#120

IN THE HIGH COURT OF NEW ZEALAND
WHANGAREI REGISTRY

CIV-2010-488-000613

IN THE MATTER OF	the Companies Act 1993
BETWEEN	KARIITI LTD Plaintiff
AND	DONOVAN DRAINAGE & EARTHMOVING LTD Defendant

Hearing: 15 November 2010

Appearances: F Collins for Plaintiff
R Bowden for Defendant

Judgment: 19 November 2010 at 4:30 pm

JUDGMENT OF ASSOCIATE JUDGE BELL

This judgment was delivered by me on 19 November 2010 at 4:30 pm pursuant to Rule 11.5 of the High Court Rules.
Registrar/Deputy Registrar

Date: .....

Solicitors/Counsel:
Gibson Sheat, Private Bag 31905, Lower Hutt
Urlich McNab Kilpatrick, PO Box 633, Whangarei

[1] Kariiti Ltd runs a modest ready mixed concrete operation at Oue near Rawene in South Hokianga. It supplied and laid concrete for Donovan Drainage & Earthmoving Ltd as a sub-contractor on the Bentzen Farms subdivision at Waipiro Bay in the eastern Bay of Islands. It has obtained an adjudicator's determination under the Construction Contracts Act 2002 that Donovan Drainage & Earthmoving Ltd pay it $110,664.89. It has entered the determination as a judgment in the District Court without opposition from Donovan Drainage & Earthmoving. It served a statutory demand. When there was no payment, it followed with an application that the defendant be put into liquidation.

[2] The defendant has applied for a stay of proceeding and restraint of advertising under r 31.11. It says that the adjudicator's determination order is wrong. It has issued a proceeding in the District Court seeking a determination of the correct amount payable under the contract. It seeks interim relief that it not be required to pay the amount of the adjudicator's determination until the District Court has found the amount payable under the construction contract.

[3] I gratefully borrow this summary from the judgment of Mallon J in *Gill Construction Co Ltd v Butler* HC Wellington, CIV-2009-406-203, 2 November 2009 [7]–[9]:

> [7] An adjudicator has the power to determine whether or not a party is liable to make a payment under a construction contract (s 48 CCA). The adjudication is binding on the parties and is of full force and effect even where any other proceeding relating to the dispute has been commenced (s 60 CCA). The amount of the adjudication is recoverable as a "debt due ... in any court" (s 59(2)(a) CCA) or an application can be made for the adjudication to be entered as a judgment in accordance with the procedures for that in the CCA (s 59(2)(c) CCA). There are only limited grounds on which the entry of judgment can be resisted and they do not include that a party disagrees with the adjudicator's view as to liability (s 74(2) CCA).
>
> [8] However, an adjudication does not necessarily finally resolve matters as between the payer and the payee. A party remains able to submit the dispute to a court (or other dispute resolution procedure) (s 26(1) CCA). The result is that a party can successfully obtain an enforceable adjudication under the CCA but separately have a judgment entered against them for the same amount. This can only occur if the Court proceeding is determined after the adjudication, because an adjudicator must terminate its proceedings if the court (or other dispute resolution) proceeding is determined first (s 26(3)). Providing the dispute is referred promptly to an adjudicator, this is unlikely to occur very often because the CCA procedure is subject to strict timeframes and few formalities.
>
> [9] A determination under the CCA therefore provides a mechanism by which payment of disputed amounts can be promptly

> required and enforced, even though the payer is able to separately contest that the payment was owing under the contract between the payer and the payee. If the payer's position is upheld in a separate proceeding, then the payee will be required to pay back the money that he or she received from the payee as a result of the CCA process. For this reason, the CCA has been described as a "pay now, argue later" regime and as giving rise to a "temporary" debt (eg. *Laywood v Holmes Construction* [2009] 2 NZLR 243 at [52]). Nevertheless, because it is a debt that may be enforced, it has been held that a statutory demand can be issued in respect of it: *Volcanic Investments Ltd v Dempsey & Wood Civil Contractors Ltd* (2005) 18 PRNZ 97.

[4] Similarly, when a payee serves a payment claim under s 20 of the Construction Contracts Act and a payer does not respond with a timely payment schedule under s 21, or does not pay the scheduled amount in a payment schedule under s 24(1), the payee may recover from the payer (s 23(1) and s 24(2)). As with the liability on an adjudication order under s 59, the liabilities under ss 23 and 24 are temporary, as their effect may be varied by the determination of disputes under the construction contract by other dispute resolution procedures under s 26(1) of the Construction Contracts Act.

[5] Under s 79, there are restrictions on counterclaims, set-offs and cross-demands that can be raised in proceedings for recovery of debts under ss 23, 24 and 59. Again, matters which a payer might wish to raise by way of counterclaim, set-off or cross-demand can be the subject of other dispute resolution procedures under s 26(1), and if resolved in favour of the payer, may result in recovery of sums paid under ss 23, 24 or 59.

[6] Payers have sometimes asserted that if they pay under ss 23, 24 or 59, the payee is unlikely to pay them back, even though they have good arguments to show that the payee will have been overpaid. At times, they have applied to the Court for interim relief. Cases in which these issues have been raised include *Concrete Structures NZ Ltd v Palmer* [2006] NZAR 513, *Gill Construction Co Ltd v Butler* [2010] 2 NZLR 229 (HC), *Yun Corporation Ltd v YOT Ltd* HC Auckland, CIV-2009-404-7656, 26 February 2010, *Canam Construction Ltd v Ormiston Hospital Investment Ltd* HC Auckland, CIV-2010-404-291, 10 August 2010.

[7] Courtney J gave the justification for providing interim relief in *Concrete Structures NZ Ltd v Palmer* at [17]:

> It cannot have escaped Parliament's notice that one party's position might be irretrievably prejudiced by the time a judicial review application had been determined. It is unlikely that it intended to preclude interim relief where

> one party faced this danger. In the balancing exercise between the rights of the party with a favourable adjudication to be paid immediately and the rights of the party claiming a breach of natural justice the significant factor must surely be the impact if the strict rights under the CCA prevailed. If the effect would be to permanently prejudice the other party so as to render its application for judicial review worthless, regardless of the outcome, then I cannot think that it was the intention. I do not consider that, as a matter of statutory interpretation, the CAA has the effect of ousting s 8 JAA.

[8] The issue in these cases is whether there should be a departure from the policy of pay now, argue later because any payment made now will not be recoverable later, that is, whether an interim payment will become a final payment.

[9] The issue may come before the Courts in a variety of applications: an application for interim relief under s 8 of the Judicature Amendment Act 1972 (*Concrete Structures NZ Ltd v Palmer*); an application for stay of a liquidation application under r 31.11 High Court Rules (the other three cases named above); an application to set aside a statutory demand on other grounds under s 290(4)(c) Companies Act 1993; an application for stay of execution under r 15.8 District Court Rules, as when an adjudicator's determination is entered as a judgment under ss 73 and 74 of the Construction Contracts Act. I do not say whether the issue could be raised in an application to set aside a bankruptcy notice. I am not required to decide that for this application and I leave it to be determined when the issue does arise.

[10] While each application will turn on its own facts and circumstances, there are two important considerations:

a) How real is the risk that the payee will not repay once there has been a final determination on the merits under a dispute resolution procedure under s 26(1)?

b) How strong is the payer's claim that the payee will have to repay under that later determination?

Risk of non-payment

[11] The risk must be more than nominal. It is not enough for the payer simply to express a concern about the payee's ability to repay. In England, the issue has arisen in applications for stay of execution under order 47 of the Civil Procedure Rules when adjudicators' orders under the Housing Grants Construction and Regeneration

Act 1996 have been enforced. That Act operates in a broadly similar way to our Construction Contracts Act. There is, therefore, helpful guidance from English decisions, just as Australian decisions under state Building and Construction Industry Security of Payments legislation are helpful. In *Total M and E Services Ltd v ABB Building Technologies Ltd* [2002] EWHC 248 at [52], Wilcox J said at 52:

> ... The risk of an inability to repay on due time is one of a number of factors to be taken account of in the balancing exercise. Where the risk is high as where there is strong uncontradicted evidence of a present inability to pay or a company is in administration a stay may be appropriate on terms safeguarding the disputed monies. The burden is clearly upon the party seeking a stay to adduce evidence of a very real risk of future non-payment.

[12] Similarly, in *Herschel Engineering Ltd v Breen Property Ltd* Technology & Construction Court, 28 July 2000, Judge Lloyd QC said:

> It is for the applicant to make out its case. It could, for example, have obtained credit references which can frequently show whether a company is in the eyes of its own bankers good for the repayment of the disputed debt. Such evidence is sometimes material. Again, it is not for the respondent to the application to produce management or other accounts. In any event that type of financial information can all too often be unreliable as it is either self-serving or of doubtful utility. It is for the defendant to establish the proposition that if there was a judgment which did not uphold the adjudicator's decision, then the amount due under that judgment would not then be honoured by the claimant. ...
>
> In addition, I cannot draw an inference that a company which was considered by the defendant to be worth the business granted to it by it within a few months of its formation last year, has somehow changed its nature in the course of the last year to become a company which is, as it were, teetering on the verge of insolvency either now and in the future, and will thus be unable to repay the money. On the evidence before me there has been no apparent change in the company. It still is an unknown entity in financial terms. That was the company with which the defendant contracted; that was the company which the defendant entrusted with the work. In my view that situation has not changed one iota between June 1999 and July 2000 except that the company itself has now become entitled to money due under the contract and the defendant does not wish to pay that money. That tells us nothing about the ability of the claimant to repay the money or its inability to do so.
>
> In my view, on an application for a stay where a party has enters [sic] into a contract with a company whose financial status is or may be uncertain and that finds itself liable to pay money to that company under an adjudicator's decision, the question may properly be posed: is this not an inevitable consequence of the commercial activities of the applicant that it finds itself in the position it is in? It has, as it were, contracted for the result. That is not normally a ground for avoiding the consequences of a debt created by the contractual

> mechanism... It is very easy (and prudent and relatively inexpensive) to carry out a search or to obtain credit references against a company whose financial status and standing is unknown. Not to do so inevitably places a person at a significant disadvantage. It has only itself to blame if the company selected by it proves not to have been substantial (as opposed to a material deterioration in its finances since the date of the contract).

[13] So, if the payee is in substantially the same financial position as it was when the payer chose to engage it under the construction contract, the payer can hardly complain about the risk of non-payment, because that is a risk the payer took when he entered into the contract with the payee. Similarly, when a payee's weakened position is attributable to a significant degree to the payer's failure to pay sums due under ss 23, 24 or 59, that is not a be good reason for relieving the payer from its obligation to pay.

[14] On the other hand, it is not the policy of the Construction Contracts Act to transfer between parties to construction contracts the risk of insolvency. So where the payee is in insolvent liquidation or receivership or administration, or there is no dispute that the payee is insolvent, then there will be evidence of an inability to repay.

[15] In this case, the defendant submitted that it was enough if there was a reasonable possibility that the payee might not pay. That puts the standard too low. Almost any payer could mount some case that it was reasonably possible that a particular payee might not repay. It dilutes the policy of the Construction Contracts Act. Relief should only be allowed when there is a high likelihood that the interim payment will become final.

Strength of payer's case

[16] When a payer asserts that his obligation to pay under ss 23, 24 and 59 of the Construction Contracts Act ought to be put on hold while a proceeding under s 26(1) is determined, he is asking to be relieved from the statutory policy of pay now, argue later. Whereas the payee's entitlement under the Act is a given, the payer is asserting a claim which has not yet been determined. The strength of the payer's asserted claim must be relevant to the decision whether to relieve him from the obligation to pay under ss 23, 24 and 59. Simply to assert a claim is not enough to justify departing from the statutory policy. The Court must be shown that the asserted claim is strong enough to warrant a departure. An appropriate standard is

that the payer must show a good arguable case. The test is a familiar one. It is used for freezing orders under r 32.2, when the court needs to assess the risk of a defendant removing or disposing of assets before judgment. See *Wilsons (NZ) Portland Cement Ltd v Gatx-Fuller Australasia Pty Ltd* [1985] 2 NZLR 11 at 21-22.

[17] For the payer to persuade the Court that it ought to be relieved from enforcement of its obligations under ss 23, 24 and 59 of the Construction Contracts Act, because of the risk that the payee will not repay, it needs to establish:

a) That there is a high degree of likelihood that the payee will not be able to repay if a determination after a dispute resolution procedure under s 26(1) goes in the payer's favour; and

b) That it has a good arguable case that it will succeed under the dispute resolution procedure under s 26(1).

[18] The above is the general approach. There will be some cases where the payer will be able to establish that one of these considerations is so obvious that there cannot be any doubt on the question. So, if the payee is in insolvent liquidation and the liquidator's report shows a gross deficiency for unsecured creditors, the likelihood of repayment does not require any discussion. Similarly, while many disputes under construction contracts can be fact specific and not susceptible to easy prediction as to success, there may be some cases where the outcome can be predicted as a foregone conclusion. In those cases, allowance for possible weakness in the payer's case becomes pointless.

[19] In cases where it is obvious that the payee will never be able to repay, or that the entitlement under ss 23, 24 and 59 will not survive a dispute resolution procedure under s 26(1), there is a reduced need to be satisfied on the other consideration. So, if a payee is a company in liquidation and there is no prospect of repayment, the Court may accept a less demanding standard for the strength of the payer's case. It might, for example, accept that there is a serious question to be tried. Similarly, if it is blindingly obvious that the payer must succeed under the s 26(1) procedure, then there is less need to prove the risk of non-payment by the payee.

[20] While I allow for the case where the payer's case is blindingly obvious, a word of caution is required. Disputes under construction contracts are typically not suitable for summary decision. Arguments about delays in performance, defective workmanship, over-charging and the like are not the materials to build an argument that the payer's case is blindingly obvious.

[21] When a payer does not adequately address both the risk of non-payment and the strength of its case, then it is hardly likely to get interim relief against non-payment under ss 23, 24 and 59.

This case

[22] On the strength of its s 26(1) case, the defendant put in evidence a letter its solicitors had written to the plaintiff's lawyers alleging error by the adjudicator. It said that it had since issued a proceeding in the District Court seeking payment of the amount of the adjudicator's determination. No copy of the District Court proceeding was provided, but I was told that the allegations in the notice of claim were general only. There was no evidence to persuade me that the adjudicator's determination might be overtaken by a judgment on the District Court proceeding.

[23] The defendant made some play of the fact that the plaintiff had not taken issue with the defendant's solicitors' allegations of error by the adjudicator. But that is beside the point. It is for the defendant to show that it has a good arguable case. Until it does so, the plaintiff has nothing to refute.

[24] On inability to repay, the defendant characterised the plaintiff as a moribund shell company. That is a misdescription. It has a site, plant and equipment, which is typical of a small-scale rural ready mix concrete operation. Trade creditors aside, it has no outside creditors. It carries no financing costs. It is current with its cement supplier. It has remained in business since it was incorporated in 1996. With the current downturn, business has dropped off but it is still trading.

[25] The plaintiff is in much the same position as it was when the defendant entered into its construction contract with the plaintiff. The commercial risk that the

plaintiff would not repay over payments has not materially changed. That is the risk the defendant took when it contracted with the plaintiff. It cannot properly ask now to be protected against that risk. The defendant has not made out a proper case for non-payment.

[26] Because the defendant is exposed to the ordinary commercial risks of non-payment, there is no reason for requiring the plaintiff to put up a bond or provide security for non-payment. The plaintiff refused to put up a bond because of the costs that go with that. I do not require it because this is not a case where there is such a risk of non-payment that the defendant requires protection.

[27] Almost in the same breath, the defendant also alleged that, because of its continuing operation, the plaintiff would not suffer if payment were withheld pending the outcome of the District Court proceeding. That submission runs counter to the policy of the Construction Contracts Act of requiring payment under an adjudicator's determination. It does not point to any risk against which the defendant needs protection. It does not give grounds for keeping the plaintiff out of the money due to it.

[28] Next, the defendant pointed to the delay by the plaintiff in presenting a payment claim. The work was carried out in 2006-2007. A payment claim was not made until October 2009. An adjudication claim was not filed until 26 May 2010. The defendant argued that this was significant delay that took the plaintiff outside the purpose of the Construction Contracts Act of ensuring cashflow during a construction project. It complained that in the intervening time it had settled with its principal and would now be prejudiced by this claim.

[29] There is nothing in the Construction Contracts Act setting a time limit after completion of a construction contract for lodging payment claims or seeking adjudication orders. There is evidence that the defendant was always aware of the plaintiff's claims. If it settled with its principal without first having settled with the plaintiff, it has only itself to blame. The alleged delay does not provide any grounds to stay the proceeding.

[30] The defendant says it has paid the sum of $110,664.89 into its solicitor's trust account to be held pending the decision of the District Court. It relies on that as evidence of its good faith. In addition, it also relies on the funds as evidence of solvency. It claims solvency as an additional ground for the stay of proceeding. The payment into the solicitor's trust account simply shows that it has the funds to pay the adjudication award. It is not evidence that it is able to pay all its debts as they fall due. It provided no evidence of its solvency.

[31] In *AMC Construction Ltd v Frews Contracting Ltd* (2008) 19 PRNZ 13, the Court of Appeal gave guidance when solvency is raised as a threshold issue, in that case as a stand alone ground for setting aside a statutory demand:

> [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 circumstances not present in this case.

[32] In *Gill Construction Ltd v Butler* at [25], Mallon J accepted that if solvency of a company is not a basis for setting aside a statutory demand, then it is also not a basis for staying the liquidation proceeding issued on the basis of an unsatisfied statutory demand.

[33] In this case, even if there were evidence as to the solvency of Donovan Drainage & Earthmoving Ltd, that would not provide proper grounds for staying the existing proceeding, in the light of its unwillingness to pay the sum due under the adjudicator's determination.

[34] The defendant also opposed advertising because of the potential detrimental effect on its business. The defendant can avoid advertising by paying the debt now under the statutory demand. There are no special factors in this case that justify restraining advertising.

[35] Taking all the circumstances into account, but especially the absence of any real basis for holding that the plaintiff will not be able to repay, and the absence of any evidence as to the strength of its claim in the District Court proceeding, I see no basis for staying the proceeding or restraining advertising. The application is dismissed.

[36] Under s 59(2)(a)(ii) of the Construction Contracts Act, the plaintiff is entitled to recover its actual and reasonable costs of recovering the sums payable under the adjudication. That includes its costs in opposing the stay application. The plaintiff has sought actual solicitor/client costs on this application in the sum of $6,695, plus disbursements of $831.90, a total of $7,526.90. The defendant is ordered to pay the plaintiff costs of $7,526.90.

R M Bell
Associate Judge