

CONSTRUCTION CONTRACTS ACT UPDATE

Perhaps we were all a little optimistic following
George Developments v Canam Construction

This paper follows up on the article on Certifying Payments under the Construction Contracts Act 2002, published in June 2005.

Following the Court of Appeal decision in *George Developments v Canam Construction*, I made the comment:

The Court of Appeal has gone a long way to correcting an indifferent start to applying the Act. If the Solidcrete case is anything to go by, their guidance has taken hold.¹

Sadly, while I was in august company², it seems my comments may have been premature.

Brooklyn Holdings Ltd v Able Handyman Services Ltd³

Following a hearing at the High Court in Wellington on 12 September 2005, in a case which was almost a re-run of *Capon v TUF Panel Construction*⁴ (which was also decided by Associate Judge Gendall), His Honour Associate Judge Gendall sitting in the High Court granted an order on 13 September setting aside a statutory demand. As in the *TUF Panel* case, the demand was issued to recover a debt which was an amount due in terms of s 23 of the Construction Contracts Act.

Facts

There is little background to be gleaned from the judgment, other than the fact that Able Handyman had issued three invoices for construction work, totalling \$8,672.90, and these were not disputed by Brooklyn Holdings by issuing a payment schedule within the prescribed period.

On that basis, Brooklyn Holdings became liable to pay the claimed amount in terms of section 22, and Able Handyman became entitled to recover the amount as a debt due in terms of section 23(2). We can safely assume that Brooklyn Holdings refused to pay the amount.⁵ Able Handyman issued a statutory demand for payment within 15 days in terms of section 289 of the Companies Act 1993.

¹ See "Certifying Payments under the Construction Contracts Act 2002", June 2005 at www.johnwalton.co.nz/publications.htm

² The Hon Robert Smellie CNZM, QC makes the observation "From it emerges a clear message that the reforms in the Act, in accordance with its stated purposes, are not to be thwarted by technical or literalist arguments." [2005] ICLR 523 at 526.

³ (HC, 13/9/2005; Gendall AJ, Wellington, CIV2005-485-1362).

⁴ (HC, 27/9/2004; Gendall AJ, Auckland, CIV2004-404-2839).

⁵ Instead, they subsequently paid it into their solicitor's trust account.

Brooklyn Holdings responded by applying for an order setting aside the statutory demand on the grounds that:

- (1) it was in fact solvent;
- (2) the debt was disputed and the company had a substantial counterclaim; and
- (3) it was an abuse of process for the statutory demand process to be used as debt collection service

Statutory Demands

A statutory demand is a common device used against companies where they fail or refuse to pay their debts when they fall due.

In that case, the creditor issues a demand against the debtor company, requiring the debt to be paid within 15 days. If the debt is not paid in accordance with the demand, this invokes a presumption under section 287 of the Companies Act that the company is unable to pay its debts as they fall due, which will result in the liquidation of the company. Statutory demands can therefore be a very effective means of encouraging companies to pay their debts.

Debtor companies can avoid the presumption most effectively by paying the debt, or by challenging the demand. In this case, Brooklyn Holdings challenged the demand under section 290(4) of the Companies Act, which allows for demands to be set aside where:

- (a) *there is a substantial dispute about whether or not the debt is owing or due; or*
- (b) *the company appears to have a counterclaim, set-off, or cross demand which is greater than the amount of the demand; or*
- (c) *the demand ought to be set aside on other grounds.*

It can be no coincidence that the wording in section 290(4) of the Companies Act mirrors the wording of section 79 of the Construction Contracts Act, which provides that:

*In any proceedings for the recovery of a debt under section 23 ... the court must not give effect to any **counterclaim, set-off, or cross demand** ... other than a set-off of a **liquidated amount** if –*

- (a) *judgment has 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*

It would be fair to say, therefore, that the ground for setting aside a statutory demand in section 290(4)(a) or (b) of the Companies Act would be ineffectual against a debt due under section 23 of the Construction Contracts Act. Section 290(a) refers to a *substantial dispute*, whereas section 79(b) requires the sum to be *liquidated* (ie an ascertained sum of money) and for there not to be *in fact any dispute*.

In relation to counterclaims, section 290(4)(b) requires that the company *appears to have a counterclaim*, while section 79 specifically excludes counterclaims, save in very exceptional circumstances.

(1) *Solvency*

His Honour granted the order setting aside the statutory demand on the ground that the company was in fact solvent.

While this is not expressly a ground for setting aside statutory demands in terms of section 290(4), His Honour took the view that this fell within the catch-all of section 290(4)(c), that the demand "*ought*" to be set aside. His Honour cited case law to the effect that, while the presumption of insolvency may be invoked if a company cannot meet its debts, it should not be invoked where the company is in fact solvent but in dispute over a debt⁶. The argument runs that the statutory demand procedure is not a debt collection procedure, but a mechanism for establishing insolvency.

Had the judgment rested there, we may have been left with the view that the sole difficulty was the means by which Able Handyman sought to recover the debt, rather than its entitlement to be paid the debt. They could still seek other enforcement action, for example summary judgment.

However, His Honour did not stop at that point.

(2) *Counterclaim*

Brooklyn Holdings argued that Able Handyman's workmanship was so poor that they incurred a further \$53,879.98 in rectification work, which they sought to recover from Able Handyman. In their view, there could be no dispute that this sum was owing.

However confident the plaintiff may have been that Able Handyman could not dispute that this sum was owing, this is a long way short of there being a "**liquidated amount**" for which there is "**not in fact any dispute between the parties**" in terms of section 79(b) of the Construction Contracts Act. It would have been helpful if this issue had been dealt with reasonably summarily.

Regrettably, while observing that he did not need to determine the matter, His Honour commented that "*at first glance there does seem to be something in this argument*"⁷.

(3) *Abuse of Process*

Brooklyn Holdings also argued that it was an abuse of process to use the statutory demand for debt collection purposes, and therefore it would be "*just and equitable*" to set the demand aside.

⁶ Master Kenney-Grant in *Medisys Ltd v Getinge Castle Ltd* (HC AK, unreported 9 February 2001, M1426/00), Master Gambrell in *Environmental Solutions Ltd v Jesco Dosiertechnik GMBH* (1999) 8 NZCLC 261; and Master Faire in *Gateway Cargo Systems Ltd v Airborne Freight Ltd* (HC AK, CIV 2003-404-7207).

⁷ At para 29

Notwithstanding his finding on the issue of solvency, His Honour was not persuaded by this argument, commenting that:

The issue of a statutory demand, in part at least, must always involve an element of debt collection, given that the debts in question are required to be outstanding.

On the issue of the invoking a presumption of insolvency when the amount of the counterclaim considerably exceeded the amount of the demand, His Honour expressed sympathy with the view that this would be unjust and inequitable.

Finding

The statutory demand was set aside, and Able Handyman ordered to pay costs.

Commentary

Where a debt arises under section 23, the provisions of section 79 of the Construction Contracts Act clearly modifies the approach in section 290(4) of the Companies Act.

Under section 79, *counterclaim, set-off, or cross-demand* are not to be given effect in **any proceedings for the recovery of a debt under section 23**. This is clearly contrary to section 290(4)(b) of the Companies Act which simply refers to a *company appearing to have a counterclaim, set-off, or cross demand*. To be effective, section 79 must surely deprive a debtor of this ground for having a statutory demand set aside.

On the issue of the debt being in dispute, while section 240(4)(a) of the Companies Act requires a **substantial dispute** over the debt, section 79(b) requires the amount to be set-off to be a *liquidated amount* and for there to be **not in fact any dispute** in relation to the counterclaim sum. Brooklyn Holdings' position seems to have been well short of this requirement.

Again, the legislative intent seems to be abundantly clear, where the sum is due under section 23 of the Construction Contracts Act, the sum should be paid to the creditor. That is not to say, however, that the counterclaim cannot be made in other proceedings. It simply means that the creditor is the one who should hold the sum pending resolution of any other aspect of the dispute.

The judgment in *Brooklyn Holdings v Able Handyman Services* is unhelpful. Had the court stopped at the finding of solvency, then perhaps the issue of statutory demands could have been raised elsewhere. However, going on as his Honour does to observe that the statutory demand procedure necessarily involves an element of debt collection, and expressing sympathy for the position of the debtor company only undermines legislative intent of the Construction Contracts Act. It is perhaps telling that the Court of Appeal decision in *George Developments v Canam Construction* was not cited in the judgment, and may well not have been referred to in argument.

There is none of the fine rhetoric about the *lifeblood* of the industry in the judgment; only fine distinctions about solvency and a failure to accept the intent of Parliament that amounts due under construction contracts belong in the contractor's bank account, and not the owner's.