#26

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2006-404-4219

IN THE MATTER OF	the Insolvency Act 1967
AND	
IN THE MATTER OF	the bankruptcy of GR Rees
BETWEEN	HOLMES CONSTRUCTION WELLINGTON LIMITED Judgment Creditor
AND	GARY JAMES REES Judgment Debtor

CIV 2006-404-4220

IN THE MATTER OF	the Insolvency Act 1967
AND	
IN THE MATTER OF	the bankruptcy of Ian Laywood
BETWEEN	HOLMES CONSTRUCTION WELLINGTON LIMITED Judgment Creditor
AND	IAN LAYWOOD Judgment Debtor

Hearing:	24 and 26 January and 8 February 2007
Counsel:	RB Hucker and A Cumming for judgment debtors D Hughes and M Casey for judgment creditor
Judgment:	9 February 2007 at 16:45

INTERIM JUDGMENT OF ASSOCIATE JUDGE FAIRE
[on application to set aside bankruptcy notices]

Solicitors:	Hucker & Associates, PO Box 3843, Auckland for judgment debtors Kensington Swan, PO Box 10 246, Wellington for judgment creditor

The applications

[1] Applications, for all intents and purposes in identical form, are made by the two debtors to set aside bankruptcy notices which have been issued against them. Counsel were agreed that my judgment should cover both applications. There are no special features identifying one which does not apply equally to the other. Accordingly, I proceed on that basis.

[2] The applications are made in reliance on s 19(1)(d) of the Insolvency Act 1967. They also rely on the Court's inherent jurisdiction.

[3] Section 19(1)(d) provides:

> **19 Acts of bankruptcy**
>
> (1) A debtor commits an act of bankruptcy in each of the following cases:
>
> ...
>
> (d) If a creditor has obtained a final judgment or final order against the debtor for any amount, and, execution thereon not having been stayed, the debtor has served on him in New Zealand, or, by leave of the Court, elsewhere, a bankruptcy notice under this Act, and he does not, within 14 days after the service of the notice in a case where the service is effected in New Zealand, and in a case where the service is effected elsewhere then within the time limited in that behalf by the order giving leave to effect the service, either comply with the requirements of the notice or satisfy the Court that he has a counterclaim, set-off, or cross demand which equals or exceeds the amount of the judgment debt or sum ordered to be paid, and which he could not set up in the action in which the judgment was obtained, or the proceedings in which the order was obtained:

[4] The applications are made in accordance with the requirements of r 830 of the High Court Rules which provides:

> **830 Setting aside bankruptcy notice**
>
> (1) Every application to set aside a bankruptcy notice must comply with rules 234 to [[262]] so far as they are applicable and with any necessary modifications.
>
> (2) If the application to set aside the bankruptcy notice cannot be heard until after the expiration of the time specified in the notice as the day on which the act of bankruptcy will be complete, the time is deemed

to have been extended until the application has been heard and determined.

(3) Until the application has been heard and determined, an act of bankruptcy is not committed by reason only of non-compliance with the notice.

What the debtors must establish

[5] Counsel were in general agreement on what a debtor must establish before the Court can make an order setting aside a bankruptcy notice. The debtor must either show that he has complied with the requirements of the bankruptcy notice or satisfy the Court that he has a counterclaim, set-off or cross-demand which equals or exceeds the amount of the judgment debt or sum ordered to be paid in which he could not set up in the action in which the judgment was obtained, or the proceedings in which the order was obtained.

[6] In the alternative, the debtor must establish proper grounds for the invocation of the Court's inherent jurisdiction.

[7] With respect to the matters pertaining to a counterclaim, set-off or cross-demand, the authorities establish that the debtor must:

a) Demonstrate that he has a claim of true substance which he genuinely proposes to pursue. *Sharma v ANZ Banking Group (New Zealand) Ltd* CA 211-92 18 August 1992 at 4 per Cooke, McKay and Anderson JJ;

b) Establish that he could not, by law, set up the counterclaim or set-off in the action on which the judgment which provides the basis for the bankruptcy notice was entered. *Clark v UDC Finance Ltd* [1985] 2 NZLR 636, 639;

c) If he relies on factual inability, he must establish some cogent circumstances because the primary emphasis is on the legal nature of the impediment: *Hardie v Booth* [1992] 1 NZLR 356, 362.

[8] I deal separately with what is required where the Court's inherent jurisdiction is relied upon later in this judgment.

The grounds advanced in support of the applications

[9] Mr Hucker advanced the applications on three grounds, namely:

a) The debtors have a counterclaim, set-off or cross-demand which equals or exceeds the amount of the judgment debt and which neither could set up in the action in which the judgment of Judge DM Wilson QC was entered;

b) Section 79 of the Constructions Contracts Act 2002 does not prevent a debtor from relying upon such a counterclaim, set-off or cross-demand in an application to set aside a bankruptcy notice;

c) In any event, the Court should exercise its inherent jurisdiction to set aside a bankruptcy notice so that the High Court may determine an appeal from the judgment of Judge DM Wilson QC and the Court of Appeal may determine an appeal from the judgment of Harrison J in respect of judicial review proceedings. In the exercise of its inherent jurisdiction Mr Hucker submitted that the Court may either set aside the bankruptcy notice, or stay the bankruptcy notice pending determination of the appeals, or simply adjourn this application so that the position is protected having regard to r 830(2) of the High Court Rules.

Background

[10] I adopt the background summary of facts set out in the judgment of Harrison J in *Willis Trust Co Ltd & Ors v Green & Anor* HC AK Civ 2006-404-809 25 May 2006 at [5]:

(1) The parties first contracted by an exchange of correspondence in September 2003 for Holmes to carry out what was described as Stage 1 of the Augusta Apartments Project to convert 37 apartments. The Stage 1 work involved partial demolition of the existing building, excavation, services, isolation and structural engineering. Holmes commenced work in November 2003;

(2) The parties entered into a formal written agreement on or about 26 March 2004 covering Stage 1 and the remainder of the work including construction of two additional levels to the building, additional annexes to the west side and courtyards. The contract documents included NZS3910. The stated price of $8,066,450 plus GST was less than the true contract price. Holmes agreed to this course to assist Willis and Messrs Laywood and Rees with their funding arrangements. In consideration Messrs Laywood and Rees agreed personally with Holmes to pay the differential of $250,881;

(3) The originally intended date for completion of the works was 16 November 2004 but the engineer did not certify practical completion until 9 June 2005. The contract works 'were not without their difficulties'. There were various delays. Holmes first claimed for a time extension in April 2004. Further extensions were claimed through until 23 August 2005;

(4) During the course of performance of the contract Holmes made and Willis paid progress claims on a monthly basis. Initially the engineer certified payment on most progress claims. As the work progressed, Holmes claimed almost 300 variations to the contract works. The engineer did not issue any variation price requests and only around 20 formal variation orders;

(5) Holmes gave notice on 28 February 2005 of its intention to suspend all work on 30 March 2005. It was dissatisfied with the engineer's treatment of its progress and variation claims. A meeting followed, resulting in Willis' agreement to pay Holmes $654,114 less retentions and plus GST by 8 April 2005 in settlement of a particular progress claim;

(6) The parties were unable to resolve other issues outstanding between them, although Willis made another payment of $129,749 including GST to Holmes in May 2005. Holmes, as noted, made a final payment claim on 23 August 2005 for $1,283,696 plus GST. On that date Holmes also applied for a further extension of 106 working days, additional to 40 days earlier granted, to 30 June 2005. The engineer did not determine this application until 22 November, granting an extension of 44 days;

(7) The engineer sent a progress payment certificate to Holmes on 20 September in response to its final claim, certifying a nil balance owing of $0.00. He wrote again to Holmes on 21 October advising that a final payment schedule was 'not able to be issued at this time'. Holmes filed its adjudication claim on 9 November.

The reference to "Holmes" is to the judgment creditor and the reference to "Willis" is to Willis Trust Company Limited

[11] His Honour's judgment further records at [3] and [4] the following:

> [3] In August 2005 Holmes submitted a final claim to Willis for payment of $1,283,696 plus GST. Its claim was expressed to be made pursuant to the Construction Contracts Act 2002. Willis neither paid the claim nor, Holmes alleges, filed the requisite payment schedule in accordance with the statutory provisions. Holmes then invoked its right to adjudicate its claim against both Willis and Messrs Laywood and Rees. In February 2006 the adjudicator, the first defendant, Mr John Green, issued his determination in Holmes' favour. On 1 March 2006 I made interim orders subject to conditions.
>
> [4] Willis and Messrs Laywood and Rees have applied to this Court for judicial review of the adjudicator's decision alleging lack of jurisdiction and numerous errors of law. They seek orders setting aside the determination and associated relief. Mr Sherwyn Williams, Holmes' counsel, accepts that the Court has a limited power of review but denies that the adjudicator erred. The adjudicator has agreed to abide this decision.

[12] Apart for disallowing an amount for GST and interest which was ordered by the adjudicator to be paid by the debtors, the adjudicator's determination was upheld by Harrison J in his judgment of 25 May 2006. His Honour made this determination on an application for judicial review of Mr Green's determination.

[13] The adjudicator's determination was entered as a judgment of the District Court pursuant to ss 73 and 74 of the Construction Contracts Act 2002 against Willis Trust Company Limited on 10 March 2006. On 29 March 2006 Willis Trust Company Limited gave notice to Holmes Construction Wellington Limited to arbitrate a dispute in relation to the construction contract. Correspondence followed between the parties' lawyers culminating in an acceptance by both of Mr Peter Fehl as arbitrator on 13 April 2006. A draft terms of reference to arbitration was exchanged but not signed. In correspondence dated 15 June 2006 Holmes Construction Wellington Limited wrote to the solicitors acting for Willis Trust Company Limited and the debtors as follows:

> Our client has now had an opportunity of considering its position in the circumstances as they now exist, including Willis Trust's continued unwillingness and/or inability to pay any part of the judgment which has

> been obtained against it (and, in the case of Messrs Laywood and Rees, to pay the moneys owed by them).
>
> Our client's claims, to the extent the moneys awarded by the arbitrator, are not in dispute and our client is continuing to take steps to enforce the adjudicator's determination. There seems little to be gained from our client's point of view, from an arbitration. Perhaps you might care to indicate your clients' position.

[14] On 21 June 2006 the debtors filed a notice of appeal against the judgment of Harrison J. No such step was taken by Willis Trust Company Limited.

[15] On 28 June 2006 Mr PG Sargison was appointed liquidator of Willis Trust Company Limited as a result of a shareholders' resolution putting the company into liquidation. The appointment of Mr Sargison was subsequently confirmed at a meeting of creditors on 28 July 2006.

[16] Judge DM Wilson QC, in the District Court at North Shore on 5 July 2006, ordered that Mr Greene's determination be enforced by entry as a judgment but in the terms as varied by Harrison J. It is this judgment on which the bankruptcy notice is based. On or about 13 July 2006 an appeal against this judgment was filed in the High Court. The appeal has been the subject of specific direction by Winkelmann J.

[17] The request to issue the bankruptcy notice was filed on 20 July 2006 and this application was filed on 7 August 2006. The liquidator, Mr Sargison, in an affidavit sworn on 1 November 2006 advised that he had instructed solicitors to finalise an opinion as to whether the arbitration is to proceed and as to whether he should consent to the continuation of the arbitration process. There has been no update of that position since Mr Sargison's affidavit was sworn.

The inherent jurisdiction ground

[18] As part of the submissions advanced in support of the invocation of the Court's inherent jurisdiction Mr Hucker advanced the following specific submissions:

a) There were no moneys due to the judgment creditor pursuant to the construction contract with Laywood and Rees;

b) The payments made under the contract ought to be applied, in the absence of agreement, to the oldest indebtedness first;

c) The oldest indebtedness is the fixed sum for the contract, ie under the contract with Willis, $6,978,060, and under the contract with Laywood and Rees, $250,881;

d) The actual sums paid by Willis as at 17 June 2005 totalled $9,388,314.40;

e) The judgment debtors were limited under their construction contract to the fixed sum portion of the contract only; and

f) Applying the rule in *Clayton's case*, the judgment debtors indebtedness has, in any event, having regard to the above, already been paid.

[19] In referring to the rule in *Clayton's case*, Mr Hucker referred to the summary contained in the judgment of Blanchard J in *Re C & D Webster Ltd (in liqn)* [1995] 3 NZLR 590 at 597 where His Honour said:

> In the absence of any statutory requirement for payments made by a debtor company to be applied in a particular manner, such as is found in subs (5), and in the absence of a binding arrangement between debtor and creditor governing the application of payments, receipts on a current account are, unless there has been a contrary appropriation by the creditor, taken to have discharged the earliest outstanding indebtedness: first in repays first out. This is the well-known rule in *Devaynes v Noble* (1816) 1 Mer 529 (*Clayton's Case*).

[20] There may have been a partial examination of the issue of what was due by the debtors to Holmes Construction Wellington Limited in the judicial review application before Harrison J. At [87] of his judgment His Honour recorded:

> [87] Second, Mr Carden submitted that Messrs Laywood and Rees' liability is reduced by payments of credits which have been made to Holmes. They are unable to quantify the amount. In the absence of

> quantification, the adjudicator was entitled to determine that they were liable for the full amount of $250,881.

[21] I should add, however, there is no reference in His Honour's judgment to the rule in *Clayton's case*. I cannot determine, on the material before me, whether the issue in fact was the subject of the examination in the way advanced by Mr Hucker both before the adjudicator or, for that matter, before Harrison J.

[22] The issue, however, caused me to ask Mr Hucker whether the matter was addressed by Judge DM Wilson QC when the District Court application to have the adjudicator's determination enforced as a judgment was determined. I raised that matter because applications to enforce adjudicator's determinations are dealt within sub-part 2 of the Part 4 of the Construction Contracts Act 2002 and, in particular, are governed by ss 73, 74 and 75 of that Act. What is significant, however, is that once an application is made to enforce an adjudicator's determination as a judgment of the District Court, a copy of the application together with a statement setting out the consequences of the defendant taking no steps in relation to the application are required to be served on the defendant pursuant to s 73(4). Section 74 sets out what a defendant, who opposes the entry of the adjudicator's determination as a judgment, must do. In particular, the grounds for opposition are set out in s 74(2) and are as follows:

> **74 Defendant may oppose entry as judgment**
>
> (2) The application for an order referred to in subsection (1) may be made only on the following grounds:
>
> (a) that the amount payable under the adjudicator's determination has been paid to the plaintiff by the defendant:
>
> (b) that the contract to which the adjudicator's determination relates is not a construction contract to which this Act applies:
>
> (c) that a condition imposed by the adjudicator in his or her determination has not been met.

[23] My initial concern was to see whether the first of the three grounds for opposing entry of a judgment had been the subject of consideration by Judge DM Wilson QC.

[24] Counsel informed me that in fact, despite the existence of an application filed by the defendant pursuant to s 74 of the Construction Contracts Act 2002 and apparently in the form required by r 461ZZL of the District Court Rules 1992 there had been no hearing of the application to enforce the judgment.

[25] The decision of Judge DM Wilson QC records that the application for entry of judgment is opposed. It records the three grounds for opposing such an application set in s 74(2). It records that the sole ground relied upon is a submission that the contract relied upon by the plaintiff to establish the liability of the defendants was not a contract to which the Construction Contracts Act 2002 applies. It records the appeal on that matter from the judgment of Harrison J on the application to judicially review the adjudicator's determination. It records the Judge's agreement with Harrison J's determination and his comment that, in any event, the High Court decision is binding on him.

[26] The notice of appeal from Judge DM Wilson QC's judgment was also produced and records the grounds of appeal as follows:

> a. the appellants were denied the right to natural justice and to have their application that the adjudicator's determination not be entered as a judgment heard and/or to be provided with the opportunity to file affidavits and/or to adduce evidence in support of their application in breach of section 27(1) of the Bill of Rights Act 1990;
>
> b. the application was determined by the Court without the appellants' being provided with an opportunity to present submissions to the Court;
>
> c. the learned District Court Judge failed to consider the exercise of any discretion to decline to enter judgment pursuant to section 74(2) of the Act and/or failed to articulate the principles on which the discretion not to enter judgment pursuant to section 74(2) of the Act could be considered;
>
> d. the learned District Court Judge applied incorrect principles in refusing to consider whether judgment ought not to be entered pending the determination of the appellant[s'] appeal to the Court of Appeal; and
>
> e. the judgment is otherwise in error in fact and/or in law.

[27] I granted a short adjournment so that counsel could check the District Court file and their respective office files. Both counsel confirmed to me that there had, in

fact, been no hearing of any application before Judge DM Wilson QC. They accepted that the Judge apparently dealt with the matter on the papers. That indicated immediately to me that there was a strong foundation for the proposition that the judgment itself had been irregularly obtained because there had, in fact, been no hearing and opportunity granted to the parties to present evidence and submissions on the issues raised by the application for enforcement and the defendants' opposition to it. That raises, at least, a foundation for the proposition that there has been a breach of s 27(1) of the New Zealand Bill of Rights Act 1990. In short, one of the components of natural justice, the principle of audi alteram partem had not been complied with. It must be emphasised that I am not specifically determining that issue because, in my view, that is either an appropriate matter for the appeal or, alternatively, a separate application to set aside the judgement. What is apparent, however, is that there is a sound foundation, in my judgment, for the first ground of appeal that has been alleged.

[28] Such a breach, if finally established, would mean that the judgment was irregularly obtained. In *O'Shannessy v Dasun Hair Designers Ltd* [1980] 2 NZLR 762 Greig J said at 654:

> The authorities are plain that where a default judgment is irregularly obtained the defendant is entitled ex debito justitiae to a setting aside. It is to be noted further that it is an irregularity in obtaining the judgment rather than the irregularity in the judgment itself.

[29] His Honour simply stated the position which was examined by Lord Greene MR in *Craig v Kanseen* [1943] KB 256 at 262 [1943] 1 All ER 108 at 113:

> Those cases appear to me to establish that an order which can properly be described as a nullity is something which the person affected by it is entitled ex debito justitiae to have set aside. So far as the procedure for having it set aside is concerned, it seems to me that the court in its inherent jurisdiction can set aside its own order; and that an appeal from the order is not necessary. I say nothing on the question whether an appeal from the order, assuming that the appeal is made in proper time, would not be competent.

From that I can interpolate that the judgment debtors may, in the alternative, file an application to set aside the District Court judgment as an alternative to carrying on with the appeal.

[30] It must be recalled that what is advanced here is a submission that the judgment was irregularly obtained. For that reason, it is not appropriate to consider the three important matters in considering applications to set aside judgments which are referred to in *Russell v Cox* [1983] NZLR 654 at 659 as they apply specifically to judgments regularly obtained.

[31] The bankruptcy notice requires there to be a valid final judgment of a Court by virtue of s 19(1)(d) of the Insolvency Act 1967.

[32] The application to set aside the bankruptcy notice relies, as one of its grounds, on the Court's inherent jurisdiction. In addition, it refers to the two appeals and, more particularly for the purposes of this part of the argument, the appeal from the District Court decision.

[33] The debtors' submission in respect of this matter relies upon the judgment of Master Kennedy-Grant in *re Wise, ex parte Benecke* HC AK B 227-95 and B228-95, 21 June 1995. In that case Master Kennedy-Granted noted that relief was not available to the debtors in that case pursuant to s 19(1)(d) of the Insolvency Act 1967 and the appropriate Rule. That was because the debtors did not have a counterclaim, set-off or cross-demand. After analysing the authorities, however, he concluded that the Court has an inherent jurisdiction where the debtors' case is based on an alleged defect in the process by which a judgment was obtained or where there is an arguable defence to the claim for which judgment was given. After satisfying himself that there was a foundation for the debtors' claim based on the two circumstances to which I have made reference, Master Kennedy-Grant then adjourned the application so that the Court could determine if the debtors' application to the District Court to set aside the judgment against them had been heard and determined. He ordered that a further adjournment would only be entertained if the debtors satisfied the Court that they had taken every step possible to ensure that their application to set aside the District Court judgment had been undertaken.

[34] Mr Hucker invited me to set aside the bankruptcy notices on terms as to the prosecution of the appeals. That approach is not justified for the reasons given by

the Court of Appeal in *Sharma v ANZ Banking Group (NZ) Ltd* at 5 to which I have already made reference. If the bankruptcy notices are to be set aside it can only be on the basis that no act of bankruptcy has occurred. In my view, the correct approach, if the inherent jurisdiction of the Court is to be invoked, is to do what Master Kennedy-Grant did in *re Wise, ex parte Benecke* and simply adjourn this application to check progress with the hearing of the appeals and on the condition that the debtors take all practical steps to prosecute those appeals diligently. In that way the effect of r 830(2) of the High Court Rules is preserved.

[35] This judgment is issued as an interim judgment. I will adjourn this application to a Miscellaneous Bankruptcy List to see what steps, if any, have been taken relative to the appeal in respect of Judge DM Wilson QC's judgment or, alternatively, if any application to set that judgment aside is made to the District Court, then, the position in respect of such application. Whether further adjournments are justified will depend upon what I am advised at the time about these matters.

[36] I record that counsel presented extensive submissions on grounds (a) and (b) referred to in [9] of this judgment. Those matters must await final determination of the outcome of the appeal or application to set aside judgment, if they are prosecuted or, if they are not, at a resumed hearing of this application. At the appropriate time, and if required, it is my intention to give specific directions concerning the completion of the hearing of this application.

Orders

[37] I order:

a) The applications are adjourned to the Miscellaneous Bankruptcy List at 11.45am on 28 March 2007;

b) The debtors are to take every step possible to ensure that the appeal, or alternatively any application to set aside the District Court judgment, is heard and determined promptly. In this respect, the

debtors must complete the matters ordered by Winkelmann J on 28 July 2006 without delay;

c) The Registrar shall refer the appeal file relating to the judgment of Judge DM Wilson QC to Winkelmann J with a copy of this judgment;

d) Costs are reserved.

JA Faire
Associate Judge