#54

IN THE COURT OF APPEAL OF NEW ZEALAND

CA145/2008
[2008] NZCA 389

UNDER	The Companies Act 1993	
BETWEEN	AMC CONSTRUCTION LIMITED Appellant	
AND	FREWS CONTRACTING LIMITED Respondent	

Hearing: 19 August 2008

Court: Glazebrook, Fogarty and MacKenzie JJ

Counsel: M J Wallace for Appellant
T J Twomey for Respondent

Judgment: 25 September 2008 at 4.30 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay the respondent costs for a standard appeal on a band A basis and usual disbursements.

REASONS OF THE COURT

(Given by MacKenzie J)

[1] This is an appeal against a judgment of Associate Judge Christiansen in the High Court at Christchurch dismissing an application for an order setting aside a statutory demand under s 290 of the Companies Act 1993. The demand was for

some $190,000 claimed as payable under a contract between AMC and Frews under which Frews had contracted to carry out excavation work on a property at Port Hills Road, Christchurch.

[2] In the High Court, reliance was placed on all three of the grounds in s 290(4). The Associate Judge considered together the grounds under subs (4)(a) and (b), namely, whether there is a substantial dispute whether or not the debt is owing or due and whether the company appears to have a counterclaim set off or cross demand. He stated the principles to be applied in terms which are not disputed, namely, that AMC is required to show a fairly arguable case for saying it is not liable for the amount demanded, or in support of any cross-claim; that it is not sufficient merely to assert the existence of a cross-claim; that the applicant must be able to point to evidence to show that it has a real basis for its claim; and that it is *bona fide* arguable. He noted that a critical analysis of affidavit evidence is standard, and undertook that analysis. He expressed the view that the evidence of Frews is to be preferred and that there was no sufficient element of substance to AMC's defence claims. Under s 290(4)(c), the ground relied on was that AMC contended that it was solvent. On this aspect of the claim, the Associate Judge held that it was incumbent upon AMC to satisfy the Court as to its solvency. He held that the information available did not meet that test.

[3] The grounds of appeal to this Court fall into two groups. These relate to the issue of solvency, and the existence of a dispute or cross-claim:

(a) As to solvency, AMC submits that the Associate Judge erred:

(i) In holding that it was incumbent upon AMC to satisfy the Court as to its solvency. It submits that the correct test is whether AMC satisfied the Court that it is arguably solvent; and that if that test had been applied, the evidence supported a finding that AMC is arguably solvent; and

(ii) In drawing inferences not supported by the evidence that because AMC is involved in the construction industry this

must adversely impact on the assessment of the evidence as to solvency; and

(iii) In expressing reservations as to solvency based on unexplained deposits into its bank account.

(b) As to whether there is a substantial dispute as to the debt, or a cross-claim against the debt, the appellant contends the Associate Judge erred:

(i) In finding that AMC could not claim for delay in the absence of a contractual term binding Frews to a completion date or referring to liquidated damages; and

(ii) In going beyond determining whether there were arguable defences or cross-claims and attempting to resolve the dispute between the parties on conflicting affidavit evidence.

Solvency as a ground for setting aside

[4] The essence of Mr Wallace's submission on this aspect is that the solvency of the company may be a ground on which the demand ought to be set aside under s 290(4)(c). He submits that the correct test in considering this ground is whether the company is arguably solvent. He relies upon the decision of the High Court in *Medisys Limited v Getinge Castle Limited* HC AK M1426 IM00 25 January 2001 Master Kennedy-Grant, and of this Court in *Link Electrosystems Limited v GPC Electronics (New Zealand) Limited* [2007] NZCA 501.

[5] The first question is whether the solvency of a company can of itself constitute a ground why the demand ought to be set aside under s 290(4)(c). The solvency of a company will very often be relevant to a consideration of the grounds in subs (4)(a) and (b). The Court must evaluate whether there is substantial dispute or a cross-claim. The Court must make an assessment whether the case is one where, as frequently occurs, the account is disputed as a means of buying time to

pay, or whether the grounds for the dispute are genuine. An examination of the company's solvency will often be a useful aid in determining whether the refusal to pay is the result of a *bona fide* dispute as to liability or whether it reflects an inability to pay.

[6] In cases such as that solvency is relevant not as a separate ground under subs (4)(c), but as a relevant consideration under subs (4)(a) and (b). In this case, the appellant, in addition to relying on paras (a) and (b), seeks to elevate the question of the company's solvency to an independent ground of which the notice ought to be set aside, under para (c). In *Medisys*, Master Kennedy-Grant accepted a submission (which was not challenged) that the solvency of an applicant company under s 290 can constitute a ground for setting aside a statutory demand against it. He further held that it is well established that the standard of proof of the existence of a dispute as to the debt, or of a counterclaim, set off, or cross demand, is the establishment of an arguable case and that there is no reason in principle why the same standard of proof should not apply in respect of the grounds under s 290(4)(c).

[7] We would not wish to rule out the possibility that the solvency of the company might constitute a stand alone ground for setting aside a notice under para (c). However, we consider that such cases are likely to be extremely rare. If there is no dispute as to the company's liability, so that para (a) or (b) cannot be invoked, it is difficult to imagine circumstances in which the company should be able to avoid paying a debt, merely by proving that it is able to pay that debt. If the debt is indisputably owing, then it should be paid. If the company simply refuses to pay, without good reason, it should not be able to avoid the statutory demand process by proving, at the statutory demand stage, that it is solvent. The demand should be allowed to proceed. If it is not met, and an application for liquidation is filed, in reliance on the presumption in s 287(a) that the company is unable to pay its debts, then the company will have an opportunity on the liquidation application to rebut the statutory presumption, which applies "unless the contrary is proved". There might be circumstances in which it is appropriate to advance the inquiry as to solvency to the s 290 stage, but that would require some particular circumstance not present in this case.

[8] The decision in *Link Electrosystems*, upon which Mr Wallace relies, does not support the proposition that solvency may be a stand alone ground for setting aside a demand under s 290(4)(c). In delivering the judgment of the Court, Hammond J said:

> [51] The alleged debtor can of course come into court and say that it is in good shape financially, or certainly such as could meet the debt (which it disputes), even if it is found liable to pay. What is remarkable about this case is that no assertion of solvency by Link was raised in the affidavits. Instead it simply sought to contest the debt.

It is clear that solvency was seen as relevant to whether there was a dispute as to the debt, not as a ground in itself.

[9] The second question relates to the standard of proof. If there may be rare cases in which the solvency of the company might constitute a stand alone ground under s 290(4)(c), the test which must be applied in such a case is whether the company is in fact solvent, not whether it is arguably solvent. The wording of the section makes it clear that different standards of proof are applicable under each of the paragraphs in s 290(4). The matters on which the Court must be satisfied are quite different. Under para (a) the question is whether there is a substantial dispute. What must be established is the existence of a substantial dispute, not that the debt is not due. Under para (b) the Court must be satisfied that the company appears to have a cross-claim. It is not required to decide whether that cross-claim would be successful. Under para (c), the Court must be satisfied that the demand *ought* to be set aside on other grounds. The grounds relied upon must be established to the level necessary to meet that threshold.

[10] To establish that a statutory demand ought to be set aside on the grounds of solvency it could not be sufficient to establish that the company was arguably solvent. Inability of a company to pay its debts constitutes a ground for appointment of a liquidator under s 241(4). The purpose of the demand procedure is to enable the creditor to take advantage of the statutory presumption in s 287, by which, if the demand is not met, the company is presumed to be unable to pay its debts. To rebut that presumption, the company must prove that it is able to pay its debts. Where neither of the grounds in s 290(4)(a) or (b) apply, a demand ought not to be set aside,

so as to avoid an inquiry into the company's solvency, solely on the grounds that the company is arguably solvent. To allow that would be to subvert the statutory process.

[11] In the light of that, we can deal briefly with the other submissions on the solvency issue. We do not see any error of principle in the Associate Judge's approach to the evidence about solvency. There is accordingly no basis to disturb the conclusions which he reached.

Whether there is a substantial dispute

[12] This leaves for consideration the question of whether there is a substantial dispute as to liability, or the appearance of a cross-claim. The demand relates to claims made for progress payments under an excavation contract. The essence of the company's contention is that it has suffered losses as a result of delays on the part of Frews which either mean that the full amount of the claim is not payable, or that it has a cross-claim for damages for delay. It also contends that the work was poorly performed.

[13] The contractual documentation is sparse. The entire documentation is a quote, a letter setting out a weekly programme, (indicating a four week's contract period) and a revised quote, for a total of $463,321. Monthly invoices were delivered, covering a total value of work of some $271,000, of which one payment on account of $80,000 was made.

[14] Although this is a construction contract within the meaning of the Construction Contracts Act 2002, neither party has sought to operate within the framework for progress payment claims which is established by the Act. Both parties accepted that the payment provisions in ss 20 to 23 of that Act had not been invoked, and that there was a right to claim progress payments which was not dependent on those payment provisions. We therefore do not need to address that aspect.

[15] The Associate Judge succinctly stated the appellant's case on delay in these terms:

> [5] AMC's case is that Frews did not complete the work within the time frame provided, and what work it did complete was not to an acceptable standard. The position is explained by Mr Summerfield, a director of AMC.
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> [6] He refers to a facsimile dated 21 February 2007 where a quote of $433,500.00, excluding GST, was submitted. It noted a period of 4 weeks within which the excavation period would be completed.
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> [7] Mr Summerfield says Frews' quote was accepted on the basis it completed the excavation work by 21 March 2007, but Frews quickly fell behind the required programme for a timely completion.

[16] He considered the evidence and held that there was no term of the contract binding Frews to a completion date or fixing liquidated damages for completion.

[17] The only part of the very limited contractual documentation which could be relied upon as creating a completion date is the work schedule which was apparently included with the original quote. The evidence supports the Judge's conclusion that this was not a contractual term. The original quote was not accepted. The revised quote, which provided for work which was approximately ten per cent by value greater, made no reference to a programme. Accordingly, the contractual documentation does not justify a conclusion that Frews was contractually committed to a four week completion period. If no completion period was agreed, then the contract would be that the work should be completed within a reasonable time. The Associate Judge noted that Mr Frew claimed that any delays alleged by AMC were caused by their own changing requirements and that Mr Summerfield of AMC did not respond to that claim. He further noted that little, if anything, by way of detail has been provided to support the allegations of delay. He also referred to evidence that the resource consent for the further work prepared on the site had not been obtained. That would substantially reduce any damages which might flow from delay. The conclusions which he reached were properly open on the evidence.

[18] As to AMC's complaints of poor performance, the Judge said:

> [68] I have serious concerns about the adequacy of AMC's evidence challenging work performance. Also, there is an almost complete

> lack of information or data by which to assess performance completion standards. Add to that the plaintiff's failure to particularise its counter claim and set off claims until it was near inevitable the Frews would withdraw the site, then the Court become concerned about the element of substance to AMC's claim of a dispute.
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> [69] The parties met on 9 November 2007, but the minutes do not record substantiation or particularisation of counter claims or set off. The Court should expect to receive such evidence, and not merely assertions. Mere assertions or little more, are not sufficient to prove substance to a claim of dispute.

[19] The assessment of that evidence too was essentially a question for the Judge. On this aspect also, the conclusion he reached was properly open on the evidence. Furthermore, as Mr Wallace acknowledged, any damages arising from poor performance would not, if there were not also significant damages for delay, reduce the amount claimed to a level below the threshold for a statutory demand.

[20] On both issues relied on for the claimed substantial dispute or cross-claim, the Associate Judge has made his assessment after a careful consideration of the evidence, and on a proper application of principle. Our own examination of the evidence would lead us to the same conclusions as those drawn by the Associate Judge, namely that the existence of a substantial dispute, or the appearance of a cross-claim, was not made out.

Result

[21] For the foregoing reasons, the appeal is dismissed.

[22] The appellant must pay the respondent costs for a standard appeal on a band A basis and usual disbursements.

Solicitors:
Duncan Cotterill, Christchurch for Appellant
Purnell Creighton, Christchurch for Respondent