

#125  
**IN THE HIGH COURT OF NEW ZEALAND  
AUCKLAND REGISTRY**

**CIV-2010-404-005878**

UNDER the Companies Act 1993

BETWEEN HERON'S FLIGHT LTD  
Plaintiff

AND NZ PROPERTIES INTERNATIONAL  
LTD  
Defendant

Hearing: 2 February 2011

Appearances: J M McBride for Plaintiff  
D G Collecutt for Defendant

Judgment: 7 February 2011 at 5:00 PM

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**JUDGMENT OF ASSOCIATE JUDGE BELL**

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*This judgment was delivered by me on 7 February 2011 at 5:00 pm  
pursuant to Rule 11.5 of the High Court Rules.*

*Registrar/Deputy Registrar*

*Date: .....*

Solicitors/Counsel:

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[1] Heron's Flight Ltd applies for an order that NZ Properties Ltd be put into liquidation. Heron's Flight is a creditor of NZ Properties International Ltd for \$9,600 under a costs order of the Court of Appeal dated 25 June 2010. It served a statutory demand under s 289 of the Companies Act on the registered office of NZ Properties Ltd but NZ Properties Ltd did not comply with that demand.

[2] The proceeding is opposed by the defendant and by its shareholder, Janine Ann Wallace. They admit that the defendant is liable for the costs order but say that it has a cross-demand for \$67,500, being commission payable under an agreement Herons Flight entered into for the sale of its business in February 2009. They also say that the plaintiff is insolvent, and that the defendant's own assets exceed its liabilities. They say the Court should not exercise its discretion to order the defendant to be put into liquidation.

[3] The plaintiff's case in essence is that it is entitled to immediate payment of the costs ordered by the Court of Appeal and the cross-demand raised by NZ Properties International Ltd ought not to affect the Court's decision on the liquidation application.

### **Procedural matters**

[4] There are two preliminary procedural matters. The first is a pleading point. Section 241(4) of the Companies Act provides four grounds for the Court to make an order appointing a liquidator. One of those grounds is that the company is unable to pay its debts.

[5] On an application that a company be put into liquidation, the applicant is required to specify in the statement of claim which of the four grounds in s 241(4) the applicant relies on. Where an applicant relies on s 241(4)(a), an appropriate pleading is to say that the company is unable to pay its debts. However, these exact words do not need to be used. Nevertheless, the pleading should contain express words to convey that inability to pay debts is the basis of the application.

[6] In this case, the plaintiff has pleaded that it served a statutory demand and has used the failure to comply with the statutory demand as the basis for the Court to make an order. It has not expressly pleaded insolvency as such. Non-compliance with a statutory demand is not one of the grounds provided under s 241(4) of the Companies Act. Instead, non-compliance with a statutory demand simply gives rise to a presumption under s 287(1) of the Companies Act that the company is unable to pay its debts. In other words, non-compliance with a statutory demand is matter of evidence only. The pleading of evidence is not the proper pleading of a ground for an application under s 241(4). Accordingly, the pleading of the statement of claim in this case is defective. For the Court to make an order, that pleading first needs to be amended. The plaintiff sought leave to amend the statement of claim to include a plea that the defendant is unable to pay its debts. The defendant is not prejudiced. The statement of claim is amended accordingly.

[7] I deal with the case on the basis that the plaintiff is alleging that the defendant is insolvent.

[8] Second, the plaintiff takes the point that the defendant's statement of claim was filed out of time. It was filed two days late. The plaintiff says that the defendant needs leave to file its statement of defence and opposed the grant of leave. It accepts that it is not prejudiced by the late filing but says that is not the test. It refers to the judgment of Paterson J in *Fresh Cut Flower Wholesales Ltd v The Living and Giving Gift Co Ltd* (2001) 16 PRNZ 173 at [9]:

With respect, I adopt the principles applied by the Masters. First, leave should not be granted unless the applicant can show on the papers an arguable basis upon which it is not liable for the amount claimed. Further, in my view, even if there is an arguable defence, leave should not be granted if the applicant is insolvent.

[9] That passage needs to be read in context. The test applied by Paterson J was relevant to the particular matters in issue for him. The other cases of Masters which Paterson J was referring to appear to include *Sayer v Capital Aviation* (1993) 6 PRNZ 401, *Mosaed v Roy Turn Ski Shop Ltd* HC Wanganui M63/92, 10 December 1992, Master Williams QC, *Orme v Parkway Investments* HC Hamilton M149/00, Master Faire 7 May 2001, *Sports Plus Australia Pty Ltd v Sports Plus Ltd*, Master

Gambrill HC Auckland M1333/96, 3 December 1996. Although each case turned on its own facts, a consistent principle running through them was that the party seeking leave to extend time for filing a defence had to show an arguable basis for defending the proceeding. Indeed, I note that McGechan quotes the *Fresh Cut Flower* decision as authority for the proposition that leave will not be granted to file out of time unless an arguable defence can be shown on the papers: see *McGechan on Procedure* HR31.17.01.

[10] This is an appropriate case to extend time for filing a statement of defence under rr 1.19 and 31.20 for these reasons:

- (a) The defendant has an arguable defence. I consider the merits of the defence below and find for the defendant. However, even if I had found for the plaintiff, the cross-demand raised by the defendant is still a matter that could be properly raised as requiring the Court's consideration on the liquidation application.
- (b) The defendant's shareholder was entitled to file a statement of defence and did so in time. The Court should consider the issues raised by her. It would not make sense to refuse to consider the same issues when raised by the defendant.
- (c) The plaintiff needed leave from the Court to put its case in order. It would be unreasonably harsh to refuse leave to the defendant to put its case in order when there is no prejudice to the plaintiff.

[11] Accordingly, I extend time to the defendant to file its statement of defence.

### **The costs order**

[12] Heron's Flight Ltd obtained its costs order on a successful appeal from a decision of Associate Judge Doogue. Associate Judge Doogue heard an application by Heron's Flight Ltd to set aside a statutory demand issued by NZ Properties International Ltd demanding payment of the sum of \$67,500, said to be owing by

way of commission on the sale of the Heron's Flight business at Matakana. The purchaser was International Xin Hua Wines Ltd, a company with Chinese ownership. An agreement for sale and purchase was signed. It was conditional on due diligence by the purchaser. Mr. Peter Lowndes, a barrister, gave notice that the purchaser was satisfied with the due diligence. The matter in issue was whether the purchaser authorised Mr Lowndes to give that notice. Associate Judge Doogue held that Mr Lowndes had ostensible authority to give that notice and dismissed Heron's Flight Ltd's application to set aside the statutory demand. Heron's Flight Ltd's appeal was successful. The Court of Appeal held that on the material before him, there was not enough evidence to allow Associate Judge Doogue to conclude that Mr Lowndes had ostensible authority to give the notice.

[13] The Court of Appeal held that the merits of the claim by NZ Properties International Ltd should go to a substantive hearing. It recognised that at that hearing, NZ Properties International Ltd may establish that Mr Lowndes did have the authority to give the notice declaring the agreement unconditional.

[14] The Court of Appeal's order for costs is a final order. There has been no appeal against the order. There is no stay of execution.

### **Inability to pay debts**

[15] The defendant's director says that the assets of the defendant substantially exceed its liabilities. Her affidavit lists three book debts of about \$800,000, said to be due to it, including its claim of \$67,500 alleged against Heron's Flight Ltd. Another book debt is for commission claimed against the shareholders of Heron's Flight on the sale of the land of the vineyard. That claim is subject to similar arguments as the defendant's claim against Heron's Flight. There is no evidence to allow the Court to assess the strength of the third claim. The liabilities it records are income tax and GST due on the book debts, legal costs, plus the liability under the costs order of the Court of Appeal. But that evidence only goes to show balance sheet solvency. It does not establish cash flow solvency. There is no evidence that the defendant holds funds from which it could pay the order for costs. In cases such as this, cash flow insolvency is sufficient to establish insolvency, allowing the Court

to make an order for winding-up. The authority frequently cited for this is the judgment of Plowman J in *Re Tweeds Garages Ltd* [1962] Ch 406:

In such cases it is useless to say that if its assets are realised there will be ample to pay 20 shillings in the pound: this is not the test. A company may be at the same time insolvent and wealthy. It may have wealth locked up in investments not presently realisable; but although this be so, yet if it have no assets available to meet its current liabilities it is commercially insolvent and may be wound up.

[16] With the non-compliance with the statutory demand, Heron's Flight Ltd has established a presumption that NZ Properties International Ltd is insolvent. NZ Properties International Ltd has not rebutted that presumption with its assertions that its assets exceed its liabilities. However, that is not the end of the question. The effect of the defendant's cross-demand also needs to be considered.

#### **The cross-demand**

[17] The defendant has now issued proceedings in this Court against Heron's Flight Ltd claiming commission of \$67,500 on the sale of the business of Heron's Flight Ltd. I was also informed that in that proceeding the defendant is also claiming commission from the shareholders of Heron's Flight Ltd for the sale of the vineyard land owned by them. As the defendant's claim is being pursued in a separate proceeding, it cannot be a counterclaim under Part 5, Sub-Part 11 of the High Court Rules. I have accordingly referred to the defendant's claim against the plaintiff as a cross-demand.

[18] The strength of the cross-demand needs to be considered. If the demand is flimsy, the Court should disregard it. On the other hand, if the entitlement is obvious, then it ought to be recognised. The present case falls in between. The defendant pointed to the judgment of Associate Judge Doogue as indicating that its claim was at least arguable. That is, even though Heron's Flight Ltd succeeded on appeal on showing that it had an arguable defence, the fact that Associate Judge Doogue did find for the defendant at first instance should be assurance that its case was at least arguable.

[19] Heron's Flight Ltd says that there are two issues. The first is the ostensible authority issue already discussed. The second is that the defendant failed to collect the deposit and that is a defence to the claim for commission. The second point was not in issue before Associate Judge Doogue and the Court of Appeal declined to consider it. The defendant did not put in evidence any further material apart from the Court judgments. I would have been assisted by more evidence. Nevertheless, while I accept that Heron's Flight Ltd has properly arguable defences, I also accept that NZ Properties International Ltd has a properly arguable cross-demand against Heron's Flight Ltd. The claim is at least strong enough to qualify as a cross-demand under s 290(4)(b) of the Companies Act. That provision allows the Court to set aside a statutory demand if it is satisfied that there is a counterclaim, set-off or cross-demand and the amount specified in the demand less the amount of the counterclaim is less than the prescribed amount. In *Covington Railways Ltd v Uni Accommodation Ltd* [2001] 1 NZLR 272, the Court of Appeal held that an application to set aside a statutory demand on the basis of a set-off, counterclaim or cross-demand under s 290(4)(b), must meet a "clear and persuasive" standard. At 274 it said:

Where a company which is the subject of a liquidation application is indisputably in debt to the applicant creditor, it may nonetheless be able to show that it has a claim against the applicant which reduces the net balance owing to the creditor or even off-sets it altogether. Where there are liquidated sums, due each way, that is simply an arithmetical exercise. It is more difficult if, on the applicant's side, there is an indisputable liquidated sum, but the other party's claim is for an unliquidated sum with liability and/or quantum in dispute. Then in order to impeach the statutory demand and overcome the presumption of s 287(a) that the company is unable to pay its debts when it has failed to comply with that demand, it must be able to do more than merely assert that there is an available set-off. It must be able to point to evidence before the Court showing that it has a real basis for the claimed set-off and that accordingly, the applicant's claim to be a creditor is, to the extent of the set-off, seriously in doubt. In the words of Buckley LJ in *Brian Stone Finance Ltd v De Vries (No. 2)* [1976] Ch 63, 78, it must show that there are "clear and persuasive grounds" for the set-off claim. Where this can be done, the party who has issued the statutory demand against the company will be shown to be using the statutory demand in liquidation procedures improperly because there is a "genuine and substantial dispute" about the net amount of the company's indebtedness *Taxi Trucks Ltd v Nicholson* [1989] 2 NZLR 297, 299). The dispute should then be resolved in the ordinary way – except as to any undisputed balance, rather than upon the hearing of a liquidation application.

[20] I find that NZ Properties International Ltd has met the clear and persuasive grounds test.

### **A further procedural point**

[21] Heron's Flight Ltd raises a further procedural point. NZ Properties International Ltd did not apply to set aside the statutory demand under s 290(4). Heron's Flight Ltd says that the failure to challenge the statutory demand means that NZ Properties International Ltd cannot now raise its cross-demand except in exceptional circumstances for which it carries the burden of proof. For that, Heron's Flight Ltd relies on authorities such as *Foundation Securities NZ Ltd v Direct Labour Services Ltd* HC Auckland CIV-2006-404-4391, 1 February 2007, Associate Judge Doogue, and *Balmoral Marketing v Karapiro Spa Ltd* HC Auckland CIV-2005-404-6396, 3 October 2006, Associate Judge Abbott. These authorities suggest that a failure to apply to set aside a statutory demand under s 290 may prevent a company later raising matters, which could have been raised in an application under s 290, except in exceptional circumstances.

[22] The Companies Act states the consequence of not applying to set aside a statutory demand under s 290. Under s 287, that consequence is that a presumption of insolvency arises if the company does not comply with the statutory demand. The Companies Act does not provide any other consequences. If Parliament had intended further consequences to arise, they would be set out in the statute. I see no reason to add a gloss to the words of the statute.

[23] The approach I prefer is that a company faced with a statutory demand has a number of lines of defence open to it. Which line is taken may turn on tactical or practical considerations (such as whether the company instructed its lawyers in time to make an application under s 290). If it is served with a statutory demand, it may apply under s 290 to set the demand aside. If it does not apply or if its application is unsuccessful and it does not comply with the statutory demand, the rebuttable presumption of insolvency will arise. But it may take other steps as the proceeding develops. It might apply for an injunction to restrain the issue of a proceeding, as in *Exchange Finance Co Ltd v Lemmington Holdings Ltd* [1984] 2 NZLR (CA) 242.



Or once the proceeding has issued, it might apply for a stay and restraint of advertising under r 31.11. Or again, it might elect simply to defend the proceeding on the merits. The fact that it has not applied to set aside a statutory demand does not stand in the way of it taking those other steps, save for this, it may be subject to the presumption of insolvency which it may have to rebut.

[24] I compare the gloss added by other cases with the doctrine of res judicata. The doctrine of res judicata says that a litigant cannot raise again a point that has already been determined in proceedings to which he was a party. What the gloss apparently holds is that a person cannot raise a matter when there have not been proceedings and the point has not been determined. The gloss purports to set up an estoppel based on res non judicata.

[25] Section 290(4)(c) allows the Court to consider an application to set aside a statutory demand on “other grounds”. The scope of “other grounds” is not clear. The courts have not laid down a clear test setting the boundaries. Potentially, “other grounds” could be extensive. If there is to be a rule that a failure to set aside a statutory demand prevents a litigant raising the matter at a later stage on a winding-up application, there is a trap for litigants. Even those well versed in the Companies Act would find it hard to advise whether a matter which could be raised to oppose a winding-up application on its merits could also constitute other grounds under s 290(4)(c). If the gloss should not apply in cases of “other grounds” under s 290(4)(c), consistency suggests that it should also not apply in cases of disputed debts and cross-demands under s 290(4)(a) and (b).

[26] I take an analogy from civil proceedings. There may be a number of courses open to defendants in civil proceedings. They might consider applying for summary judgment. They might consider applying to strike out. Or they might instead file statements of defence and defend on the merits. The fact that they do not apply for summary judgment or do not apply to strike out does not stand in the way of their defending on the merits. No one has ever suggested that the failure to apply for a summary judgment prevents a defendant raising a point that might otherwise have been raised in a defendant’s summary judgment application. In a similar way, a failure to apply under s 290 does not stand in the way of a defendant raising all

potential issues on a liquidation application, except that the defendant may face the presumption of insolvency.

[27] The fact that NZ Properties International Ltd did not apply under s 290(4)(b) does not stand in the way of it raising its cross-demand at the substantive hearing of the application for a liquidation order.

**Heron's Flight Ltd's *pay now, argue later* argument**

[28] Heron's Flight Ltd says that it is entitled to enforce the order for costs immediately. There is no order staying enforcement. NZ Properties International Ltd ought to pay the costs now and argue its cross-demand later. I call this a pay now, argue later approach. It cites two authorities: *Wiseline Corporation v Hockey* HC Auckland CP143/SD99, 27 July 2002, Nicholson J, and *Spencer v Jed Rice Building Contractors Ltd* HC Auckland CIV-2007-404-7539, 21 February 2008, Associate Judge Abbott.

[29] In the *Wiseline* decision, there was an application to set aside a statutory demand. The creditor had a costs order and the company alleged a counterclaim. Nicholson J declined to set aside the statutory demand in the exercise of his discretion under s 290(4)(b).

[30] NZ Properties International Ltd submits that that decision has to be seen in the light of its particular circumstances. That case involved an unmeritorious claim by a company without legal representation.

[31] In *Spencer v Jed Rice Building Contractors Ltd* there was an application for a stay of proceeding. Associate Judge Abbott followed an approach similar to that of Nicholson J. In particular, Associate Judge Abbott cited *Anglian Sales Ltd v South Pacific Manufacturing Co Ltd* [1984] 1 NZLR 249 (CA) at 252 for the proposition that a counterclaim does not provide a proper foundation for an injunction to restrain the issue of a winding-up petition, and instead the matter should proceed to determination, with the Court retaining the discretion as to whether it ultimately

makes a winding-up order or not. Associate Judge Abbott dismissed the application for stay.

[32] NZ Properties International Ltd cites *Popely v Popely* [2004] EWCA CIV-463. That case was an application to set aside a statutory demand under English insolvency legislation. The English statutory provision is similar to s 290 of the New Zealand Companies Act. The English Court of Appeal held that a cross-demand could provide grounds for setting aside a statutory demand when the creditor was demanding payment of a Court order for costs.

[33] Those cases were all decided at a stage earlier than the actual hearing of the liquidation application. Different considerations arise on the exercise of the discretion. The liquidation order changes the status of the company and places the assets of the company under the control of a liquidator. As I will discuss later, it also has a substantive effect on debts owed by and to the company. A court hearing an application for a liquidation order is entitled to take those effects into account in exercising its discretion.

[34] In another area of pay now argue later, the Construction Contracts Act 2002, the Court of Appeal has recognised that different considerations may arise on an application to set aside a statutory demand and on a decision to put a company into liquidation – *Laywood v Holmes Construction* [2009] 2 NZLR 243 (CA) at [61] and [65].

[35] As a general proposition, Heron's Flight Ltd is correct when it says that it is entitled to enforce an order for costs now and should not have its payment deferred while the defendant pursues its cross-demand. When there is no stay of execution, the judgment creditor is entitled to enforce the judgment without contested cross-demands being raised against the judgment creditor. But that approach does not necessarily apply when the Court is required to consider whether to make an order placing a company in liquidation.

[36] A particular reason why liquidation changes matters is the effect of s 310(1) of the Companies Act. That says:

### **310 Mutual credit and set-off**

(1) Where there have been mutual credits, mutual debts, or other mutual dealings between a company and a person who seeks or, but for the operation of this section, would seek to have a claim admitted in the liquidation of the company,—

- (a) An account must be taken of what is due from the one party to the other in respect of those credits, debts, or dealings; and
- (b) An amount due from one party must be set off against an amount due from the other party; and
- (c) Only the balance of the account may be claimed in the liquidation, or is payable to the company, as the case may be.

[37] Section 310 is a mandatory provision that operates at the time of liquidation. In *Rendell v Doors & Doors Ltd* [1975] 2 NZLR 191 at 199, Chilwell J said that the mutual credit and set-off provisions cannot be bargained away. When applied, the section produces a single balance of account between creditor and debtor company, and the liquidation proceeds on the basis of that single balance. Only the balance can be claimed in the liquidation or can be sued for by the liquidator. As Lord Hoffman explained in *Stein v Blake* (1996) 1 AC 245 at 251-254 the set-off operates automatically to extinguish credits, debits and dealings. It is self-executing and does not require action on the part of the parties. Where there is a contested claim, proceedings may be taken to establish the validity of the claim.

[38] In this case, the cross-demand by NZ Properties International Ltd may be set-off against its liability for costs. There is mutuality. Heron's Flight Ltd obtained its cost order in proceedings involving NZ Properties International Ltd's enforcement of its cross-demand. The claim for commission comes within "mutual credit, mutual debts or other mutual dealings".

[39] On an order putting the company into liquidation, s 310 will create one debt between Heron's Flight Ltd and NZ Properties International Ltd. NZ Properties International Ltd has a clear and persuasive case that Heron's Flight Ltd will owe NZ Properties International Ltd the net balance - \$57,900.

[40] That consideration is clearly relevant to the exercise of the discretion whether to make an order for the company to be put into liquidation. No other creditors have entered any appearances. There is no evidence of other creditors who would prove

in the liquidation. NZ Properties International Ltd can properly point to its cross-demand as giving it grounds to say that on liquidation Heron's Flight Ltd will not be a creditor.

[41] In *Covington Railways Ltd v Uni Accommodation Ltd* the Court of Appeal used the clear and persuasive standard for setting aside a statutory demand on the basis of a cross-demand. If that standard is appropriate for setting aside a statutory demand, it must also apply when the Court is considering the merits of a cross-demand in the context of a defended liquidation application.

[42] Accordingly, as NZ Properties International Ltd has established proper grounds to argue that under s 310 Heron's Flight Ltd will not be a creditor of the company, and as there are no other creditors pressing for a winding-up order, it cannot be right for the Court to make an order putting the company into liquidation.

[43] For these reasons, I decline to make an order that NZ Properties International Ltd be put into liquidation. Heron's Flight Ltd will have to look to other means of enforcement to secure payment of its order for costs.

[44] NZ Properties International Ltd suggested that Heron's Flight Ltd itself was in financial difficulties. That consideration is not relevant to the exercise of the discretion in this case.

[45] I make the following orders:

- (a) The application is dismissed;
- (b) Heron's Flight Ltd will pay NZ Properties International Ltd's costs in the sum of \$4,700. The defendant proposed this sum in its counsel's memorandum of 3 February 2011.

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R M Bell  
Associate Judge