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IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV2006-404-4528

UNDER	The Insolvency Act 1967
IN THE MATTER OF	the bankruptcy of John Sadler
BETWEEN	INSITE DESIGN & DEVELOPMENT LIMITED Judgment Creditor
AND	JOHN SADLER Judgment Debtor

Hearing: 30 January 2007

Appearances: M Keal for Judgment Creditor
J R F Anderson for Judgment Debtor

Judgment: 27 April 2007 at 5.15 pm

JUDGMENT OF ASSOCIATE JUDGE H SARGISSON

Solicitors:
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[1] Mr Sadler, the judgment debtor, applies to set aside the bankruptcy notice served on him on 2 August 2006.

[2] The notice is based on a final judgment of the District Court in *Insite Design & Development Limited v Sadler* (District Court Auckland, CIV2005-004-3134, 7 April 2006) in which Judge Hole gave summary judgment for Insite. He ordered Mr Sadler to pay $118,164.67 in respect of a payment claim served on him by Insite under the Construction Contracts Act 2002, together with costs and disbursements of $10,019.13 and interest of $15,648.82.

[3] Mr Sadler has not paid the judgment debt and contends he is entitled to have the bankruptcy notice set aside. He relies on s 19(1)(d) of the Insolvency Act 1967.

[4] The relevant part of s 19(1)(d) states:

> (1) A debtor commits an act of bankruptcy ...
>
> (d) If a creditor has obtained a final judgment ... for any amount ... and he does not within fourteen days ... 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 ... which he could not set up in the action in which judgment was obtained ...

[5] Mr Sadler's position is that he has a genuinely triable claim which exceeds the amount of the judgment debt and which he could not set up as a counterclaim in the summary judgment proceeding. He says the reason why he could not set up the counterclaim is that s 79 of the Construction Contracts Act prevented him doing so and that he has commenced a separate proceeding in the District Court to pursue the claim.

[6] Insite opposes the application on three grounds:

a) First, that Mr Sadler's purported counterclaim does not satisfy s 19(1)(d) as it is not genuinely triable and in any event that it is less than the amount of the judgment debt.

b) Secondly, Mr Sadler could have set up his claim as a counterclaim in the summary judgment proceeding but for his own failure to take advantage of the payment schedule procedures under the Construction Contracts Act.

c) Thirdly, and in the alternative, s 79 of the Construction Contracts Act prevents the Court's giving effect to any counterclaim when considering Mr Sadler's application to set aside the bankruptcy notice.

[7] Mr Sadler also relies on the Court's inherent jurisdiction. He says that he is solvent and that the Court should, in its inherent jurisdiction, set aside the bankruptcy notice. Insite says there are no grounds for the exercise of the Court's inherent jurisdiction.

Legal Principles

[8] Under s 19(1)(d), the onus is on the judgment debtor to either show that he has complied with the requirements of the bankruptcy notice or to 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 which he could not set up in the action in which the judgment was obtained or the proceedings in which the order was obtained: see *Clarke v UDC Finance Limited* [1985] 2 NZLR 636 where Casey J dealing with the similar former provision stated at 637:

> Before I set the notice aside under r 41(3) of the Insolvency Rules 1970, he [the debtor] must satisfy me that he has a counterclaim, set off, or cross demand that equals or exceeds the amount of the judgment debt and which he could not have set up in the action in which the judgment was obtained.

[9] The authorities establish that the judgment debtor must:

a) Demonstrate that he has a claim of true substance which he genuinely proposes to pursue: *Sharma v ANZ Banking Group (NZ) Limited* CA (1992) 6 PRNZ 386 at 390 per Cooke, McKay and Anderson JJ;

b) Establish that he could not by law, set up the counterclaim, set-off in or cross-demand in the action on which the judgment which provides the basis for the bankruptcy notice was obtained: *Clark v UDC Finance Limited* [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.

[10] It is trite law that where the judgment debtor relies on the exercise of the Court's inherant jurisdiction, it is for the judgment debtor to show that there are proper grounds for the exercise of the Court's inherent jurisdiction.

Background

[11] In his judgment Judge Hole summarised the background facts to the summary judgment proceeding as follows:

> 1. By written agreement dated 11 September 2003 the plaintiff agreed with the defendant to undertake extensive renovations to a dwelling at 31 Orakei Road, Remuera, Auckland. The estimated cost recorded was $1,000,000.00 including GST.
>
> 2. By December 2004 the defendant had expressed to the plaintiff (*inter alia*) that he was concerned that he was being overcharged, that some of the work was substandard, and that the works were taking an excessive amount of time for completion. In a letter dated 4 December 2004 the plaintiff sought details of the defendant's concerns and suggested a meeting. It seems that some of the concerns of the defendant were ongoing. In a letter dated 8 August 2005 from the defendant's solicitors, the various concerns were repeated; but the letter did not contain any estimate of loss which the defendant might have sustained, other than that he was paying accommodation costs of $1,800.00 per week "since the expiry of the one year period"
>
> 3. Clause 41 of the agreement noted that the Construction Contracts Act 2002 applied and then set out how progress payments were to be made and paid; effectively incorporating the provisions of ss 20 to 23 (inclusive) of the Act.
>
> 4. By letter dated 23 September 2005 the solicitors for the plaintiff wrote to the solicitors for the defendant enclosing four payment claims in respect of the works totalling $118,164.67 including GST. Each payment claim noted it was made in accordance with s 20 of the Act and referred to attached very detailed invoices. Section 20 was

complied with. In accordance with the contract, unless a payment schedule was submitted by the defendant, the claim for $118,164.67 was payable within 10 days after receipt of the payment claim.

5. By letter dated 3 October 2005, the solicitors for the defendant acknowledged receipt of the payment claims. It repeated the complaints about overcharging and substandard work which it suggested "in some instances amount to a complete failure to perform the contract". It suggested there were additional problems with the house caused by the plaintiff's negligence which would be expensive to rectify. It specifically referred to plumbing errors and stated that it was estimated that rectification of them would cost $6,000.00. It concluded:

   Mr Sadler instructs that the defects in the renovations to his house will cost more to rectify than the amount claimed by your client. In addition he believes that Insite should reimburse him for all accommodation costs incurred after the one year period in which the project was to be completed, together with reimbursement for scaffolding retained due to unjustified delay by your client.

   Mr Sadler instructs that, for the above stated reasons, together with the reasons set out in the writer's letter of 6 August, he is not prepared to pay anything further to your client. On the contrary, he invited Insite to recompense him as suggested above.

6. As the plaintiff has not received payment of the claim for $118,164.67, the plaintiff has issued summary judgment proceedings against the defendant seeking that sum, plus contractual interest thereon and actual and reasonable costs of recovery pursuant to cl 41(d) of the contract. It claims that as the defendant has not served a payment schedule (as defined in s 21 of the Act) on the plaintiff, the defendant is liable to the plaintiff for the amount claimed under s 23 of the Act and cl 41(d) of the contract.

[12] His Honour summarised Mr Sadler's case at [10] – [13]:

10. I deal with the defendant's submissions in a different order from the way they were framed as the first two can be disposed of shortly.

11. The defendant has suggested that regardless of any deficiency which might be found in the letter of 3 October 2005 (which it says was a payment schedule) the reasons given for non payment constitute an arguable defence to the claim and accordingly summary judgment cannot be given. Venning J disposed of a similar submission in *West City Construction Ltd v Edney* (CIV2005-404-001006, 1 July 2005, Auckland registry). After referring to the well known dictum of Somers J in *Pemberton v Chappell* [1987] 1 NZSLR 1, 3 he said, simply:

    > The appellant's claim for summary judgment is based on the payment claim issued by its pursuant to that [Construction Contracts] Act. It must be considered in the context of the Act.

12. It was also suggested that as there was a dispute the matter should have gone to arbitration in accordance with cl 41 of the contract. (He may have meant cl 43). It matters nought. If there was a dispute about the claim, s 21 should have been invoked. The claim itself has never been disputed; rather a set off has been suggested. If the defendant thought there was a dispute, then he could have invoked the arbitration provisions. He did not do so.

13. The principal submission for the defence was that the letter of 3 October 2005 did amount to a payment schedule and that there was sufficient information in it to indicate how the zero scheduled amount was calculated. Further, if necessary, the letters of 4 December 2004 and 8 August 2005 could also be enlisted in aid of obtaining a calculation of the scheduled amount.

[13] His Honour rejected these submissions, including the principal submission that the letter from Mr Sadler's solicitors was sufficient to constitute a payment schedule that complied with s 21 of the Construction Contracts Act. He said:

> .. the tenor of the Act is to provide for payment claims being met promptly and the prevention of there being held up by specious unspecified counterclaims or set-offs. I doubt that the purpose of the Act is achieved by an unpaid employee being forced to undergo the sort of tortuous exercise which I undertook in paragraph 17 to work out how much is being deducted from its payment claim. In this case the problem faced by the defendant is compounded by the inadequacy of information set out paragraph 18. Finally, in this case it is material to observe that to require a strict adherence to s 21 does not significantly disadvantage the defendant whose remedies for his various complaints are still available to him notwithstanding that he must meet the payment claim of $118,164.67 now. If he does not like this result, he has little cause for complaint: all he needed to have done to achieve a result in his favour now was to have complied with s 21 and properly quantified his perceived losses.

[14] On 2 May 2006, before Insite had taken any steps to enforce the judgment, Mr Sadler made application to the District Court seeking an order staying the execution of the judgment pending payment into Court of the judgment sum and until the applicant's claim against the respondent has been heard and disposed of. Two of the grounds relied on were that Mr Sadler's income and cash flow were highly reliant upon seasonal conditions in the dairy industry and that he was currently heavily indebted, but that his financial position would improve on or about 30 June 2006.

[15] On 22 May 2006 and prior to the hearing of the stay application, Mr Sadler filed his District Court proceeding. His claim relies on three causes of action against Insite as follows:

a) An action for money had and received. This relates to alleged overpayments of labour costs and material costs.

b) Breach of contract. This relates to an alleged failure to complete various works including soundproofing in a proper and tradesmanlike manner, and on time.

c) Breach of the Fair Trading Act based on an alleged misrepresentation by Insite's director, Mr Hare, about the amount of materials used in the works and the number of man hours used in the works.

[16] Judge Everitt declined to make an order to stay execution. He heard the application in June 2006. He indicated that he was satisfied at that time that Mr Sadler was able to pay the debt.

[17] In his judgment, Judge Everitt also found that Mr Sadler did not take advantage of the opportunity afforded by the Construction Contracts Act to challenge Insite's payment claims served in 2005 and that real progress on Mr Sadler's claim could take some considerable time due to its "rather nascent stage". He said:

> It is my view that should the Court grant a stay as sought, in the circumstances of the judgment delivered by Judge Hole, it could be said that essential provisions of the Construction Contracts Act as to payment schedules and contested schedules would be circumvented.

[18] The Judge went on to find that the overall balance of convenience came down in favour of Insite and that Mr Sadler had not discharged the onus on him to prove that a stay was needed to avoid a probable substantial miscarriage of justice.

[19] Notwithstanding his clear obligation to make payment, Mr Sadler did not made any payments in satisfaction of the summary judgment. As a result, Insite issued a bankruptcy notice on 2 August 2006.

[20] The bankruptcy notice requires payment of $147,387.00. The sum is made up as follows:

a)	Judgment sum	$143,832.62
b)	Sealing fee on judgment	$30.00
c)	Certificate of judgment	$40.00
d)	Interest on judgment debt at the rate of 7.5% per annum from 7 April 2006 to 31 July 2006 under s 65A of the District Courts Act 1947 and continuing at the rate of $29.55 per day until judgment is satisfied	$3,338.25

[21] Mr Sadler filed his application to set aside the bankruptcy notice on 16 August 2006. A number of affidavits have been filed in support of each side's positions. The application was adjourned part-heard to allow the parties the opportunity to discuss settlement. Those discussions failed and I am required to determine the application.

Issues

[22] The primary issues for determination are:

a) Whether the counterclaim exceeds the amount of the judgment debt and is genuinely triable;

b) Whether Mr Sadler "could not set-up" his claim as a counterclaim in the summary judgment proceeding, as that term is used in s 19(1)(d).

c) Whether s 79 prevents the Court's giving effect to any counterclaim when considering the present application.

d) Whether the Court should set aside the bankruptcy notice in the exercise of its inherent jurisdiction by reason of Mr Sadler's assertions of solvency.

Consideration

Is the counterclaim genuinely triable? If so does the amount exceed the amount of the judgment debt?

[23] Mr Sadler relies on the following statement in the decision of Judge Everitt at paragraph 53:

> The Court is prepared to accept that there is a sufficient dispute raised by Mr Sadler to enable his claim to be treated as a bona fide claim.

[24] Mr Anderson conceded properly at the hearing that the claim lacks particularity as to quantum. Mr Anderson argued however that Mr Sadler's affidavit filed in support of the stay application rectified the deficiency, and when read together with the figures that are provided in the statement of claim, there is a claim in excess of $209,000.00.

[25] Mr Anderson pointed to estimates for labour overcharges - $65,000.00; materials overcharged - $42,168.00; repairs - $28,437.54; and delay - $54,000.00. He submitted it was reasonable to add to these figures $20,000.00 for stress and inconvenience making a total of $209,605.54.

[26] I am prepared for present purposes to accept that there is a triable claim that exceeds the amount of the judgment debt.

Is it correct that Mr Sadler could not set up his claim as a counterclaim in the summary judgment proceeding?

[27] Counsel for Mr Sadler argued that s 79 of the Construction Contracts Act caused a legal inability to raise a counterclaim in the summary judgment proceeding. He went on to argue, in effect, that the operation of s 79 compels a finding that Mr Sadler could not set up the counterclaim in the summary judgment proceeding. He

relied on *Re Capon (a bankrupt); Capon v Tuf Panel Construction Limited* (2004) 18 PRNZ 105 and particularly on [18] in the following part of the judgment:

> 15. Here, counsel for the judgment debtor argues that he could not set up his counterclaim in the North Shore District Court proceedings, in the sense that that phrase issued in s 19(1)(b) Insolvency Act 1969, because of the effect of s 79 Construction Contracts Act 2002.
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> 16. Section 79 states:
>
> In any proceedings for the recovery of a debt under s 23 or s 24 or s 59, the Court must not give effect to any counterclaim, set-off or cross-demand raised by any party to those proceedings, other than a set-off for a liquidated amount if –
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> a. judgment has not been entered for that amount; or
>
> b. there is not in fact any dispute between the parties in relation to the claim for that amount.
>
> 17. As to this, Judge Wilson in the District Court proceedings held at paragraph 32.2 that:
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> In view of the factual finding that the present defendant (the judgment debtor) is the correct defendant, and that the specific provisions of s 79 of the Act exclude counterclaim, set-offs or cross-demands, except in circumstances which do not apply here, this defence must fail.
>
> 18. Given this comment, on the face of it, I am satisfied that if the judgment debtor has a counterclaim, set-off or cross-demand here, it is clearly one which he could not have set up in the action or proceeding in the District Court in which the judgment was obtained against him.

[28] I reject the submission that s 79 compels a finding that Mr Sadler could not set up the counterclaim in his summary judgment proceeding.

[29] Section 19(1)(d) is obviously designed to ensure that all issues between the parties both ways be tried at once and that a bankruptcy notice only be set aside if the debtor has a counterclaim, set-off or cross-claim which either legally or factually could not be set up in the same proceeding: see *Hardie v Booth,* Tipping J at 362.

[30] The underlying principle is that s 19(1)(d) does not aid those who sleep on their rights but rather aids those who were unable to assert their rights due to factors beyond their control. It cannot be the correct position that the phrase "could not set

up in the action in which judgment was obtained" aids a debtor who could readily have provided a payment schedule to dispute a payment claim but failed without good reason to do so. I am led therefore to the conclusion that if the legal inability relied on is s 79, then the debtor must establish cogent circumstances which show that it is reasonable to rely on s 79 and that the legal inability relied on has not occurred because of the debtor's own inexcusable failure to take advantage of the payment schedule procedure under the Construction Contracts Act.

[31] There is no basis on the evidence for concluding that Mr Sadler's failure to take advantage of the payment schedule procedure was justified or excusable. There is no dispute that Mr Sadler could have set up his counterclaim in the summary judgment proceeding if he had simply complied with s 21 of the Construction Contracts Act and properly quantified his perceived losses under the payment schedule procedure. It is also clear on the evidence that Mr Sadler knew about the payment schedule procedure and that, through his lawyer, he told Insite he intended to invoke the procedure. All he needed to do was to provide a proper payment schedule, but he did not take the opportunity to do so.

[32] Judge Gendall's statement at [18] of the *Capon* case does not lead me to a contrary view. The statement needs to be read in the context of the case he was dealing with. He was concerned with circumstances in which the judgment debtor was caught out by the relative newness of the Construction Contracts Act and through excusable inadvertence failed to follow the strict procedures in the Act. He considered the creditor's argument that the debtors had slept on his rights and that the debtor's own failure to exercise rights under the Construction Contracts Act was the cause of his inability to set up his counterclaim in the District Court proceedings. He said:

> **Under the circumstances here, I reject this argument**. There can be little doubt that, perhaps as a result of the relative newness of the Construction Contracts Act, the judgment debtor did not follow the proper counterclaim procedures set out in the Act. That this should disqualify him from raising his counterclaim in these bankruptcy proceedings cannot, in my view, be the correct position. I do not accept that a judgment debtor with a genuine counterclaim should be subjected to the serious consequences of bankruptcy adjudication without the opportunity to raise this counterclaim simply through inadvertence or an omission to follow the strict procedures set out in the Construction Contracts Act.

[Emphasis added].

[33] Judge Gendall did not therefore rule out the possibility that the phrase in s 19 "could not set up" would not apply to a situation where a debtor failed without good reason to take the opportunity to provide a payment schedule under the Construction Contracts Act.

[34] For these reasons, I do not accept that s 19(1)(d) is intended to allow debtors a second chance where they themselves have created, without good cause or justification, the legal inability on which they rely.

[35] It follows that I am not satisfied that Mr Sadler has demonstrated that he could not set up his counterclaim in the summary judgment proceeding.

Does s 79 prevent the Court's giving effect to any counterclaim when considering the present application?

[36] Given my finding on the previous question, it is not necessary for me to consider whether s 79 of the Construction Contracts Act prevents this Court taking into account the counterclaim when dealing with an application to set aside a bankruptcy notice.

[37] A similar question was considered by the Court in *Volcanic v Investments Ltd v Dempsey & Wood Civil Contractors Ltd* 2006 PRNZ 971. The Court held that s 79 prevents the Court taking into account a counterclaim when dealing with an application to set aside a statutory demand, where the debtor failed to respond to a payment claim by way of the payment claim procedure. However, it is appropriate that I leave for occasion whether the same applies in an application to set aside a bankruptcy notice.

Should the Court set aside the Bankruptcy Notice by the exercise of its inherent jurisdiction?

[38] I come to Mr Sadler's alternative submission that the Court should set aside the bankruptcy notice in the exercise of its inherent jurisdiction. He says he is

solvent and that he has more than demonstrated his willingness to meet his obligation on the debt in the event that his District Court action fails by paying the amount of the judgment debt to a solicitor's trust account.

[39] I reject the submission. My reasons are as follows:

a) Solvency is not a specific ground for setting aside a bankruptcy notice under s 19 (1)(d). Counsel for Mr Sadler recognised this and advanced an argument that the Court should exercise its inherant jurisdiction to stay the application pending the outcome of Mr Sadler's District Court proceeding in order to avoid an abuse of process.

b) The debtor's submissions in respect of this ground rely on the judgment of Master Kennedy-Grant in *Re*: *Wise, ex parte Benecke* HC AK B277-95 and B228-95, 21 June 1995. In that case the Master noted that relief was not available to the debtors under s 19 (1)(d) because the debtors did not have a counterclaim, set-off or cross-demand. However after considering the authorities, he concluded that the Court has an inherent jurisdiction to stay the application to set aside, where the debtor's case is based on an alleged defect in the process by which judgment was obtained or where there is an arguable defence to the claim for which judgment was given which the debtor had been unaware of. The debtor had filed an application to set aside judgment.

c) Mr Sadler has not pointed to any circumstances of the kind described by Master Kennedy-Grant as a foundation for the exercise of the Court's inherent jurisdiction to stay the current application. There is no basis for concluding other than that the judgment in the District Court against Mr Sadler was properly obtained.

d) Counsel for Mr Sadler emphasised the payment into the solicitor's trust account. However at the resumed hearing, he made very clear

that those monies belong to a family trust and not to Mr Sadler. He also indicated that the trustees are not willing to make monies available to meet the judgment debt in the event that Mr Sadler's District Court action fails. The payment in these circumstances appears as merely a device to overcome Mr Sadler's difficulty in raising specific grounds under s 19(1)(d) for setting aside the bankruptcy notice. It does not provide the foundation for a finding that this proceeding should be stayed to avoid an abuse of process.

e) If, as Mr Sadler contends, he is solvent then that is a defence he can raise on a petition.

Result

[40] I conclude that Mr Sadler has not established the grounds for relief in terms of s 19(1)(d) or for relief in the exercise of the Court's inherent jurisdiction. In the circumstances he is not entitled to have the bankruptcy notice set aside.

[41] The application to set aside the bankruptcy notice is declined accordingly.

[42] Insite, the judgment creditor, is entitled to costs which I fix on a 2B basis together with disbursements as fixed by the Registrar.

Dated at Auckland on _____ at _____am/pm.

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Associate Judge Sargisson