they did not take the matter any further than the clear statement of law, in Mann v. Goldstein [1968] 1 WLR 1091 at 1099. Ungoed -Thomas J, upon a motion to restrain advertisement of the petition, which was successful said:-

“For my part, I would prefer to rest the jurisdiction directly on the comparatively simple proposition that a creditors petition can only be presented by a creditor’s, that the winding-up jurisdiction is not for the purpose of deciding a disputed debt, (that is, disputed substantial and not on 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 has become clear that it is so disputed) is an abuse of the process of the Court. This seems to me to be in accordance with the statement of Kekewich J. in *New Traveller's Chambers Ltd. 70 L.T. 271 at 272* which I have quoted, even though it be bournne in mind that the Company in that case was solvent; and the references to irreparable damage in the other cases which I have mentioned, where the petitioners were contributories or creditors petitioning against solvent companies, do not exclude an injunction being granted to prevent an abuse of the process of the Court.”

It must be bournne in mind in this case there is no real evidence of this Company being solvent. It is further to be noted that the Company has made no attempt to seek an injunction in respect of a stay of these proceedings nor to seek special directions as to the resolution of any given disputed matter. Nevertheless, if a substantial dispute is shown according to the onus of proof, which I shall deal with below, the petition

must fail. In this context I refer to the dictum of Hoffman J, as he then was, *In re. Foulds (1986) 2 B.C.C. 99,269 at 99,273:-*

“It has been the practice of the Courts at any rate since the decision of Ungood - Thames J in *Mann v. Goldstein* to treat as an abuse of the process of the Court a petition which is presented upon the basis of a debt which is bona fide disputed on substantial grounds. This is regarded as a very improper use of the machinery of a winding-up petition. *The reason is that the very presentation of a winding up petition puts very great pressure on the Company and it is not right for that pressure to be used in order to induce the Company to abandon a fairly arguable defence to a claim*” .

I appreciate that on the basis of dicta by the same learned judge in *Re A Company [1991] 1 W.L.R. 351 at page 354* it has been argued that the phrase “bona fide” and “substantial grounds” should be treated disjunctively and creates separate tests... “*I must come to the conclusion that the argument is either not put forward in good faith or that it really has no rational prospect of success.*” I do not think that his Lordship was going further than the long line of authority which seems to indicate

that a demonstrated lack of bona fides would drive a Court to the conclusion that “substantial grounds did not exist.” Vide Re Welsh Brick Industry [1946] 2 ALL.E.R. 197.

I conclude therefore that the real test is, is the debt 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 and done as I find them to be. It is in this context that the Court takes heed of the warning that is only too easy for a debtor “to raise a cloud of objections and affidavits and 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”. Vide in Re A Company No. 006685 of 1996 [1997] B.C.C. at page 830 or to the more pithy comments of Lord Denning in Claybridge Shipping Company [1997] 1 BCLC at page

575 -

“If the defence is obviously a “put-up job” or if it is so insubstantial that a Queen Bench’s Master would only give conditional leave to defend - then I should think

that the petition to wind-up should stand.”

I therefore conclude that in view of the “Smellie ground rules” I must resolve the relevant issues as to whether the Company has demonstrated that the debts are disputed on substantial grounds. I will therefore have to judge the weight to be given to the “Investment Agreement” and side letter together with the conflicting affidavits on either side. I am not called upon to decide whether criminal offences have been committed and will not do so.

(ii) Upon whom does the burden of proof lie in establishing whether the debt is disputed on substantial grounds?

I have had a dictum cited to me by in *Needham J Medi Services v. Jarson (1978) 3 ACLR 518*, a New South Wales case; with respect to the learned judge, he seems to confuse the criminal and civil standard of proof and in any event I reject his view that it is for the petitioner to “show plainly and without doubt on a balance of probability that there is no substance in the alleged dispute which the respondent to the petitioner asserts”. The normal principle is “he who states must prove” and I therefore conclude that it is for the respondent in this case to demonstrate, on the balance of probability, that the dispute as to the debt

or debts exists on substantial grounds once he raises that issue or issues in detailed form. In this case, quite extraordinary propositions are advanced by the Company and I must therefore have in mind the dictum of *Lord Nichols of Birkenhead in Re H. Minors [1996] A.C. 576* to the effect that the more remarkable the proposition advanced the more cogent must the evidence be to establish it. This is now the leading case dealing with the standard of proof in non-criminal matters.

11. I must now address myself to the complaints made by counsel for the Company as to the potential unfairness of proceedings in which I am invited to make a judgment as to the provenance and effect of the Investment Agreement, its side letter, together with other issues of conflict between the parties. Mr. Martin's general complaint is that without the definition of such issues, especially where allegations of dishonesty or dishonourable conduct have been made, especially against Mr. Donnelly and Mr. Azevedo, it would be quite wrong for the Court to come to any conclusion on them. Mr. Donnelly makes a specific complaint as to the lack of discovery to enable him to obtain documents to counter assertions made against him. In any event, claims Mr. Martin, winding-up proceedings are not the appropriate vehicle for such disputes to be resolved. The issues he claims, should be resolved by



Writ action in which matters are specifically pleaded, particulars sought and given and full discovery made. My judgment on these complaints are as follows:-

- (a) “the Smellie ground rules” specifically ordered that these matters be resolved; they were from the Company’s point of view those very issues raised by them. Especially, but not exclusively, the issue as to the Investment Agreement and the side letter.
- (b) To complain about the fact that discovery has not taken place verges on the disingenuous, in view of the comments of his Lordship and my specific invitation at the commencement of these proceedings in Open Court to seek it. From the terms of my invitation it follows that an adjournment, no doubt, on terms as to costs, would have been granted by me.
- (c) The refusal of the offer to cross-examine the witnesses present in Court who had sworn affidavits on behalf of the Bank, especially Mr. Neeser, Mr. Pessoa and Mr. Barbosa seems consistent with a tactical manoeuvre designed, no doubt, to give

colour to any appeal which might be mounted in the event of a winding-up order.

(d) By parity of reasoning, the failure to call Mr. Donnelly and Mr. Azevedo (who were, it seems not too busy on that day not to attend) was a tactical one and fraught with the dangers adumbrated by Smellie J.

(e) It is for the Court to set its own procedure. The rules on winding-up petitions are rules of procedure and not rules of law. There are no divisions of the Grand Court as there are in England and Wales. There is no separate Companies Court in this jurisdiction. In my judgment, provided appropriate warnings and rulings have been given as to the nature of the disputes to be resolved, as they clearly were in this case, then the resolution of disputed matters is fair and proper provided it goes no further than that. The Court will therefore not come to conclusions as to matters such as “forgery” and “dishonesty” as such. I will, however be bound to make certain findings of fact.

In Allipour v. Aty [1997] 2 WLR p. 534 the Court of Appeal of England and Wales, (McCowan, Hutchinson and Peter Gibson L.JJ) reversing the judge at first instance, underlined this principle at page 541. The judgment of the Court was delivered by Peter Gibson LJ (a well-known specialist in Company matters whilst at the Bar).

“It has long been the practice of the Companies Court when faced with a creditor’s petition based on a disputed debt to dismiss the petition insisting that the dispute be determined outside the petition:

See e.g. *Stonegate Securities Ltd. v. Gregory*

[1980] Ch. 576.”

“The reason for the practice has been essentially pragmatic.

The vast majority of petitions to wind up a company are creditors’ petitions. The Companies Court procedure on such petitions is equipped to deal with the resolution of disputes of fact.

There are no pleadings, there is no discovery and there is no oral evidence normally tolerated on such petitions, even though no doubt, pleadings and discovery could be ordered

and oral evidence received, and the Companies Court like any other Court is perfectly capable of determining such disputes. But that it is only a rule of practise and not one of law for the Companies Court to refuse to determine a dispute on the creditor petitioner's locus standi as was made clear in two cases".

His Lordship went on to cite -

- (i) In re Russian & English Bank [1932] 1 Ch. 663 and
- (ii) In re Claybridge Shipping Company S.A.

The Court went on to rule in that case, that where the Company is dormant and no alleged "detriment" could be substantiated, the Court, in its discretion had no doubt that notwithstanding the dispute as to the petitioners' locus standi, the petition should proceed so that the petitioner was not left without an effective remedy. At page 546 His Lordship

said:-

"The position as we see it, in the light of the authorities as affected by the current procedures of the Companies Court, is this. (1) A creditor's petition based on a disputed debt will normally be dismissed. (2) It will not be dismissed if the petitioning creditor has a good arguable case that he is a creditor and the effect of dismissal would be to deprive the petitioner of a remedy or otherwise injustice would result or for some other sufficient reason the petition should proceed. (3) On a contributory's



petition where the locus standi of the petitioner is disputed, the Court will consider all the circumstances, including the likelihood of damage to the Company if the petition is not dismissed, in determining whether to require the petitioner to seek the determination of the dispute outside the petition. ”

12. (i) I now turn to the Investment Agreement and side letter. I set out the terms of each in full. This agreement is reproduced (with errors, as exhibited).

INVESTMENT AGREEMENT

This agreement is between BANCO ECONOMICO S/A - CAYMAN ISLANDS BRANCH (BANK) and ALLIED LEASING AND FINANCE CORPORATION and its subsidiaries (INVESTOR) and it confirms the terms and conditions, previously agreed, under which the BANK shall purchase Investment Certificates from the INVESTOR, and the INVESTOR will invest in Brazilian securities and/or other assets under the guidance of the BANK.

THE CERTIFICATES

The CERTIFICATES will convey to the BANK the right to claim on the INVESTOR for repayment of the amount invested plus stated rate of return, also, the CERTIFICATES shall evidence the INVESTOR's obligation to repay to the BANK, on the maturity date of each CERTIFICATE, the face amount of the CERTIFICATE plus the stated amount of return.

THE INVESTMENTS

The INVESTMENTS, object of the issuance of the CERTIFICATES, will be represented by Brazilian securities and/or other assets, acquired by the BANK or its related parties in Brazil, through several mechanisms that allows for foreign investment in Brazilian securities and/or other assets, including but not limited to ANNEX IV and CC-5 ACCOUNTS and its tenure should coincide with the tenure of the CERTIFICATES.

CONDITIONS

1. Neither the CERTIFICATES nor the INVESTMENTS or this agreement is intended in any way to convey any sale, pledge, assignment, lien or any other transfer or conveyance or ownership of any INVESTMENT owned by the INVESTOR, whatsoever.

2. All INVESTMENT transactions relating to the CERTIFICATES which are sold to the BANK, shall be concluded through the BANK or through ECONOMICO S/A CORRETORA DE CAMBIO E VALORES MOBILIARIOS who will also act as the exclusive custodian of the Brazilian INVESTMENTS.

3. The INVESTOR shall be permitted to use the services of ECONOMICO S/A CORRETORA as an investment advisor in brazil whenever the investor brings its own or other's investment resources, in which case the investor will pay only the official brokerage fees and taxes.

4. The BANK is authorised to debit the INVESTOR's account at the maturity of each CERTIFICATE or arrange to have the CERTIFICATE renewed.

5. Any unanticipated repayment of any INVESTMENT shall prompt the immediate prepayment of CERTIFICATES, partially or in full.

6. If, at any time, as a result of failure of the investment transaction or any act of government that imposes the non-repayment of INVESTMENTS, the BANK will accept any or all securities and/or other assets, at its face value, in partial or full settlement of the INVESTOR's debt, provided those securities and/or other assets were acquired under the guidance of the BANK, including those acquired prior to this Agreement.



This is intended to be a continuing agreement but it may be canceled, by either party, subject to ninety days written notice. In the event of cancellation of this agreement both parties shall agree on the most expedient way to effect the total settlement of outstanding Investment CERTIFICATE or debt caused by maturity of such CERTIFICATE.

NEGATIVE PLEDGE

While any CERTIFICATE, which are covered by this agreement, are outstanding the INVESTOR agrees as follows:

A. The INVESTOR shall not pledge, assign transfer or in any way encumber its title to the underlying securities or permit any such encumbrance or lien to exist for any reason.

B. The INVESTOR shall not sell, assign, lease or transfer the title to the underlying securities to any other person or use the securities as collateral for any loan or to secure other type of transaction whatsoever, except those transactions completed by the BANK,

C. The INVESTOR will keep all records of the CERTIFICATES and the underlying INVESTMENTS completely separated from any other business which the INVESTOR may be engaged.

D. The INVESTOR shall not sell or dispose of any of the underlying INVESTMENTS or permit any other person to do so unless such sale or disposal shall

be duly reported to the BANK. The BANK shall have a first claim on any funds resulting from such action and the INVESTOR is obligated to pay such funds to retire all or part of the INVESTOR's obligations to the BANK.

This agreement is to be governed by the laws of the Cayman Islands, B. W.I.

Date of Agreement: March 14, 1994

BANCO ECONOMICO S/A
Cayman Islands Branch

ALLIED LEASING AND FINANCE CORP.
George Town - Grand Cayman

Andre Neeser

William Donnelly

The side letter reads as follows:-

“BANCO ECONOMICO S.A.

March 22, 1994

Allied Leasing and Finance Corporation
At. Mr. W.J. Donnelly, Director
George Town, Grand Cayman
B.W.I.

Dear Mr. Donnelly,

As per our phone conversation, we are confirming the terms of the Investment Agreement between Banco Economico and Allied Leasing and Finance Corporation. Under such agreement, provided the funds are managed and kept by Banco Economico, the bank undertakes the responsibility for the quality of those investments. Consequently, Banco Economico accepts any or all those investments, in full settlement of any liability derived from your investment refinancing, registered under your company's name or any of its subsidiaries.

We take this opportunity to confirm also, that this commitment is to include but not be limited to: leasing operations, trading and financing operations, loans to third parties, securities or any other assets, which have been purchased, for your account, by Banco Economico and kept under its custody, including those assets acquired prior to the underlying agreement.

Sincerely,

.....
Azevedo

(ii) These documents, in respect of which only copies are exhibited, are attached to the affidavit of Mr. Azevedo dated 1st February 1998. It has been seen that the "Agreement" and the "side letter" are respectively dated 14th March 1994 and 22nd March 1994. The Agreement is witnessed by Andre Neeser, on behalf of the Bank, and by William Donnelly on behalf of the Company. The Agreements are said to have been signed in Grand Cayman. Nowhere in the records of the Bank in Brazil, as found by the liquidator, nor in the records of the Company in Grand Cayman, as discovered by the provisional liquidators, is to be found even in the most tangential reference to those documents. No minute as to the creation of the document(s) is to be found in the records of the proceedings of the Board of the Company, as Mr. Pessoa says in his affidavit he would have expected. The "originals" are not available so that no date test is possible. There have been occasions in the past where forensic evidence is able to establish from the intrinsic characteristics of the paper used, the rough date of the Agreement. Such evidence is not available to me and therefore I have to rely upon the evidence given or not given by the parties. I am satisfied that the

existence of the Investment Agreement was never mentioned by Mr.

Azevedo to Mr. Pessoa, despite many meetings. Mr. Azevedo is described as the “key man” in Allied Leasing and, in effect its Controller.

I must now deal with the claim by Mr. Donnelly that the Investment

Agreement is based on the BDI Investment Agreement between the

Bank and BDI Inc. This is to be found exhibited to Mr. Pessoa’s second affidavit dated the 17th July 1998. The Company had claimed that they

had no copy of it but it was produced by Mr. Pessoa. It turns out to be at a perfectly normal Investment Agreement in every respect and contains nothing resembling the controversial Clause 6. To claim therefore, that

the disputed Investment Agreement is based on it is at best egregious; and was made, significantly, before its production by Mr. Pessoa. One searches the clauses of the BDI Agreement in vain, for any sole recourse and no risk/no reward limitation. I find that the wording of the B.D.I.

Agreement does not amount to a sole recourse agreement but was an attempt to limit the liability of B.D.I. for negligence. It was never

mentioned by Dr. Felmanas despite receiving instruction from the

Directors of Allied Leasing. The original of the side letter was addressed to Mr. Donnelly, why can he not produce the original? He

does not tell the Court who drafted the Agreement; Mr. Azevedo is

silent on the point and Mr. Neeser says he did not draft it. It is wrong to say that it was referred to in the New York proceedings, as has been submitted to me, a quite different form of Investment Agreement was there referred to. The affidavit of Andre Neeser to be found at Volume

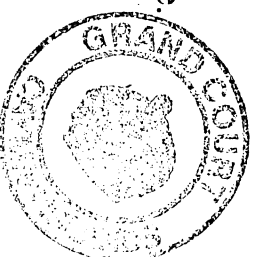
B. Tab. 10 date the 10th June 1998 It reads as follows:-

1. "I was employed by Banco Economico S.A. between 1987 and 1996. I was Manager of and worked at Economico's Cayman Islands Branc from February 1994 to 9th August 1996. The Cayman Islands Branch was strictly a booking operation and had no authority to engage in any business without the express authorisation from either New York or the Head Office in Brazil. I make this affidavit from facts and matters of which I am personally aware of. I have read Mr. Pessoa's affidavit and in particular the parts that refer to me, which I confirm are accurate.

2. Since the intervention of Economico I have at various times assisted the intervenor and liquidator firstly in winding down the operation of the Cayman Islands branch, and secondly in assisting Mr. Pessoa, the liquidator's agent, in locating documents and investigating the affairs of Economico. I am presently assisting Mr. Pessoa in New York as a consultant. Specifically, over recent months Mr. Pessoa has asked for my assistance concerning numerous transactions between Economico and Allied Leasing and Finance Corporation ("Allied Leasing") and its subsidiaries (jointly "The Allied Leasing Group").

3. I have been asked by Mr. Pessoa to state what my understanding was of the relationship between Allied Leasing and Economico. In respect of funds made available by Economico to Allied Leasing for Annex IV investments, my understanding was that:

- i) Economico had set up and at all times ultimately controlled the Allied Leasing Group;



- ii) Its purpose in doing so was to generate a return from investments through Allied Leasing in Brazilian assets;
 - iii) To achieve this purpose Economico would *lend* money to Allied Leasing which would make investments in Annex IV assets in Brazil; these investments would then be held by Economico Corretora as custodian for Allied Leasing;
 - iv) *In economic terms and on a consolidated basis*, I believed that Economico took both the risk and the reward in respect of these investments;
 - v) However, as between Economico and Allied Leasing *there was a debt in the amount of the loans. Allied Leasing would issue debt instruments to Economico recognising such indebtedness accordingly*;
 - vi) In the case of the Unitary participation Investment Certificates (“UPIC’s”) these debt instruments also conferred on Economico a right to look to the assets acquired by Allied Leasing; but it was never my understanding that there was any legal restriction or limitation on Economico’s other rights of recourse against Allied Leasing still less a provision requiring Economico to accept the face value of the investments as their actual value.
4. I have been asked by Mr. Pessoa if the purpose of the transactions with the Allied Leasing Group was to refinance Economico by selling the certificates issued to Economico by Allied Leasing in the market. So far as I am aware not one of the UPIC’s was sold or attempted to be sold. I can also confirm that no third party ever bought or redeemed any such certificate. I would have known had they done so as the UPIC’s were issued to the Cayman Islands’ branch and were redeemable there also.
5. I have also been asked by Mr. Pessoa to explain the context in which I came to sign the Investment Agreement purportedly dated 14th March 1994, a copy of which appears at pages 28 and 29 of “JRA1”:

- i) When I signed the Investment Agreement I believed that Economico ultimately controlled Allied Leasing. The recent suggestion that in fact a third party (a Mr. Melo) had acquired ownership and control of the Allied Leasing Group has come as a complete surprise to me. So far as I was concerned there had never been any suggestion of any third party involvement in the Allied Leasing Group.
 - ii) Although the Investment Agreement is dated 14th March 1994 I did not sign it then. It was signed much later, as I explain below.
 - iii) After the Intervention and shortly after I returned from Grand Cayman to New York on the 10th August 1996, I was telephoned by Mr. Azevedo, the former Financial and International Operations Vice-President of Economico. He said he wanted to discuss an agreement he was proposing to put in place between Economico, Cayman Islands branch and Allied Leasing referring to CC-5 and Annex IV transactions.
 - iv) When we met, Mr. Azevedo seemed to be very upset over the Economico intervention. He talked about how the Central Bank and the politicians in Brazil were after Mr. Calmon de Sa. He also explained to me that the agreement he wanted to put in place was designed to calm down Mr. Donnelly and Mr. Bonnard who, as I understood from what Mr. Azevedo said, were worried about their personal liability as a result of their involvement as directors of Allied Leasing. He did not elaborate and I did not inquire further.
 - v) I read the agreement quickly but did not focus on its terms nor on the date of the agreement. I do not recall seeing the side-letter that Mr. Azevedo said he would write at that time.
6. I signed the Investment Agreement in good faith and on Mr. Azevedo's assurance that it was in Economico's interest. I never contemplated it being used to suggest that Allied Leasing should not be liable in the full amount of its indebtedness so as to benefit Mr. Melo or any other third party.

(iii) Mr. Donnelly's account of the matter in question is contained in his first affidavit sworn in February 1998. (my copy of the affidavit has an incomplete jurat (Vol. C. Tab. 18)

He says at paragraph 4 having previously stated that he agreed with the contents of the first affidavit of Mr. Azevedo:-

"4. In August 1993 Mr. Azevedo asked me if I would carry out administrative services for a refinancing operation conducted through the Allied Group of companies by which I mean Allied Leasing and Investment Corporation and its subsidiaries, Asset Management and Finance, Gulf Canadian International Company and Allied Investment Fund. The companies were used by Economico to enable foreign capital to be invested in investment portfolios maintained under what was known as the Annex IV regulations or in deposits in accounts known as CC-5 accounts. The attraction of this was that the investment did not have to be tied up long term. In this way Allied provided a special purpose service to Economico.

"5. The structure of the transactions was that Allied would obtain loans from Economico which would be invested by Economico in the Annex IV portfolios or in the CC-5 accounts on behalf of Allied. Those investments would be kept in the custody of Economico. Allied's repayment obligation would be represented in the investment certificates or promissory notes issued to Economico (specifically according to Economico's instructions) to match the maturity of the underlying investments which Economico had acquired on behalf of Allied. These instruments which normally gave participation rights in underlying investments were redeemable by the holder of the paper at the offices of Economico in Cayman. The certificates or notes could then themselves be sold by Economico to foreign investors or placed in a fund in which foreign investors could participate.

"6. Allied would not handle or withdraw funds because it did not

need to do so, thus never leaving Económico's control or custody. Under the in investment certificates Allied assumed an obligation to allow the holder a participatory interest in the investment portfolio or repayment of the nominal value of the paper instrument. Although Allied assumed liabilities under the paper issued to Económico it had no control over how the original loan was invested or how the underlying investments were managed. This was in reality, a refinancing operation which enabled foreign investment to be attracted to Brazil during a time when it was suffering from acute liquidity problems. It was therefore self-evident that Allied would not assume the risk of a fall in the investments.

“7. Mr. Azevedo explained to me that Allied had previously operated as a leasing finance company whereby Económico lent funds to Allied which were invested in a manner dictated by Económico in assets then held by Económico. The idea was always that Económico would have sole recourse to the assets to protect itself. I asked Mr. Azevedo for the sake or good order to clarify this arrangement in a written agreement which he did in March 1994 and which Mr. Azevedo exhibits to his affidavit. This was not then checked by lawyers for Allied but I saw no need for this. What I did do was ask Mr. Azevedo to confirm in writing that the agreement extended to all of Allied's other assets and commitments and which I accept that the letter is not as clear as I would like it to be it is nevertheless a reflection of the clear agreement between Allied and Económico.”

He went on to claim that he had sought an opinion from Brazilian lawyers who allegedly approved the arrangements. That is of course, hearsay.

In his second affidavit dated the 5th May 1998 Mr. Donnelly says:-

“9. I understand that it is to be argued by the petitioner that the investment agreement which is described by Mr. Azevedo cannot cover the promissory notes which form

part of the alleged debt on which the petition is based. Initially, the way in which Economico documented the transactions was by way of promissory note rather than the investment certificates which by March 1994 had come to be used to show that the payment obligation of the Allied companies were linked to Annex IV investments. In about mid 1994 Economico decided that the promissory notes should not be used for the Annex IV portfolio. Until that time both the investment certificate and promissory notes were used more or less interchangeably. On 22nd June, 1994 Economico faxed a copy of a draft resolution to Mr. Berger (page 12 of WJD2). As can be seen it was Economico that dictated the form of the promissory notes as well as of the investment certificates. In the draft resolution it was proposed to replace the promissory notes with investment certificates. As can be seen from Mr. Berger's fax to Mr. Neeser of 24th October, 1994 (see pages 15 and 16 of WJD2), the draft minute which had been proposed 14 months earlier was still not finalised and I do not know whether it was in fact signed off. I note that the promissory notes relied on in the petition were issued on 2nd December, 1994."

The Court has seen no evidence of the draft resolution actually being converted into a resolution.

"10. Unfortunately, on occasions promissory notes continued to be issued for specific loans which were used for some purposes other than Annex IV investments (but nonetheless investments were made by Economico or under its direction). It is significant that Economico has claimed this debt without any explanation of the underlying transaction despite the fact that Economico never lent money to the Allied companies unless the funds were being invested or used by Economico. An extract from Allied's historical ledger (page 44 of WJD2) shows that \$11,861,471.86 was booked as a credit in respect of \$13.7m notes and immediately debited by reference to Account No. 101. Account No. 101 was the code used for Allied's bank account. There must have been a further transaction with Economico which will show that these proceeds were used to fund an

investment transaction. In other words, these promissory notes were used to document a loan the proceeds of which were invested by Economico or at its direction. The underlying loan was for a lesser amount because the maturity value on the promissory notes were discounted. It was almost certainly sold on by Economico. I am certain that at the time when the promissory notes matured namely on 27th November, 1995, Economico must have been in possession of some underlying matching investments which also automatically “matured” with which to pay the promissory note. As I have already explained, Mr. Berger would normally have obtained an explanation from Economico of such transactions when preparing the financial statements of the company. Because of Economico’s liquidation this information has never come into the possession of the companies”.

And later -

“12. In paragraph 15 of his affidavit Mr.Cunha refers to remaining indebtedness of \$5.801m on Account 603. Until Economico has provided the information relating to the Annex IV and CC-5 investment activities it is impossible to reconcile the bank statements to any records of underlying transactions. When that is done I am confident that it will appear that an equivalent sum in underlying investments has not been credited to Allied Leasing. I respectfully suggest that there is no reason why Economico should not provide detailed information as it did prior to the intervention.”

(iv) I have set out these quotations, in extenso, as I must make a finding on the origin of the Investment Agreement and its meaning. The Company declined the opportunity to challenge Neeser’s account in Court. That account critically challenges not only the basis of the relationship between the Bank and the Company but informs the Court that the Agreement and side letter were back-dated after the official

intervention and liquidation in Brazil. That is a very serious allegation to make. Mr. Azevedo, a Brazilian resident, knows what a serious allegation it is. Mr. Donnelly resides in New York. In respect of Neeser, it is necessary for me to warn myself that his account if, given in a criminal case, would require the Court to warn itself as to the danger of accepting the evidence of an accomplice. I do so, but, bearing in mind however, the fact that no evidence whatsoever has been found to support either the existence of the Investment Agreement or the side letter in investigations either by the provisional liquidators in Cayman or the official liquidators in Brazil; I prefer the evidence of Mr. Neeser to that of Messrs. Azevedo and Donnelly, both as to the date of the alleged Investment Agreement and its side letter and secondly, as to their account that no true indebtedness arose out of the relationship between the Bank and the Company. The account of Mr. Neeser is confirmed by the surrounding circumstances which I have already set out. I therefore accept Mr. Neeser's evidence on this matter. I find that the Investment Agreement and its side letter are documents which were created to be used, in extremis, and were created to seek to present the Court with a "defence" to the petition. They are not evidence of a generally agreed course of business between the parties and have no legal effect

whatsoever. They were produced, late in the day, without proper provenance and are designed to deflect the Court from a proper consideration of the facts. Mr. Neeser was prepared to have his evidence challenged on oath with all that that entails. Donnelly and Azevedo, whether on advice or otherwise, were not. That decision was taken by them in the full knowledge of the Smellie ground rules.

12. What would be the effect of the "Investment Agreement" and its side letter if my conclusions in paragraph 12 are incorrect?



i) To answer this question the terms of the Investment Agreement and its side letter must be construed to see if they can co-exist with the submission of no risk/no reward and the equivalent of the amount of a loan and corresponding specific investment. To begin with, there is no evidence from the documents before the Court that it represents, in written form, a settled, particularised and consistent agreement which was agreed between the parties with intent that legal relationships should be entered into between them. In other words a contract as understood by a common lawyer. It goes without saying that it would be most unusual for a commercial relationship of this type and of this quite exceptional magnitude to be entered into unless its terms and conditions were reduced to writing, after consultation with lawyers. This did not take place.

ii) On the face of the UPIC Certificates this Investment Agreement cannot, even on a strained interpretation be said to govern them. The UPIC are to be interpreted as meaning what they say to the world. It is the Company's case that they were to be traded on the open market, although they in fact they never were. It does not accord with commercial sense to say that such a document is to be offered to the world for sale but has some undisclosed restriction of which the holder in due course is not made aware. If that were the case it would

be a patent fraud. It would be contrary to all established law on this subject which is so trite as to require no recitation by me.

- iii) The side letter attempts to widen the scope of the Investment Agreement by use of the words “*this commitment is to include but not be limited to leasing operations, trading and finance operations, loans to third parties, securities or any other assets*”. It was initially submitted to me that that phrase included the unpaid promissory notes but that argument was, sensibly abandoned in favour of the proposition that if I found that the Investment Agreement was evidence of a general course of dealing then it should, by extension apply to the promissory notes! It is indeed the attempted extension of the Investment Agreement by the side letter which underlines the want of precision, consistency and intent critical for the enforcement of such a purported agreement. They are wholly lacking.

- iv) It does not require a judge to be an expert in the workings of the stock exchange to doubt whether it could ever be *conceivably* possible to match loans to investment in order to produce a like sum on maturity on an individual basis. It is not the Company’s case that the sole recourse would be to the underlying total value of the Company but to individual investments. It is therefore necessary to question whether such an arrangement was ever contemplated by the parties. When I asked Mr. Martin to respond to my query in this regard his reply was that sometimes people agree to silly things! I shall pass from that observation without further comment.

- v) I have described the Demand Clear Advance relating to the Aratu Aircraft Lease as the paradigm for the claim that there existed an arrangement for sole recourse and no risk/no reward long before the coming into being of the Investment Agreement. (whenever that may have been). At paragraph 3.3 of the first Azevedo’s affidavit, the rental payments for the aircraft were to require the Company to *service and repay* the loan. The lease is to be found at File E (4) Tab. 15. The loan amount is US\$2,554,072.82. The aggregate amount of the 24

quarterly payments was the sum of US\$93,281.24 together with interest at libor plus 1.125% of the outstanding balance. This amounted to US\$315.321 short of the payment of the principal. If the lease had run its course, and the option to purchase had been exercised, the Company would have made a profit based on the difference between \$315.321 shortfall and the residual purchase price of \$746,250 that is to say US\$430.929. This is a clear "reward". In the event of the option not being exercised the Company would have the aircraft free of any encumbrance save for the US\$315,321. This would be a very plain benefit to the Company. The Company claims that its liability to the Bank was settled by procuring the lessee of the Aratu Lease to assign it. This would include both a benefit and burden to the Bank. The assignment is dated "1995" (without any further particulars). What in fact it did, was not to discharge the Bank but to impose burdens without benefit and to create a reward for the Company. Such an arrangement is quite incompatible with the lease itself. By the end of the lease in 1995 it had no value, merely the burden of the rental payment. The term was six years and was notarised on the 14th April 1989. Six years from that takes the date to the 14th April 1995.

In this context a memorandum from the Collector's Department of the Bank to Andre Neeser reads:-

16th March 1995 Collections Allied Leasing/Aratu Taxi

"On the 15th March 1995 we remitted to you the last (24th) instalment collected on the above-mentioned collection and closed our files accordingly.

Kindly contact Antonio Ivo of BESA Salvador to see if you need to do something about the residual value of the underlying contract.

Also, we understand that all proceedings received from the above mentioned collection were applied to make partial payment of Allied Leasing's loan with yourselves. *If those proceeds are the only source of Allied Leasing's payment how would they*

make payments from now on?

A note of 17th March 1995

reads “Andre: Any news?”

The reality I find to be as follows:-

(a) If a lease had expired, the option to purchase was of no effect. In that event the Company retained the aircraft free of any further debt. If it had not expired the Bank would have had to pay the Company without the Company having paid the outstanding US\$315,321.

(b) If the lease had expired, then the option was of no further effect. It could not be enforced as it calls for “further negotiations”. It is trite law to record that an agreement to make an agreement is unenforceable. If the lease had not expired, then the Bank would have to pay for the use of the aircraft it had funded with no “back to back” obligation for the Company to pay as the loan had been paid off.

(c) Thus in one event, the Company is US\$315.321 better off. In the other the Company has the aircraft worth US\$746,250.24 plus the right to re-let the aircraft at a no doubt profitable rate.

The argument that this is an example of a no risk/no reward arrangement is thereby demonstrated to be without merit. This is said to be the foundation of the alleged course of conduct of the no risk/no reward arrangement between the Company and the Bank. It can therefore be seen that this submission, as the foundation of such an argument is also without merit, although persisted in. Mr. Martin did not attempt to reconcile his submission with the precise terms of the Investment

Agreement and the side letter because it would not have been possible for him to do so.

13. It is submitted to me that there exists a significant and unrealised series of loans “the Sugar Mill Loans” which would cover any possible indebtedness on the part of the company. Further, that due to the intervention and subsequent liquidation in Brazil, it has not been possible to realise those assets. The second report of the provisional liquidators dated the 10th July 1998 notes that there have been no payments under those loans since as long ago as 1987. They put no value at all upon those loans at the present time. More to the point, they have discovered documentary evidence which shows that White Lightning, a British Virgin Island Company has “an indirect ownership” in the Sugar Mill Loan.

“It appeared that this transaction comprised a complex exchange of Euronotes and Brady bonds. To date we have not obtained sufficient information fully to understand these transactions. On the face of it and at this stage the Sugar Mills are now under the control of Mr. Melo under the umbrella of the White Lightning Company which is registered in the British Virgin Islands”.

There is therefore considerable doubt on the evidence presented to the Court, that the loans are owned by the Company. No reliable value of

these loans has been demonstrated to the Court. Even if they have some value, it is impossible to come to any conclusion at all, such as would assist the Company.

Accordingly, that argument wholly fails.

Even if it were to be demonstrated that the loans were valuable, this would not assist the Company in resisting a winding-up petition as where a Company is under an undisputed obligation to pay a specific sum and fails to do so, it could be inferred that it was unable to do so; that accordingly the Bank could properly swear to their belief in the insolvency of the Bank and present a petition for its winding-up.

Vide *Cornhill Insurance PLC v. Improvement Services Limited & ors.*

[1986] 1 W.L.R. 114. In that case Harman J. refused to grant the *Cornhill*

Insurance Company an injunction restraining the defendants from pursuing a winding-up petition in the sum of 1,154 sterling. This demonstrates the strict approach of the Companies Court in England.

14. The provisional liquidators in their report have expressed their reservations about the conduct of Mr. Donnelly. They are concerned about his dealings with respect to the share transfers from Transworld to

White Lightning on the 12th July 1994 and the 10th August 1995.

Those are the transactions in which Mr. Donnelly appears to have personally transferred or approved of the transfer of the shares to Mr. Melo's company in the British Virgin Islands. They inform me that they have made attempts to contact Mr. Melo but without success. They are anxious to know the full detail of the price for which he acquired the shares. At the moment it is merely described as "a modest sum". Mr. Pessoa complains that the Directors of the Company will not discuss the transfer of the Company to Mr. Melo nor the purchase price. If that transfer is to be set aside then the exact size of the "modest sum" will have to be determined. The report concluded that "people other than the directors were effectively in control of the Company." Mr. Melo, who appears to be under the control of the former directors of the company, seems extremely unwilling to be seen by the official liquidators or to assist them. Even if I find, as I have, that there is significant indebtedness on the part of the Company to the Bank I am still required to exercise my discretion as to whether to make a winding-up order or not. Such discretion would have to have regard not only to the debts, but to all the surrounding circumstances. In this context I am bound to consider whether the indefinitely postponed liquidation of the Company,

as suggested by its counsel, can do other than assist the personal interests of Mr. Melo or whosever controls him. In view of his lack of co-operation, and involvement in questionable transactions affecting the value of the Company, the Court is bound to be suspicious as to what other transactions he might achieve in the interim period, further to attempt to put assets out of the hands of the liquidators. He must not be allowed to do this.

The petitioner must not be left without an effective remedy vide *Allpour v. Ary* [1997] 1 WLR p. 534. In addition the details of the sale by Azevedo to Melo must not remain hidden until it suits those persons to reveal them.

15. At the present time the provisional liquidators have made some progress in realising the assets of the Company. They have now identified over \$13m worth of assets and have in fact recovered \$4m in respect of one of the four aircraft owned by the Company and leased out. Their efforts continue with regard to the other three. In the liquidation process proofs of debt can be presented in the ordinary way. The Official Liquidators are the officers of the Court. They owe a duty to all

the parties concerned to be fair, impartial and even handed. The Court is in overall control so that the combination of the work of the Official Liquidators and the Court is designed to ensure fairness to all the parties concerned and not to any individual in particular.

16. (i) Mr. Pessoa is a very important figure in this litigation. He is the appointed agent of the Brazilian liquidator of Banco Economico and has the day to day care and conduct of the liquidation of Economico both in the United States and in the Cayman Islands. He has no obvious axe to grind, and, on the face of it, is to be treated as an honest and objective person. It is submitted to me that I should treat with reserve, and indeed reject, the many assertions of indebtedness and other matters made in his affidavit. This is on the basis of a letter dated 1st March 1996 written by him to the Central Bank of Brazil. The relevant portions of that letter reads as follows:-

b) The Allied Investment Fund Limited was incorporated by instructions of the then Managing Director, Mr. Jose Roberto Azevedo, according to the enclosed copy of memorandum dated the 14th June 1993. In these instructions, Allied Leasing appears

have a future holding of the 99% of the capital of the new Company.

- c) Both Companies, Allied Leasing and Allied Investments Fund obtained funds to invest via Annex IV and non-resident account in national currency (CC-5) in Brazil from the Cayman branch. All funds taken by the two Companies have their origin in the Cayman Branch that both bought its investment certificates keeping them in its portfolio.

- d) The Grand Cayman branch never sold the certificates in the market; therefore, all funds that are supporting the more than US\$400m of assets that it maintains with the Allieds are from loans from banks and depositors (persons and companies), greater share being from government entities and from BACEN itself.

- e) *I enclose a copy of a letter dated the 31st July 1995 from BESA, head office signed by the Director of the International Division, Mr. Azevedo listing investments in the amount of*

US\$107m that were secured by debts owed to Allied by Sugar Mills in Brazil.

f) *According to the above facts, it may be concluded that the companies in question are no more than interposed persons that hide inter-office operations, that is, between the Headquarters and the branch.*

g) One comes to conclusion that all existing assets, in Brazil and elsewhere, in the name of Allied Leasing and Allied Investment Fund consequently belong to Banco Economico - Grand Cayman branch.

(ii) It is noteworthy that that letter was written seven months after the intervention and depends, or so it would seem, (see italics) upon information coming from Mr. Azevedo. There is no suggestion in the letter that Mr. Pessoa had carried out a detailed examination. He has merely passed on the information given to him. Further enquiries have revealed, as he would have it, the real facts as set out in his affidavit.



I reject the submission that I should give no weight to his evidence because of the letter written on the 1st March 1996. What it really does, is to demonstrate Mr. Azevedo's skill in manipulating the views of officials whose recommendations might not be to his liking.

17. There is good authority, which in fact accords with common sense, for the proposition that, if at one stage, a debt is admitted by an officer of a Company or its lawful agent, then its later repudiation will be looked at with suspicion when deciding whether a bona fide dispute based on substantial grounds really exists. In this connection I now refer to a letter of relatively recent date, the 6th January 1998, when all the true facts should have been known. Dr. Felmanas is a Brazilian solicitor acting on behalf of the Directors of Allied Leasing, Allied Finance International, Gulf Canadian etc. It reads:-

“(the Directors) told me that Allied was a debtor of BEESA due to loans taken out by Allied and invested in Brazil, under BEESA's guidance or their partner Economico Corretera They told me that Allied has been intending to pay off their debts for some time through payment in kind of the investments made with the Loans, as they understand that this

institution was responsible for their solvency and liquidity.”

And later:-

“I then made sure that there would not be any incompatibility between my position as Banco Economico’s lawyer and nominee and having a similar capacity defending Allied’s interests, as my job consisted only of negotiating the hand over of assets for the settlement of the Loans made to acquire them. Therefore, in this case, interest were, and still are, convergent as it is in my client’s interest to recover their assets and Allied’s interest to pay off their debts”.

(It is to be noted that there was no mention at that stage of an Investment Agreement).

“Dr. Felmanas swore an affidavit on the 5th May 1998 on behalf of the Company. He limited his explanation of the correspondence as follows:

“I understand that it was suggested by counsel on behalf of Economico before Smellie J that my letters acknowledged that Economico was not in possession of Allied’s assets and investments. I did not acknowledge anything of the kind.”

What he has not explained is what I regard as a clear admission, which he made on behalf of the Directors of Allied Leasing, that they were indebted to the Bank and had been trying to pay them off for some time.

If there is one document which exposes the defence to this petition as a “put up job”, this is the one. Vide:-

(i) Claybridge Shipping Company Limited [1997] 1 BCLC 572

(ii) Record Tennis Centres Limited (1991) BCC 509

(iii) Delaine Properties Limited v. Quato Publishing PLC ACSR 81.

18. In the course of his submissions Mr. Martin, when faced with the difficult problems of the clear advance - aircraft leases, the UPIC's, and the promissory notes asked me to conclude that all these transactions were designed to deceive the financial regulator in Brazil. They did not mean what they appeared to say. Contrary to the evidence given on affidavit by Mr. Azevedo, everything he submitted, save the Investment Agreement and the side letter were to be construed as the exact opposite of their face value meaning. It was in reply to that very striking submission that counsel for petitioner and the court jointly recited the following quotation from Alice through the Looking Glass:-

“When I use a word “Humpty Dumpty said in a rather

scornful tone, “it means just what I chose it to mean -
neither more or less”!

I am asked to take this as a serious submission leading to the conclusion that the petition is opposed on bona fide and substantial grounds. If, as appears now to be conceded, all the transactions were made with a view to deceive, it is difficult to see how the dispute can be a substantial one. It is based on a series of lies. This is to judge the case on Mr. Martin’s own analysis of it. A submission of this kind will simply not do and I specifically reject it. It is all of the piece with the general conduct of this particular litigation by the Company.

19. At one stage, counsel for the Company sought to rely on alleged financial irregularities on the part of the Bank as, in some way, disqualifying it from obtaining the relief sought in the petition. For that reason, Mr. Stephen Hall-Jones, the Senior Crown Counsel, attended Court on various occasions. At the end of submissions by counsel for the parties he informed me that speaking on behalf of the Monetary Authority of the Cayman Islands, he wished to re-assure the Court that expressions of concern made sometime ago by way of letter, were made by junior official, in perhaps what might be described, as an excess of

zeal. He assured me that the present view of the Monetary Authority was that there was nothing that they wished to bring to my attention. In fact, it supported the application to wind up the Company. Of course, its views as to the desirability of making such an order plays no part in my decision-making process.

20. I now wish, in conclusion, to record my specific findings on the principal issues which have arisen in this prolonged and complex

dispute:-

- i) The Company has not established a bona fide dispute based on substantial grounds in opposition to the petition brought by the Bank.
- ii) If I am wrong in law in my findings as to the burden of proof resting on the Company I specifically say that had the burden of proof been upon the Bank to satisfy me, on the balance of probabilities, that no bona fide dispute based on substantial grounds exists, they would have done so in every particular. Each leg of the claim made when subjected to critical analysis has been demonstrated to lack either credibility or substance.
- iii) The Bank has established itself as a creditor in respect of -
 - (a) the CC5 loan
 - (b) the secured advance loan
 - (c) the Promissory Note
 - (d) the Demand Claim Advance
 - (e) the Overdraft

Accordingly it was granted the relief sought in the re-amended petition.

- iv) This dispute has been litigated by the Company based on insubstantial and unreliable evidence. There was never a basis for the proper opposition to this petition. The result of that is that a very great deal of money has been wasted. This finding will govern certain findings as to costs which I am likely to make at the appropriate stage. Mrs. DaCosta informs me that a decision as to the appropriate legal representation of Mr. Donnelly, Mr. Azevedo, Mr. Melo and White Lightening will have to be made before submissions as to costs can be made. I order that such submissions be made within 14 days of today's date.



Hon. Mr. Justice Graham
Judge of the Grand Court

23rd October 1998

