

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

CIV-2010-404-3209

BETWEEN SPOTBURN FARMS LIMITED
 Applicant

AND STOCKCO LIMITED
 Respondent

Hearing: 27 September 2010

Counsel: S Grant for Applicant
 M Morrison for Respondent

Judgment: 22 February 2011 at 2:30 PM

**RESERVED INTERIM JUDGMENT OF ASSOCIATE JUDGE SARGISSON
(Setting aside Statutory Demand)**

*This judgment was delivered by me on 22 February 2011 at 2.30 pm pursuant to
Rule 11.5 of the High Court Rules*

Registrar/Deputy Registrar

Date

*Solicitors:
Knight Coldicutt, Auckland City
Lowndes Jordan, Auckland*

Introduction

[1] The applicant, Spotburn Farms Limited, applies for an order under s 290 of the Companies Act 1993 setting aside a statutory demand. The statutory demand, dated 7 May 2010 was served on Spotburn on 12 May 2010, and seeks payment of \$323,773.12. The payment, sought by the respondent, Stockco Limited, is essentially repayment of \$224,500 plus GST of \$28,062.50 paid under an agreement that the parties entered into for the sale and purchase of livestock. Stockco seeks the remaining \$71,210.62 as interest pursuant to the agreement.

[2] Spotburn's application was filed and served within the statutory time limits prescribed by s 290.

[3] The application is opposed. Save for the GST and interest components Spotburn concedes it is liable to repay the amount claimed in the statutory demand. It contends nonetheless that the demand should be set aside. It does so essentially on alternative grounds: that the demand is invalid, and that there is a substantial dispute about its liability to refund the GST and about the calculation of the interest claimed.

[4] It seems no order was made extending the time for compliance with the demand when the application was first before the Court on 16 June 2010. But agreement to such an order is implicit in the way the parties have proceeded. Plainly such an order would have been made but for the parties' oversight, and should now be made. I proceed on that basis.

Background

[5] The essential facts are as follows.

[6] The parties entered into a livestock agreement on 3 June 2008. The relevant terms of the agreement provide:

- (a) Spotburn was to procure livestock on Stockco's instructions and at Stockco's cost, with payment to be made on receipt of Spotburn's invoice: cls 1.1 and 1.2;

- (b) Title to the stock was to pass to Stockco on acquisition: cl 2.1;
- (c) Spotburn was to farm the stock: cl 3.2;
- (d) Spotburn was to deliver the stock to a processing plant or sale venue nominated by Stockco on a specified date: cl 6.1;
- (e) Spotburn was to ensure that the stock delivered met requirements set out in Schedule A to the agreement, and that it passed the Ministry of Agriculture's export inspection requirements at the time of delivery and slaughter: cl 6.3;
- (f) Spotburn was to pay Stockco any difference between Stockco's payment and the processing price as a debt payable immediately together with contractual interest: cl 6.8.

[7] The agreement also provided that:

- (a) Spotburn was to indemnify Stockco against any cost, loss, liability, or expense whatsoever incurred as result of failure to act other than in strict accordance with the authority given by the agreement: cl 1.6;
- (b) Spotburn was required to pay Stockco liquidated damages should stock die or be lost during the term of the agreement in the amount of the cost price paid for the stock plus contractual interest: cl 5.2;
- (c) Stockco also had the right to terminate the agreement for specified acts of non-performance. Upon termination Spotburn was to repay the cost price paid for the livestock plus contractual interest and penalty interest if it had sold, disposed of, or otherwise parted with possession of the livestock: cl 8.3.

[8] Materially, under the agreement interest for the purposes of cls 5.2 and 8.3 is calculated on different bases. Broadly, in both cases, there is a right to interest on the price of the stock calculated at the rate specified in Schedule A and compounded

monthly from the date of the payment, but under cl 8.3 there is a right to penalty interest at the rate of 6% above the Schedule A rate.

[9] Stockco's first instruction to procure stock was set out in the agreement. On Spotburn's behalf, Spotburn was to buy, take possession of and farm 700 deer and 1100 lambs that Spotburn had contracted to buy as part of a farm purchase to which Stockco was not a party. It was also to deliver the stock to a nominated plant for processing on Stockco's instruction. Spotburn received an advanced payment from Stockco for the stock's acquisition and was expected to take possession of the stock on settlement of the farm purchase.

[10] Spotburn failed to comply with Stockco's instruction. It lacked the funds to settle the farm purchase without which it could not obtain possession of the stock.

[11] In November 2008, Stockco gave a three month extension to enable Spotburn to obtain the livestock and otherwise perform its obligations under the agreement. On 18 December 2008 and before the three months was up Stockco sent an invoice seeking a refund of the price it had paid for the stock (including the GST it had paid) plus interest, apparently anticipating the possibility that Spotburn's default would go unremedied.

[12] Spotburn remained unable to settle the farm purchase. The extension expired and Spotburn's breach indeed continued largely unremedied. On 12 June 2009 the parties did attempt to implement a repayment plan. One payment of \$20,000 was made by PGG Wrightson on Spotburn's behalf. However, no further repayments were made.

[13] Accordingly, Stockco issued successive statutory demands on 23 December 2009 and 7 May 2010. The first lapsed. The parties sought a resolution by discussion. The discussions broke down and Stockco proceeded with the second statutory demand. This too did not result in payment. Stockco sent a letter of demand on 14 May 2010. Spotburn proposed a repayment plan. The proposal came to nothing. On 21 May 2010 Spotburn took a different tack. It advised Stockco that the demand was invalid because GST was not claimable and no breakdown of

account had been provided for the interest claimed. On 25 May 2010 it filed its application.

[14] Stockco gave formal notice of termination of the agreement on 28 May 2010. It did on the basis that Spotburn was in breach of cls 6.1 and 6.3 of the agreement. Spotburn accepts Stockco was entitled to terminate at that time and that its notice was effective for that purpose.

[15] Spotburn concedes that it is in breach of the agreement. It accepts its liability to repay \$204,500, the basic purchase price of the stock less the \$20,000 payment, and that such amount at least is now a debt that is due. But it argues:

- (a) The second statutory demand (despite concession) is invalid and must be set aside. It is invalid because it was issued before a refund of the basic price was a debt due. The refund did not become due until formal notice of termination was given;
- (b) Even if the statutory demand was issued after the refund was due, the Court should in its discretion set aside the demand because the GST and interest components of the demand are the subject of a substantial dispute;
- (c) In terms of the agreement the dispute should be resolved by arbitration.

Legal principles- setting aside statutory demands

[16] The application to set aside the statutory demand relies particularly on s 290(4)(a) Companies Act 1993. Subsection 4 provides:

290 Court may set aside statutory demand

- (4) The Court may grant an application to set aside a statutory demand if it is satisfied that—

- (a) There is a substantial dispute whether or not the debt is owing or is due; or
- (b) The company appears to have a counterclaim, set-off, or cross-demand and the amount specified in the demand less the amount of the counterclaim, set-off, or cross-demand is less than the prescribed amount; or
- (c) The demand ought to be set aside on other grounds.

[17] In *Fletcher Homes Ltd v Ellis*, Associate Judge Faire (as he then was) confirmed that an applicant must demonstrate there is a substantial dispute as to whether or not the debt claimed in the statutory demand is due or owing.¹ In that case, the principles applicable to the applications of the present kind are stated as follows:

- a) The onus is on the applicant to establish a fairly arguable case for its claim that it is not liable for the amount claimed;
- b) A mere assertion that a dispute exists is insufficient. The applicant must put forward material which, although short of actual proof, nevertheless supports the claim that the amount is in dispute: and;
- c) If such material is available, the dispute should be tried elsewhere and not on application to set aside the statutory demand.

[18] In order to succeed, the applicant must demonstrate that the dispute which it raises is genuine. See *Taxi Trucks Limited v Nicholson* where the Court stated:²

The applicant must show a genuine and substantial dispute as to the existence of the debt, and that it would be unfair- as it usually would be- to allow that dispute to be resolved by the Companies Court rather than by action commenced in the usual way.

¹ *Fletcher Homes Ltd v Ellis* HC Auckland M471/99, 23 July 1999 at [31].

² *Taxi Trucks Limited v Nicholson* [1989] 2 NZLR 297 at 300.

Issues

[19] It is for Spotburn to establish that the statutory demand was invalid. This turns on whether a refund of the purchase price was not payable until notice of termination of the agreement was given on 28 May 2010, and therefore was not a debt due before 7 May 2010 when the demand was issued.

[20] If indeed the refund was due by the earlier May date, Spotburn must also establish a fairly arguable case that:

- (a) Stockco is not entitled to a refund of GST;
- (b) There is uncertainty about the amount of interest claimed.

[21] If there is such a case, it is for Spotburn to show that the statutory demand should not be allowed to stand in a reduced amount, but rather the dispute should be resolved by arbitration under the agreement.

Discussion

Was a refund of the sum of \$204,500 payable, and therefore a debt due, before 7 May 2010?

[22] Self evidently a contractual obligation to refund a payment gives rise to a debt due for the purpose of s 290. The words of the Court of Appeal in *OPC Management Rehab Limited v ACC* are apposite.³

...if a payment is received in circumstances where the recipient is obliged to repay it, whether because of a contractual or statutory provision to that effect or because the circumstances give rise to an obligation to repay on the basis of money had and received, the amount can be treated as a “debt due” for the purposes of s 289(2)(a).

[23] Spotburn argues that until termination on notice had occurred under cl 8.1, no refund would be payable under cl 8.3 and therefore there could not be a debt due. While acknowledging that Spotburn had committed a qualifying breach under cl 8.1

³*OPC Management Rehab Limited v ACC* [2006] 1 NZLR 778 (CA) at [54].

before 7 May, counsel submitted that termination on notice was not given until 28 May 2010. As the statutory demand of 7 May 2010 preceded termination it was invalid and must be set aside. The deficiency in the demand, she argues, goes beyond a mere defect or irregularity capable of cure by amendment of the demand under s 290(5).

[24] The submission begs the question whether the obligation to refund can arise outside of cl 8. I agree with counsel for Stockco that it can and that it does not matter whether termination occurred prior to the issue of the demand. I agree also that the obligation had indeed arisen before 7 May although not, as counsel for Stockco submits, under cls 5.2 or 6.8.

[25] Counsel for Stockco argues that the obligation arises under cl 5.2 or alternatively cl 6.8. That is doubtful. Each allows recovery of loss but only where Spotburn has taken possession of the stock in accordance with the agreement. Spotburn failed to gain possession of the stock, a point that counsel did not really grapple with. But the doubt I have about these provisions is not fatal to Stockco's right to a refund. An obligation arises under cl 1.6 to indemnify Stockco for any cost, liability or expense incurred should Spotburn fail to act in strict accordance with the agreement. Spotburn failed to so act. It failed to complete its acquisition and to take possession of the stock. It failed to farm the stock and to make it ready for delivery to the processing plant. The result was that Stockco having incurred the cost or expense of paying for the stock is entitled to be indemnified for that cost. Indemnity for such cost equates to repayment and I do not doubt that the obligation to make that repayment crystallised when the alleged three month extension expired in February 2009.

[26] For the above reasons I am satisfied that Spotburn had an obligation to refund the payment of \$204,500 and that the refund was due when the second statutory demand was issued.

Is there a fairly arguable case that Stockco is not entitled to a refund of the GST?

[27] Counsel for Spotburn's submission in respect of the GST is twofold. First, that under s 9 Goods and Services Tax Act 1985 the right to claim GST on the supply of goods does not arise until either an invoice is issued by the supplier or earlier if payment is received by the supplier in respect of those goods or services. Secondly, that when Stockco invoiced Spotburn for the stock the price included a GST portion and Stockco would have claimed the GST back from IRD already. It cannot also claim the GST from Spotburn. When the stock is sold, Spotburn will account to the IRD for the GST. If Spotburn is also required to pay the GST to Stockco it will be paying GST twice.

[28] The submission cannot succeed. Section 9 sets out when the supply of goods and services is deemed to have taken place for the purposes of paying Goods and Services Tax to IRD. Yet, this is not at issue here. The issue is whether Spotburn has a contractual obligation to refund the GST component of the purchase price it received for stock it failed to supply. I have already found that Stockco is entitled to a refund of the cost or expense it incurred for the stock. That cost or expense included the GST for which it was invoiced. Spotburn has not demonstrated, as it must, that it is not bound by its contractual obligation to refund the GST. Its argument to the contrary founders on unsubstantiated assertion. The evidence is wholly devoid of any basis for the suggestion that Stockco would already have claimed back the GST. But if Stockco had indeed done so, nothing was put before me to show why it would not be for it to account to IRD for the GST component of the refund.

[29] For the above reasons I am satisfied that Spotburn has failed to establish any arguable basis for its contention that it will be paying GST twice or to establish its entitlement to retain GST on goods it was never able to supply.

Is there a fairly arguable case that there is uncertainty about the amount of interest claimed?

[30] Counsel for both parties accept that contract interest is payable on the refund once due, but they disagree on the contractual provisions for interest that govern liability and amount. Counsel for Spotburn argues that the relevant provisions governing interest are those set out in cl 8.3. She contends that they trigger the right to interest plus penalty interest but only after termination for breach and therefore that the demand for interest in the statutory demand falters on the same basis as the demand for the basic debt. Counsel for Spotburn also submits there is no breakdown in the statutory demand or the evidence that demonstrates that the amount Stockco has claimed has been calculated correctly under cl 8.3.

[31] If Stockco were relying on cl 8.3 then I would accept it would be to no avail, but not for the reasons that counsel for Spotburn submits. While cl 8.3 does indeed outline the agreed interest and penalty interest rates when the agreement is terminated, payment at those rates upon termination is subject to a proviso. The proviso is that Spotburn must have “sold or disposed of or otherwise parted with possession of the Stock”. As Spotburn did not gain possession of the stock it never parted with it. Plainly the proviso is not satisfied and the clause has no application to Stockco’s entitlement to interest whether before or after termination.

[32] Counsel for Stockco argues that interest in the amount claimed is recoverable under cl 5.2. That is a submission I am also unable to accept. The clause applies where stock dies or is lost during the term of the agreement. Such is not the case here, and Stockco has not shown how this clause avails it to claim any entitlement to interest.

[33] It is for Stockco to establish the basis for contractual interest under the agreement. It has not done so. Presumably, it will have incurred interest on the costs of funding the purchase of the stock, which will be recoverable under cl 1.6. But in the absence of further evidence and submissions I cannot be satisfied that the amount claimed as interest has been justified.

[34] The result is that I am satisfied that there is a real dispute over the amount of interest claimed.

Should the demand be allowed to stand in a reduced amount or should it be set aside and the dispute referred to arbitration?

[35] Counsel for Spotburn submits that if there is any dispute over the amount claimed in the statutory demand, or part of it, the dispute must be referred to an arbitrator under cl 12.1 of the agreement. Counsel submits that cl 8 of the First Schedule of the Arbitration Act 1996 requires the Court to stay a proceeding where the dispute is subject to an arbitration agreement entered into on or after 1 July 1997. She advises that if liquidation proceedings are filed, Spotburn will seek a stay of the proceedings on the ground that cl 12.1 is such an agreement. This, she submits, is a further reason why the statutory demand should be set aside.

[36] The submissions lack cogency for two reasons. First, s 290(5) prohibits the Court's setting aside a statutory demand where the demand contains a defect or irregularity unless satisfied that allowing the demand to stand would cause serious injustice. Defect includes material misstatements as to amount owed and material misdescriptions as to the debt (s 290(6)). Where such a defect or irregularity is identified, it is implicit that the Court is able to rectify the error before upholding the statutory demand. In *United Homes (1988) Limited v Workman*, the Court of Appeal approved the established practice of allowing statutory demands to stand in reduced figures to reflect items not open to dispute.⁴ With the exception of the interest claimed, there is no difficulty in identifying the items that are not the subject of any real dispute. It is therefore appropriate to follow established practice and allow Stockco's demand to stand in reduced figures to reflect those items, being the purchase price paid for the stock (less the payment of \$20,000) and the GST.

[37] Secondly, the Arbitration Act does not require items that are not open to dispute to be referred to arbitration. Where an item is not truly open to dispute, arbitration would no more serve a useful purpose than would a court hearing.

⁴ *United Homes (1988) Limited v Workman* [2001] 3 NZLR 447 at [46].

Pointless hearings over items that are beyond dispute, whether at arbitration or before the courts, is what s 290 is designed to avoid.

[38] I am satisfied for these reasons that the demand should stand in a reduced amount. There should be deductions of \$20,000 and the amount of the disputed interest. The dispute over the interest is the only matter which might properly be referred to arbitration.

Result

[39] The application is allowed to the extent that:

- (a) The statutory demand will stand in the reduced amount of \$232,562.50, which represents the two items that are beyond dispute. These are the basis purchase price less the \$20,000 repayment (\$204,500) and GST on that basic price (\$28,062.50);
- (b) The time for compliance with the demand is extended till further order. The extension takes effect from 16 June 2010.

[40] The question whether there should now be an order under s 291(1)(a) or an immediate order for liquidation under s 291(1)(b) is one on which I will hear further from the parties.

[41] The application is therefore to be relisted for further hearing on **23 March 2011 at 11.45 am**. I will not necessarily refuse to grant a liquidation order if Spotburn has not paid by this date.

[42] I will deal at the same time with the issue of costs.

Associate Judge Sargisson