IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

CIV-2013-419-000929
[2014] NZHC 520

BETWEEN	JONATHAN DOUGLAS SEALEY and DIANE MICHELLE SEALEY Appellants
AND	GARY ALLAN CRAIG, JOHN LEONARD SIEPRATH, NEVILLE WARWICK WOODS, THOMAS GEORGE NELSON-PARKER, PAUL LEO BORICH and SCOTT ALAN HUNTER as partners of the firm of solicitors trading as Rice Craig Respondents

Hearing:	12 March 2014
Appearances:	T Braun and N J Edwards for Appellants P J Grace for Respondents
Judgment:	20 March 2014

JUDGMENT OF LANG J
[on appeal against order striking out part of claim]

This judgment was delivered by me on 20 March 2014 at 3.30 pm, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……

[1] This is an appeal against a decision of Judge Spiller in which he struck out part of a claim brought by Mr and Mrs Sealey ("the Sealeys") in the District Court against their former solicitors, the law firm Rice Craig.[1] The Sealeys contend that the Judge erred in striking out their claim, and that this Court should reinstate their claim in full.

Background

[2] The Sealeys entered into a construction contract with Bruce Downing Builders Ltd ("the builder") in respect of the construction of a new residence. After the Sealeys had made several progress payments, they received a payment claim from the builder in respect of the final amount owing under the contract. This sought payment of the sum of approximately $51,000.

[3] The Sealeys received the payment claim on 17 February 2011. If they wished to dispute the builder's claim, the contract required them to serve a payment schedule on the builder specifying the matters in dispute no later than 28 February 2011. The Sealeys were not happy with the amount of the builder's claim, and they also believed they had a counterclaim against the builder for defective building work. Mr Sealey initially spoke by telephone to Mr Norton, a partner of Rice Craig, on 24 February 2011. The Sealeys then met with Mr Norton on the afternoon of 28 February 2011 to discuss the problem.

[4] The Sealeys allege that Mr Norton did not tell them during either of these conversations that they were required to serve the payment schedule on the builder no later than the close of business on 28 February. Nor did he advise them of the consequences of failing to take that step. As a result, the Sealeys became liable to pay the full amount claimed in the payment notice, together with interest and the reasonable costs of recovering the debt.[2]

[5] The builder then issued proceedings against the Sealeys in the District Court. It sought judgment in respect of the amount due under the payment claim, together

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1 *Rice Craig v Sealey* DC Hamilton CIV-2011-019-727/732, 23 October 2013.
2 Construction Contracts Act 2002, s 23(2)(a).

with interest on that sum at the rate of 23 per cent per annum and legal costs. The Sealeys responded by issuing a counterclaim against the builder seeking damages of approximately $62,000 for defective workmanship. They also joined Rice Craig as a third party to the proceeding. The claim against Rice Craig was then stayed pending determination of the substantive disputes between the builder and the Sealeys.

[6] The builder went into liquidation in July 2013. Messrs Peri Finnigan and Boris van Delden were appointed as liquidators. The liquidators and the Sealeys then settled the claim and counterclaim in terms of a Deed of Settlement dated 14 August 2013 ("the deed of settlement"). The deed of settlement recorded that the Sealeys would pay the sum of $45,000 towards the builder's legal costs. The liquidators also agreed that the builder would pay the Sealeys the sum of $30,000 in settlement of their counterclaim. These two debts were to be set off against each other, resulting in the Sealeys being required to pay the net sum of $15,000 to the builder. The deed then prescribed a formula for payment of that sum. This was linked to the recovery by the Sealeys of any monies produced as a result of their third party claim against Rice Craig.

[7] The Sealeys then reactivated their claim against Rice Craig. Their claim has two bases. First, they allege that Rice Craig breached an implied term in the contract of retainer with the Sealeys. The implied term is broadly to the effect that Rice Craig would take reasonable steps to protect the Sealeys' interests in relation to the payment claim issued by the builder. This included the provision of advice regarding the requirement to issue a payment schedule in response to the builder's payment claim no later than 28 February 2010, as well as the consequences of any failure to comply with this requirement. Secondly, the Sealeys allege that Mr Norton acted negligently in failing to advise them of these matters. Under both heads they allege they have suffered loss in the sum of $45,000, being the amount they are required to pay to the builder under the deed of settlement in respect of legal costs.

[8] Rice Craig applied to strike out this aspect of the Sealeys' claim. It contended that the deed of settlement required the Sealeys to pay the builder the net sum of $15,000, and that they are not entitled to claim a greater amount from Rice Craig. Judge Spiller upheld this argument. He held that the Sealeys did not suffer a

net loss of $45,000 under the deed of settlement. Rather, they suffered a net loss of $15,000. That loss reflected the benefit that the Sealeys received as a result of the set-off arrangement in respect of the amount payable by the builder in relation to the Sealeys' claim for defective workmanship.

Strike out: relevant principles

[9] The jurisdiction to strike out a plaintiff's claim is contained in r 2.50.1 of the District Courts Rules 2009. This provides that a pleading may only be struck out if it discloses no reasonable cause of action, is likely to cause prejudice or is otherwise an abuse of the Court's process. The discretion is sparingly exercised.[3] As the Judge correctly observed, it will be justified only where the case as pleaded is so untenable that the claim cannot possibly succeed. The case must be "so certainly or clearly bad" that it should not be permitted to proceed further.[4]

[10] In considering a strike out application, the Court must proceed on the basis that the plaintiff will be able to prove the factual allegations that form the basis of its claim. Where the defendant contends that the plaintiff's pleadings do not disclose an arguable cause of action based on those facts, extrinsic evidence may only be taken into account if it is uncontroversial and does not contradict the pleadings.[5] In the present case, the Judge was required to determine Rice Craig's application on the basis of the allegations contained in the notice of claim that the Sealeys have filed in the District Court, together with the terms of the deed of settlement.

Preliminary issue

[11] Rice Craig did not seek to strike out either cause of action upon which the Sealeys propose to rely at trial. Rather, it sought an order striking out one of methods by which the Sealeys seek to calculate the quantum of their loss. Ordinarily, and subject to the provision of appropriate particulars, issues relating to quantum will be matters requiring proof at trial. The plaintiff calculates its loss, and then endeavours to prove it in accordance with established legal principles.

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3 *Attorney-General v Prince & Gardner* (1998) 1 NZLR 262 at 267.
4 *Couch v Attorney-General* [2008] NLSC 456 at [33].
5 *Attorney-General v McVeagh* [1995] 1 NZLR 558 at 566.

[12] Objections to the manner in which the plaintiff seeks to establish the quantum of its loss will not generally be capable of resolution using the strike out procedure. An exception to this principle may exist where the defendant can show that the plaintiff has not suffered any loss as a result of the acts or omissions giving rise to the claim. In such a case the Court may properly find that it would be an abuse of process for the claim to be permitted to proceed further.[6] In the present case, however, the builder accepts that the Sealeys have an arguable claim to damages in the sum of $15,000. That principle is therefore of little assistance in the present case.

[13] In determining that it was appropriate to strike out part of the Sealeys' claim, Judge Spiller relied on the following passage from the judgment of Associate Judge Faire (as he then was) in *Envirosand Mercer Ltd v Perry Resources (2008) Ltd*:[7]

> [8] A partial strike out of a pleading may be justified where the portions to be struck out support a cause of action *which relies on different facts to the remaining causes of action in the claim.* That is because both the preparation for trial and the time of the trial itself may be substantially reduced thus justifying the benefit of the interlocutory examination. (emphasis added)

[14] In the present case, the issue is whether the appropriate quantum of damages is $45,000 or $15,000. In either case, however, the claim is based on the same allegation of fact - the alleged failure by Rice Craig to advise the Sealeys of the requirement to serve a payment schedule no later than 28 February 2010, and the consequences of not responding to the builder's payment claim by that date.

[15] I therefore have very real doubts as to whether the strike out procedure was appropriate in the present case. It would have been preferable, particularly given the relatively small sum in dispute, for the parties to have proceeded to trial based on the existing pleadings. The Sealeys would then have been required to satisfy the trial Judge that their interpretation of the effect of the deed of settlement was to be preferred.

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6 *Garrett v Max Pennington Motors Ltd* [1996] DCR 244 at 262.

7 *Envirosand Mercer Ltd v Perry Resources (2008) Ltd* HC Hamilton CIV-2000-419-944, 23 June 2010, cited at [11] of Judge Spiller's decision.

[16] Be that as it may, both counsel now ask this Court to determine whether the Judge was correct in his analysis of the net effect of the deed of settlement on the Sealeys' claim for damages against Rice Craig.

The arguments

[17] The arguments for both parties can be simply stated. Both rely upon the terms of the deed of settlement as supporting their respective stances. These are as follows:

> **Payment and Offset**
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> 9. The parties acknowledge that the Company has incurred legal fees of $48,012.48 in attempting to recover the alleged sums owing under the payment claim. The Sealeys agree to settle their alleged liability in respect of the Company's Claim against them by a payment of $45,000.00. For the sake of clarity, the sum of $45,000 is by way of payment from the Sealeys towards actual and reasonable costs of recovery of the claimed amount in the payment claim pursuant to section 23(2)(a) of the Construction Contracts Act 2002.
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> 10. The Sealeys say the total cost of remediating any alleged defects to the Property are $62,008.00. The Sealeys agree to settle issues in respect of the value of their Counterclaim by payment from the Company to them of $30,000.00.
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> 11. The payments described in clauses 9 and 10 are to be set-off with the net result being a payment from the Sealeys to the Company of $15,000.00 ("Settlement Sum").
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> 12. The net payment of $15,000.000 is to be made as follows:
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> (a) The Sealeys are to pay $1,000.00 to the liquidators within 30 calendar days of the execution of this Deed by all parties.
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> (b) The Sealeys are to pay the remaining $14,000.00 upon determination of the Rice Craig Claim as follows:
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> ...

[18] The Sealeys point out that Clause 9 of the Deed required them to pay the builder the sum of $45,000. This reflected a compromise of the builder's claim in respect of the actual and reasonable legal costs that it incurred in attempting to recover the debt created when the Sealeys failed to respond to the payment claim

within the prescribed time. The Sealeys contend that they incurred this debt as a direct result of the failure by Rice Craig to provide them with proper advice.

[19] The Sealeys maintain that it is irrelevant that the parties also agreed that this debt could be partially set off against the debt owing by the builder in respect of the defective workmanship. The Sealeys say that the builder cannot obtain the benefit of that particular arrangement, because it merely reflected the means by which the parties to the deed agreed that the debt could be paid. The Sealeys contend that Rice Craig should not receive the benefit of their counterclaim against the builder for defective workmanship. That was an entirely separate issue, and did not affect their liability to the builder in respect of legal costs.

[20] The Sealeys argue that there is a distinction between mitigation and set-off. They accept that Rice Craig is entitled to the benefit of mitigation, but argue that it is not entitled to the benefit of the set-off agreement as it is not a party to that agreement. They argue that the loss that flowed from Rice Craig's wrong was the full $45,000. If the parties had not agreed to set off the amounts, the Sealeys would have been entitled to recover this full amount as the counterclaim had nothing to do with the loss suffered.

[21] Rice Craig does not accept the validity of the Sealeys' arguments. It contends that the deed reflects a compromise of all claims that the parties had against each other. It imposed a net liability on the Sealeys to pay the sum of $15,000 to the builder. They will never have to pay more than that sum to the liquidators. It would therefore be wrong in principle to permit the Sealeys to recover a greater amount from Rice Craig.

[22] Rice Craig emphasises that the focus needs to be on the Sealeys' actual loss. They submit that in setting off their claim against the builders the Sealeys reduced the loss actually suffered to $15,000. The extra $30,000 was, in Rice Craig's submission, a completely hypothetical loss. The legal effect of the set-off agreement was that the Sealeys' liability was limited to $15,000, there was no liability to pay $45,000.

[23] Rice Craig relies on the following statement of Viscount Haldane in *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of Ltd Ltd*:[8]

> When in the course of his business he [the plaintiff] has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act.

[24] Rice Craig submits that this passage provides support for the proposition that it should be entitled to the benefit of the set-off arrangement, as this agreement reduced the actual loss suffered by the Sealeys. The Sealeys never had a liability to pay $45,000.

[25] Rice Craig further submits that it is irrelevant that if the matter had proceeded to trial there would be no set-off between the builder's claim against Sealey and the Sealeys' claim for defective workmanship. Once again the focus needs to be on the loss actually suffered.

[26] Rice Craig does not accept that an innocent party that takes steps to mitigate its loss is entitled to recover the expenses incurred in mitigating that loss, but submits that the Sealeys have not incurred additional loss or damage as a result of mitigating their loss.

Decision

[27] The deed of settlement imposed an obligation on the Sealeys to pay the builder the sum of $45,000. That sum related specifically to the builder's claim for reimbursement of the legal costs it incurred when it enforced the debt created by the Sealeys' failure to serve a payment schedule within the prescribed time. The debt was therefore arguably incurred as a result of Rice Craig failing to advise them of that requirement. It can also be argued, however, that the Sealeys elected to mitigate this loss by foregoing their counterclaim for the defective work. In agreeing to the set-off arrangement they gave up their contractual right under the deed of settlement

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8 *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of Ltd Ltd* [1912] AC 673 (HL) at 689.

to be paid the sum of $30,000 in respect of their counterclaim. Prima facie, it cost them $30,000 to reduce their overall liability under the deed in that way.

[28] A plaintiff who elects to mitigate its loss is generally entitled to be reimbursed for the reasonable costs of mitigation by the party responsible for causing the loss.[9] Whether or not the Sealeys can seek to be reimbursed in respect of the sum of $30,000 will depend, in my view, on whether the builder was in a position to pay them that sum at the time the deed was signed. If the builder had the ability to make that payment, the Sealeys' claim must be arguable. In that event, the fact that they agreed to forego a payment that they would otherwise have received meant that they suffered a total loss of $45,000.

[29] The position would be different, however, if the builder did not have the means to pay the Sealeys the sum to which they were entitled under the deed. In that event their counterclaim was effectively worthless, because it could not have produced the sum for which they received the benefit of the set-off under the deed. The cost of mitigating the loss would therefore be negligible. In that event, the Sealeys' loss would be reduced to $15,000, being the amount they are still required to pay to the builder under the deed.

[30] Although the builder was in liquidation when the deed was signed, that does not necessarily mean that it was insolvent. It is possible that as at 14 August 2013 it had the means to pay all of its debts, including the debt owing to the Sealeys under the deed of settlement. Whether or not that is the case cannot be determined within the context of the present strike out application, because neither the pleadings nor the deed of settlement deal with the issue. It must therefore be determined at trial.

[31] In addition, the Sealeys might argue that the strength of their counterclaim was such that if they had served a payment schedule within time, they would have obtained a payment of more than $30,000 from the builder. Alternatively, the builder could argue that the counterclaim was so weak that the Sealeys would have obtained a greatly lesser sum. These are issues that cannot be determined within the context

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[9] See *Jagger v Lyttelton Marina Holdings Ltd* [2006] 2 NZLR 87 (HC) at [189]; and *Adros Springs (Owners) v World Beauty (Owners)*[1970] P 144 (CA) at 156.

of a strike out application. They depend on facts that are not contained within either the pleadings or the deed of settlement.

[32] If Rice Craig wish to pursue a defence based on mitigation, their pleadings will obviously need to be amended accordingly. That will provide the Sealeys with the opportunity to amend their claim so as to seek reimbursement in respect of the reasonable costs of mitigating their loss. It might be more cost effective for the Sealeys to amend their claim first and for Rice Craig to respond to the amended claim, but that is a matter for the parties and their counsel. As matters stand, however, I have concluded that it was premature for the Sealeys' claim to be partially struck out.

Result

[33] The appeal is allowed. The order striking out the Sealeys' claim for damages in the sum of $45,000 is set aside.

Costs

[34] To some extent both parties have succeeded on the appeal. The Sealeys have succeeded in having Judge Spiller's order set aside, but Rice Craig has succeeded in its argument that it is entitled to the benefit of the manner in which the Sealeys mitigated their loss. My initial impression is therefore that costs should lie where they fall. If either party takes a different view, succinct memoranda should be filed within the next 14 days and I will deal with that issue on the papers.

Lang J

Solicitors:
Rice Craig, Papakura
Counsel:
P J Grace, Pukekohe