IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2005-404-5526

UNDER	the Companies Act 1993
BETWEEN	JIAN HUA PROPERTY LTD Applicant
AND	FREEMONT DESIGN & CONSTRUCTION LTD Respondent

Hearing: 29 November 2005

Appearances: Ms J A Wickes for applicant
Mr B J Burt for respondent

Judgment: 16 February 2006

INTERIM JUDGMENT OF ASSOCIATE JUDGE DOOGUE

Solicitors:
Loo & Koo, PO Box 99687, Newmarket, Auckland
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Background

[1] The parties entered into a contract for construction works at Ranui on 11 February 2005. The contract document was a substantial one running to some 80 pages. The contract sum was $967,189 plus GST.

[2] The contract appointed Engineering Design Consultants Limited ("EDC") as engineer. The role of the engineer is defined in the contract as being the principal's representative, giving directions to the contractor on behalf of the principal and issuing payment schedules on behalf of the principal (Clause 6.2.1(a) of General Conditions). The engineer was also to be an independent decision-maker and it was his role to value the work and issue certificates (Clause 6.2.1(b) of the General Conditions).

[3] The contract did not run its course. On 7 July 2005 Mr Patrick Harris of EDC e-mailed the respondent:

> Dear Keith, we met with the client Jian Hua yesterday ... with the frustration we are receiving from the ARC at present it is unlikely that much progress will be able to be made over the winter months before October. We have been asked to advise you that the client now wishes to seek a mutually agreeable ending to the present contract. All work completed and certified by EDC will be paid for. Could you please provide your view on this proposal.

[4] On 9 July the respondent replied:

> Thanks for this Patrick. Not an ideal situation but it is the client's decision at the end of the day. We will prepare a final account and advise accordingly.

[5] The following describes the events thereafter. On 16 August 2005 the respondent issued an invoice dated 31 July 2005 for $214,251.17 comprised of:

a) $24,202.19 (+ GST) for contract works;
b) $26,216.81 (+ GST) for variations;
c) $44,325.43 (+ GST) for down time due to ARC imposed restrictions and hold placed on work; and

d) $95,701.05 (+ GST) "for loss of profit incurred when the client instigated termination of the contract".

The due date for payment was 26 August 2005.

[6] On 25 August 2005 Mr Harris, who is an engineer, forwarded to the applicant and respondent his assessment of the respondent's claim with a schedule of prices and explanations of differences. He assessed the amount payable to the respondent at $8468.85. His letter had attached to it a document headed "Progress Certificate" which in its body stated:

> Progress Certificate No: 7 for period ended: 30 July 05

[7] That document set out the calculations as to what was owing. It summarised the total value of the work carried out, the retentions that needed to be made, the total net payments that had been made to that point in previous payments and the net amount, which appeared as follows:

Make payment number 7	$7,687.85	
	960.98	GST
	$8,648.83	Including GST

[8] The document also had annexed to it calculations of quantities and prices which fed into the "Progress Certificate" amount which the engineer certified for.

[9] On 16 September 2005 the respondent served the applicant with a statutory demand for $214,251.17.

[10] On 27 September 2005 the applicant paid the respondent Mr Harris' assessed amount of $8468.85.

[11] Following payment of that sum the respondent refused to withdraw the statutory demand and this application was filed on 29 September 2005 by Jian Hua.

[12] At the hearing, considerable discussion centred on the legal effect of the facsimile dated 25 August 2005.

The application and notice of opposition

[13] The applicant applies to set aside the statutory demand for $214,251.17. The grounds given are:

1) There is a substantial dispute as to whether or not the debt claimed in the demand is owing or due; and

2) What appears in the affidavits of Mr Sen (Jason) Xiao and Mr Harris filed in support of this application.

[14] In its notice of opposition the respondent states that it is opposed to the orders sought by the applicant on the following grounds:

> 1. there is no substantial dispute as to whether the debt stated in the demand is owing or due as:
>
> 1.1 the amount claimed was demanded as a payment claim pursuant to s 20 of the Construction Contracts Act 2002 (the Act);
>
> 1.2 no payment schedule was provided by the applicant to the respondent within the time required pursuant to s 22 of the Act;
>
> 1.3 the amount claimed is a debt due by the applicant to the respondent, pursuant to s 23(2) of the Act; and
>
> 1.4 will appear in the affidavits of Keith Douglas Logie and such other affidavits as may be sworn and filed herein.
>
> This application [sic] is made in reliance on:
>
> s 290 of the Companies Act 1993;
>
> ss 20-23 of the Construction Contracts Act 2002;
>
> rr 244 and 458(1) of the High Court Rules; and
>
> the affidavits to be filed in support of this application [sic].

Principles

[15] I adopt the following statement of principles which is taken from the judgment of Faire AJ in *Italia Motorsport Ltd v European Motors Ltd* (High Court, Hamilton, 18 October 2004, CIV-2004-419-950):

(4) The approach, which the Court takes to applications on each ground, can be shortly summarised. When considering an application pursuant to s 290(4)(a) of the Companies Act 1993 the Court is required to determine if the applicant can show a fairly arguable basis upon which it is not liable for the amount claimed. *Forge Holdings Ltd v Kearney Finance (NZ) Ltd* (High Court, Christchurch, M 149/95, Tipping J, 20 June 1995) at page 2 and *Queen City Residential Ltd v Patterson Co-Partners Architects (No 2)* (1995) 7 NZCLC 260,936. That formulation was approved by the Court of Appeal in *United Homes (1988) Ltd v Workman* [2001] 3 NZLR 447, 451-2.

....

(6) With respect to the Court's power to set aside a statutory demand under s 290(4)(c) the Court of Appeal examined this question in *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395. At 397 Tipping J said:

If the focus is on the justice of the particular case the discretion must always be exercised on a principled basis and not on some ad hoc perception of what individual justice might require. All cases involving s 290(4)(c) must in the end come down to a judgment by the Court as to whether the creditor's prima facie entitlement is outweighed by some factor or factors making it plainly unjust for liquidation to ensue.

(7) The following further observations must be made:

a) Whilst mere assertion will not be enough some sort of material short of proof which backs up the claim that the amount is in dispute is required: *Paramoor Eleven Ltd v Pramb Wong Enterprises Ltd* (High Court, Auckland, M 1460/94, Master Gambrill, 10 April 1995);

b) With respect to s 290(4)(c), the Court has a discretion to set aside a statutory demand on grounds other than those specified in ss (4)(a) and (b);

c) I endorse the comments of Wild J in *Apple Fields Ltd v Trustees Executors and Agency Co of NZ Ltd* 13 PRNZ 387, 395. He said:

The legitimate purpose of a statutory demand is to obtain payment of a debt due.

The arguments as to the claimed amount

[16] The procedure for making and responding to payment claims is set out in ss 19 –24 of the Act. The provisions of the Act bind parties to a construction contract, unless it is otherwise stipulated. The applicant submits that it complied with both the provisions of the Act and the contract. The applicant also submits that having received the respondent's claim on 16 August 2005, it complied with the

necessary steps in the Act and the contract by giving notice to the respondent that it did not accept the respondent's assessment as to final payment.

[17] The respondent submitted that the applicant failed to take the necessary steps to resist the claim set out in the invoice for final payment dated 31 July 2005. The respondent did not accept the applicant's assessment for final payment for two reasons.

[18] First, the respondent said that the applicant did not respond to the claim for payment in a way that complied with the requirements of the Construction Contracts Act 2002. A number of submissions were made under this head but the only one that I need to consider is based on the contention that the applicant never sent to the respondent a response to its payment claim which constituted a valid denial of liability pursuant to the procedure established by the Act. Specifically, such response as the applicant provided to the payment claim did not amount to a "payment schedule" within the meaning of s 21.

[19] The second main ground is that the applicant's assessment did not deal with payment claims for downtime and loss of profits (items (c) and (d) in the payment claim). EDC stated that it was not its responsibility to determine whether damages for downtime and loss of profits were in fact payable. The applicant's position is that these are claims for damages or compensation: that they are not claims in debt arising out of performance of work out of the contract and therefore they are not covered by the provisions of the Act. The applicant says that it did give proper notice declining those claims. The issue is whether the applicant is correct in that assertion.

[20] In order to assess these arguments I will need to consider the provisions of the contract and the Act.

The contract and the Construction Contracts Act 2002

[21] Sections 22-24 of the Act govern the procedure for making and responding to payment claims made by the payee (in this case the respondent) to the payer (in this

case the applicant). A payment claim is usually served on the payer for each progress payment. A progress payment includes any final payment under the contract.

[22] The first step in the procedure is that the payee must serve a payment claim on the payer in accordance with s 20 of the Act. Certain formalities are required. For example, the claim must be in writing and contain sufficient details to identify the contract in question: see s 20(2).

[23] The second step is that the payer may serve a "payment schedule" under s 21 on the payee. Certain formalities are required of a payment schedule. If a lesser amount than the claimed amount is included in the payment schedule then certain additional requirements must be met. Section 21(3) of the Act provides:

> If the scheduled amount is less than the claimed amount, the payment schedule must indicate—
>
> (a) the manner in which the payer calculated the scheduled amount; and
>
> (b) the payer's reason or reasons for the difference between the scheduled amount and the claimed amount; and
>
> (c) in a case where the difference is because the payer is withholding payment on any basis, the payer's reason or reasons for withholding payment.

[24] There are no prescribed forms in the Act for payment claims or payment schedules.

[25] Section 22 says, in substance, that a payer becomes liable to pay the claimed amount if a payee serves a payment claim on it and the payer does not provide a payment schedule to the payee within the time required by the relevant construction contract or within 20 working days.

[26] The procedure set out in the contract for the lodging of and response to claims was more elaborate than that contained in the Act. The steps were:

a) The contractor would submit a progress payment claim.

b) Within seven working days the engineer was required to issue a certificate in the form of a "Provisional Progress Payment Schedule" ("provisional schedule") to the principal and a duplicate to the contractor showing:

   i) The work to which the contractor's payment claim relates;

   ii) The sum certified by the engineer. This sum was the amount of contractor's payment claim less previous certified payments, less other deductions required by law or contract;

   iii) Show how (ii) was calculated; and

   iv) Set out reasons for any difference between the sum certified by the engineer and the contractor's claimed amount.

c) If the work to which the contractor's progress payment claim relates cannot be verified within seven working days, the engineer shall certify a reasonable estimate of the due amount.

d) Within three working days after the receipt of the engineer's certificate under b) the principal was to notify the engineer of any amendments or deductions that he/she required to be made from the sums certified by the engineer. Again, calculations and reasons were required.

e) Within two working days of receiving any notice from the principal under d), and in any event no later than 12 working days after receipt of the contractor's payment claim, the engineer was to issue a Progress Payment Schedule. This would contain the information in his original provisional schedule plus any additional "amendments or deductions" not notified under b) with reasons and calculations set out. The engineer is to also provide a Scheduled account (account in c) less/plus new amendments).

f) The engineer would send the original of the Progress Payment Schedule (that is the final certificate) to the principal and a duplicate copy to the contractor.

g) The scheduled amount then becomes payable within five working days of the date of the progress payment schedule.

First issue: Was the engineer's letter of 25 August 2005 to the payee a payment schedule for the purposes of s 21 of the Act?

[27] As I noted above, the Act does not prescribe forms for payment claims or payment schedules. The Act only requires that a payment schedule complies with the requirements set out in ss 20 and 21. The key is the provision of sufficient information to make clear the manner in which the claimed amount or the scheduled amount has been calculated: Bayley and Kennedy-Grant, *A Guide to the Construction Contracts Act*, 2003 p65-8.

[28] Although compliance with the requirements is essential, it is unlikely that "technical quibbles" that a payment claim or a payment schedule has not complied with Act will receive much of the court's attention: Smellie, *Progress Payments and Adjudication* 2003, p31-32. The Court of Appeal in *George Developments Ltd v Canam Construction Limited* (CA 244/04, 12 April 2005), stated at para [43] that "technical quibbles should not be allowed to vitiate a payment claim that substantively complies with the requirements of the Act." However, there must be substantial compliance with the requirements of s 23 of the Construction Act if the payer is to avoid the consequences set out in s 23 of the Act.

[29] A payment schedule is a notice to the payee that the payer does not accept part of the payee's claim. If a payer does not serve a payment schedule, then by default, the payee may enforce the payment of the amount claimed "as a debt". If that situation arises, a payer is limited in the matters that it can thereafter raise in opposition to a claim for the resulting debt. It seems likely that a payer can resist a claim in debt on the grounds that there never was a contract between the parties – at least that seems to be implicit in the judgment of *Salem Ltd v Topp End Homes Ltd*

(CA 169/05 27 September 2005). Also, pursuant to s 79 of the Act, a payer has very limited entitlements to set-off liquidated amounts that are owed to it by the payee.

[30] If the payer does not issue a document that can be reasonably viewed as a statement addressed to the payee that the payer does not accept liability for part of the claimed amounts, then the payer will not be protected from the enforcement provisions contained in the Act. The payee should not have to guess at the payer's intentions. A reasonable degree of certainty is required if the mechanisms contained in the Act are to accomplish the Act's objectives.

[31] In this case the communication which the payer relies upon is a document, the primary addressee of which was the payer and not the payee. The document did not describe itself as a "payment schedule".

[32] The document was conditional in some respects. For example, the engineer did not seem to come to a final view as to the extent of the earthworks and recommended that an earthworks "as built" survey be conducted for that purpose.

[33] There is also the relevant background circumstance which was the payments approval mechanism adopted in the contract. That contemplated that in two intermediate stages, over and above the two-stage process contemplated in sub-part 3 of Part 2 of the Act. That is, the contract contemplated that the next step after the receipt of a payment claim would be the engineer issuing a provisional schedule to the principal with a duplicate to the contractor. Thereafter, the principal had the right to require any amendments that must be made to the items in the provisional schedule. If the payer had required additional amendments or deductions the engineer would issue a progress payment schedule to the contractor reflecting the amounts the engineer provisionally certified for in the provisional schedule as modified by any amendments or deductions that the principal required.

[34] The significance of the engineer's document has to be seen against the background that the contractual procedure for processing claims was rather more elaborate than the procedure set out in the Act. The letter that the engineer sent to the applicant on 25 August 2005 could well be viewed as satisfying the first step in

the contractual procedure. That step as I have said envisages that the engineer will notify the principal of what sums the engineer believes are to be paid. That notification though is directed to the principal. The respondent was entitled to take the view that it was a notice complying with 12.2.1 of the contract and that it was preliminary to the "progress payment schedule" envisaged by 12.2.4 which might be expected at a later date. If that is correct, it was not a "scheduled amount" as defined in s 19 of the Act. The term "scheduled amount" is defined in s 19 in the following terms:

> **Scheduled amount** means an amount of progress payment specified in a payment schedule that the payer proposes to pay to the payee in response to a payment claim.

[35] The engineer's letter of 25 August 2005 does not clearly amount to a statement of the amount that "the payer proposes to pay to the payee". That letter is a preliminary communication between the engineer and the payer. An objective reading of the document would not convey to the payee that this was the statement by the payer of the amount that it proposed to pay. For that reason, it is not reasonably arguable that the payer in this case has complied with the requirements of the Act.

Second issue: Did the purported payment schedule not comply because it did not refer to the loss of profits and downtime claims?

[36] I understand that Mr Burt's next submission is that the letter of 25 August 2005 did not meet the requirements for a payment schedule as it did not certify payment to the contractor for its "downtime claim" of $44,325.43 and "loss of profit" of $95,701.05.

[37] Mr Burt drew to my attention to this passage in the engineer's letter to the applicant:

> The contractor's claim includes damages for downtime and loss of profit which we trust that you will review and seek a resolution on with legal advice if necessary. We are not going to negotiate a settlement on these matters given the opposing views of Principal and Contractor. EDC will provide impartial input if you wish to pursue an informal disputes resolution process.

[38] Mr Burt said that if the engineer's letter were a payment schedule, it would be required to include a response to the respondent's claim for loss of profits and downtime. He said the letter simply did not deal with the respondent's loss of profits and downtime claims and instead left those issues to the applicant. He said the letter therefore failed to indicate a total amount that the applicant proposed to pay to the respondent. For that reason, he said, the entire amount of the payment claim became due and owing because of the operation of s 25 of the Act.

[39] Before considering this issue further it is necessary to consider the circumstances in which the parties ended their involvement with each other.

[40] As I have already mentioned, the evidence is that on 7 July 2005 the engineer, Mr Harris, sent the e-mail to the contractor, which I have already referred to in paragraph [3]. In it he recorded that he had met with Jian Hua on 6 July 2005. It will be helpful to set out the text of that e-mail again:

> With the frustration we are receiving from the ARC at present it is unlikely that much progress will be able to be made over the winter months before October. We have been asked to advise you that the client now wishes to seek a mutually agreeable ending to the present contract. All work completed and certified by EDC will be paid for. Could you please provide your view on this proposal.

[41] The reply two days later, again by e-mail was sent by Mr Keith Logie of the respondent:

> Thanks for this Patrick. Not an ideal situation but it is the client's decision at the end of the day. We will prepare a final account and advise accordingly.

[42] Following that e-mail the respondent sent the invoice for $214,251.17.

[43] Ms Wickes for the applicant submitted that what occurred here was a mutual agreement between the parties to terminate the contract. She said that the applicant did not breach or repudiate the contract and accordingly no damages flowed. She said that the contractor's invoice included items which can only be explained as a claim for damages. She said these items were not contract claims which the contractor was entitled to issue payment claims for.

[44] Section 3(c) says that one of the objects of the Act is to provide remedies:

> "for recovery of payments under a construction contract."

[45] Sub-part 3 of Part 2 of the Act refers to "claimed amounts". The expression "claimed amount" appears in ss 20 to 24. It is defined in s 19 as:

> **claimed amount** means an amount of progress payment specified in a payment claim that the payee claims to be due for construction work carried out

[46] Section 16 establishes the right to progress payments. That term is defined in s 5 as follows:

> **progress payment—**
>
> (a) means a payment for construction work carried out under a construction contract that is in the nature of an instalment (whether or not of equal value) of the contract price for the contract (other than an amount that is, or is in the nature of, a deposit under the contract); and
>
> (b) includes any final payment under the contract

[47] Section 17 of the Act also makes it clear that payments are linked with work actually carried out.

[48] Here, the "loss of profits" claim is not something that the respondent is entitled to under the contract. Nor is the claim for downtime. These claims are not debts owed under the contract. They are the respondent's estimates of the loss it has suffered because it is no longer possible to carry out the work under the contract.

[49] It may be that the payee can claim for loss of expected profits and greater than expected expenditure incurred under the contract by way of damages or relief under s 9 of the Contractual Remedies Act 1979. But in my view the payer cannot invoke the payments regime under the Act to recover what are effectively claims for damages or compensation.

[50] If that analysis is correct, the claims are not covered by the procedure in Part 2. Therefore, the claims are not of a type that ought to have been included in a

payment schedule. If that is so, there was no obligation on the part of the applicant to respond to them.

[51] On this point, it follows that the applicant has a fairly arguable case.

Result

[52] I am not prepared to set aside in its entirety the statutory notice that the respondent served on the applicant. My intention is that the respondent should be able to proceed to enforce the claims that it has against the applicant with the exception of the figures for downtime and loss of profit. With those items excluded, I assess the balance payable as being $56,054.82, including GST. I understand that there should be deducted from this amount the sum of $8,468.85 which the applicant has paid. If that is correct, the amount owing is $48,252.53. These figures have not been the subject of express submissions from the parties, but I believe them to be approximately correct. If they are, the applicant has no basis for setting aside the statutory demand. However, I will allow the parties a period of seven days from date of delivery of this interim judgment to file any memorandum they may wish to in order to correct any substantial misunderstanding on my part concerning the resulting balance that is payable by the applicant based on the general thrust of my judgment. Thereafter I will issue a final judgment in the proceeding.

J P Doogue
Associate Judge