CASE AND COMMENT

STATUTORY DEMANDS, BANKRUPTCY NOTICES AND THE *CONSTRUCTION CONTRACTS ACT 2002*

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I. Introduction

The recent landmark decision of the Court of Appeal in *Laywood v Holmes Construction Wellington Ltd*[1] has done much to clarify the interrelationship between the *Construction Contracts Act 2002* on the one hand and the *Insolvency Act 2006* and the *Companies Act 1993* on the other. The judgment stated the relevant principles clearly and coherently and, in doing so, resolved the approaches between conflicting High Court decisions with respect to the availability of the bankruptcy notice and statutory demand procedures to enforce payment of a debt under the *Construction Contracts Act*.

This note considers the Court of Appeal decision on the question. It outlines the extensive judicial history of the case and, for completeness, its subsequent progress. It concludes with a consideration of the impact of the decision on liquidation and bankruptcy proceedings including its influence on the oft debated question of the legitimate purpose of the statutory demand and bankruptcy notice procedure. But first it provides a brief outline of the relevant legislation.

II. Outline of *Construction Contracts Act* Regime and Relevant *Insolvency Act* and *Companies Act* Provisions

The *Construction Contracts Act 2002* emphasises the need for prompt payment of contractual sums so as to address the cashflow problems which are common in the construction industry.[2] In order to do this, the Act provides a fast track process whereby payment obligations of parties in a construction contract are created and enforced. The Act provides three ways in which a party to a construction contract may become entitled to recover money from another party. Two of these are found in Part 2 of the Act and relate to payment claims[3] while the third relates to adjudication of a dispute under Part 3 of the Act.[4]

First, a payee seeking payment may issue a payment claim to the payer. The payer must respond to the payment claim within a specified time, either by paying the claim or providing the payee with a payment schedule which sets out the amount the payer proposes to pay. If the payer does

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1 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243 (Court of Appeal).

2 The purpose of the Act is described in s 3 of the *Construction Contracts Act 2002*. See also the discussion in *Salem Limited v Top End Homes Limited* (2005) 18 PRNZ 122 (Court of Appeal).

3 *Construction Contracts Act 2002*, ss 19-24.

4 *Construction Contracts Act 2002*, ss 25-71.

not pay the claim or provide a payment schedule within the required time then, pursuant to s 23, the payer becomes liable to pay the amount claimed on the due date. Second, under s 24 a payer also becomes liable to pay the amount claimed on the due date if the payer has provided the payee with a payment schedule and the payer has failed to pay the scheduled amount within the prescribed time. Where either of these situations arises, the consequences are that the payee can recover from the payer, as a debt due, the unpaid portion of the claimed amount in any court, plus actual and reasonable costs of recovery.[5]

The third way in which a party to a construction contract may become entitled to recover money from another party is by taking its default claim to adjudication. Where an adjudicator makes a determination that a party is liable to pay an amount to another, and that other party fails to pay, s 59 provides that the party to whom the debt is owed may recover the unpaid amount together with actual and reasonable costs of recovery as a due debt in any court or the party may apply, under s 73, for the adjudicator's determination to be enforced by entry as a judgment in the District Court. Once the determination has been entered as a judgment, the creditor can make use of any of the general debt collection procedures available to that Court.[6] The defendant may oppose entry of an adjudicator's determination as a judgment but the grounds of opposition are strictly limited by s 74(2). Those grounds are: that the amount has been paid after the determination has been made; that the contract is not a construction contract to which the Act applies; or that a condition imposed by the adjudicator has not been met.[7]

As stated above, once a 'due debt' arises under ss 23, 24 or 59, proceedings may be issued for the recovery of the debt. In practice, the most common processes used to enforce payment under the *Construction Contracts Act* are by summary judgment and statutory demand or bankruptcy notice.

If a statutory demand is issued, the debtor may apply to the High Court to have it set aside under s 290 of the *Companies Act 1993*. The grounds for setting aside a statutory demand, found in s 290(4), are that the Court is satisfied that:[8]

5 *Construction Contracts Act 2002*, ss 23(2)(a) and 24(2)(a). 'Any court' is defined in s 5 as meaning the District Court or High Court.

6 *Construction Contracts Act 2002*, ss 77, 78. Section 77 provides that '[t]o avoid doubt' the determination may be enforced by execution in accordance with the District Court Rules 1992. Section 78 also provides an 'avoidance of doubt' provision in relation to the application of a charging order issued under the Act in respect of the construction site.

7 The first two grounds in s 74(2) were argued unsuccessfully by Laywood and Rees in *Willis Trust Company Ltd v Green* (Unreported, High Court Auckland, CIV-2006-404-809 Asher J, 25 May 2006). The Court of Appeal in *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [39] agreed with Asher J in this regard. In *Laywood v Holmes Construction Wellington Ltd* [2008] 2 NZLR 493 (High Court), Asher J held that the question of whether payment had been made before the determination could not be raised under s 74(2) of the *Construction Contracts Act 2002*.

8 For a discussion of the grounds in s 290(4) of the *Companies Act 1993* see J Farrar (ed), *Companies and Securities Law* (2008) 814-822 and the cases cited therein.

(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 than the amount of the counterclaim, set-off or cross demand is less than $1000; or
(c) The demand ought to be set aside on other grounds.

Similarly, where the debtor is an individual and a bankruptcy notice has been issued, the debtor can apply to the High Court to have the notice set aside. The grounds for setting aside a bankruptcy notice are now found in s 17(1)(d)(ii) and (7) of the *Insolvency Act 2006*, which replaced s 19(1)(d) and (2) of the *Insolvency Act 1967* from 3 December 2007,[9] but without any substantial change to its terms. The statutory grounds are that the debtor satisfies the High Court that he or she has a counterclaim, set-off, or cross demand equalling or exceeding the amount of the judgment debt which could not have been used as a defence in the proceedings in which the judgment or order was obtained. There is no equivalent 'other grounds' in s 17 of the *Insolvency Act 2006* as there is in s 290(4)(c) of the *Companies Act* but the court does have an inherent jurisdiction to set aside or stay a bankruptcy notice to prevent an abuse of the court's processes.[10]

However, where proceedings are issued for recovery of a debt due under the *Construction Contracts Act*, s 79 of that Act may be important. It provides:

> In any proceedings for the recovery of a debt under section 23 or section 24 or section 59, the court must not give effect to any counterclaim, set-off, or cross-demand raised by any party to those proceedings 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.

Thus s 79 prohibits the court from giving effect to any counterclaim, set off or cross demand in any proceedings for the recovery of the debt, except in the limited circumstances set out in the section. The purpose of s 79 clearly is to enhance the policy objective of the Act for speedy payment. It adopts a 'pay now, argue later philosophy',[11] but this does not mean that the debtor who is disputing the creditor's claim has no remedy. nothing in the Act prevents the parties to a construction contract from submitting a dispute to another dispute resolution process such as to a court, tribunal, mediation or arbitration.[12] However, the submission of a dispute to another

9 *Insolvency Act 2006*, s 443(1)). Note that the *Insolvency Act 1967* continues to apply, to the exclusion of the *Insolvency Act 2006*, if any of the following events first occurred before 3 December 2007, or a step or proceeding is taken as a consequence of any of these events, even if the step or proceeding is taken after 3 December 2007:
(a) issuing a bankruptcy notice;
(b) filing a petition for adjudication;
(c) filing an application for a summary judgment order;
(d) the making of a proposal;
(e) the making of a compromise;
(f) filing an application for an order for the administration of an insolvent estate.

10 Discussed further in Part IV below. See also Brookers, *Insolvency Law & Practice*, IN17.11.

11 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243 (Court of Appeal), 255, [52].

12 As Asher J observed in the High Court, '… the enforcement process [in the Act] is not intended to transform an adjudicator's determination into a final judgment, and it is not intended to prevail over other dispute resolution procedures'. *Res judicata* does not apply to

dispute resolution process does not bring the adjudication to an end or otherwise affect it.[13] If an adjudicator makes a determination that an amount is due to be paid, that determination is binding on the parties and continues to be of full effect notwithstanding the fact that a party has applied for judicial review or that any other process relating to the dispute have commenced.[14]

Clearly s 79 will apply to summary judgment proceedings[15] but the question is whether the section applies where steps are taken under the 1967 or 2006 *Insolvency Acts* or the *Companies Act 1993*. The question comes down to the correct interpretation of s 79 of the *Construction Contracts Act*, specifically, whether the steps taken under the bankruptcy processes in the *Insolvency Acts* and the winding up provisions in the *Companies Act* are 'proceedings for the recovery of a debt under section 23 or section 24 or section 59 …' of the *Construction Contracts Act*. If the answer to this question is no, then there is no conflict between s 79 and the bankruptcy and liquidation provisions of the *Companies Act* and the *Insolvency Acts* and thus the defences in those Acts (set-off, cross-claim or counterclaim) could be used to defeat a *Construction Contracts Act* demand.

III. Conflicting High Court Decisions

Until the Court of Appeal decision in *Laywood*, there were conflicting decisions on the question. In *Volcanic Investments Ltd v Dempsey & Wood Civil Contractors Ltd*,[16] a building contractor, Dempsey & Wood, referred a dispute under a construction contract with its employer, Volcanic Investments, to an adjudicator under Part 3 of the *Construction Contracts Act*. The adjudicator determined the matter in favour of Dempsey & Wood who then issued a statutory demand to Volcanic under s 289 of the *Companies Act*. Volcanic responded by applying for an order under s 290 of the *Companies Act* setting aside the statutory demand. Volcanic claimed a set off for losses which it said resulted from the delay of Dempsey & Wood in carrying out the work, losses which Volcanic was seeking to recover in District Court proceedings. The central issue was whether Dempsey & Wood could invoke s 79 of the *Construction Contracts Act* to bar Volcanic from raising any cross-claim in response to the statutory demand.

this enforcement procedure where all the parties' rights are otherwise preserved: *Laywood v Holmes Construction Wellington Ltd* [2008] 2 NZLR 493, 502.

13 *Construction Contracts Act 2002*, s 26(2).

14 *Construction Contracts Act 2002*, s 60. The court or tribunal in these other proceedings may adjust the debt arising under the Act even where the debt is part of a court judgment as a result of the enforcement proceedings in the Act: *Construction Contracts Act 2002*, s 27.

15 Examples of its application in the summary judgment context are *Metalcraft Industries Ltd v Christie* (Unreported, High Court Whangerei, CIV-2006-488-645, Harrison J, 15 February 2007); *Halls Earthworks Ltd (in liquidation) v Donovan Drainage & Earthmoving Ltd* (Unreported, High Court Whangerei, CIV-2007-488-144, Associate Judge Faire, 18 July 2007); and *Invent Solutions Ltd v Chan Developments Trustee Ltd* (Unreported, High Court Wellington, CIV-2008-485-2834, Associate Judge Gendall).

16 *Volcanic Investments Ltd v Dempsey & Wood Civil Contractors Ltd* (2005) 11 TCLR 256; (2005) 18 PRNZ 97.

Randerson J noted that there was no limitation on the type of proceedings for recovery of a debt which might be relied upon for the purposes of s 79 and there was nothing in the *Construction Contracts Act* to suggest that the statutory demand procedure was not a proceeding contemplated by s 79. He reached that conclusion because the procedure for dealing with statutory demands, and the use to which statutory demands are put, were integral steps in the whole winding up process under part 9A of the High Court Rules.[17] He considered it appropriate, therefore, that when the matter was raised in a s 290 application to set aside a statutory demand, that was a proceeding which fell within the definition of proceeding contemplated by s 79.

On the question of whether s 290(4) of the *Companies Act* was to be interpreted as overriding s 79 of the *Construction Contracts Act*, Randerson J held, applying the usual canons of interpretation, that it should not because, inter alia:[18]

> … s 290(4) is a provision relating to the recovery of debts generally. In contrast, the Construction Contracts Act is special legislation dealing with the recovery of specific types of debt under a specific type of contract, namely construction contracts as defined in the Act. As such, the usual rule applies and the later specific legislation should prevail over the earlier general enactment. If it were otherwise, s 79 would be of no effect in this context.

The decision in *Volcanic* had been followed on numerous occasions.[19] However, the High Court in *Silverpoint International Ltd v Wedding Earthmovers Ltd*[20] squarely challenged this position and put the use of statutory demands and bankruptcy notices to enforce *Construction Contracts Act* debts in doubt.[21]

The case involved the issuing of six statutory demands by WEL, an earthmoving contractor, against a group of four property development companies in response to unanswered payment claims under Part 2 of the *Construction Contracts Act*. The companies in the group applied to have the statutory demands set aside asserting that they had a counterclaim, cross-demand or set off which neutralised any liability they might have to WEL. As in *Volcanic*, the issue was whether WEL could invoke s 79 of the *Construction Contracts Act* to bar the companies from raising any cross claim in response to the statutory demands.

17 Part 9A of the High Court Rules is now repealed and replaced by part 31 of the High Court Rules 2008.

18 *Volcanic Investments Ltd v Dempsey & Wood Civil Contractors Ltd* (2005) 11 TCLR 256; (2005) 18 PRNZ 97 [31].

19 See, for example, *Brooklyn Holdings Ltd v Able Handyman Services Ltd* (2005) 9 NZCLC 263,930; *10 Gilmer Ltd v Tracer Interiors and Construction Ltd* HC Wellington (Unreported, High Court Wellington, CIV-2005-485-2009, Associate Judge Gendall, 6 December 2005); *SCI Development & Construction Ltd v NZ Built Ltd* (Unreported, High Court, Auckland, CIV-2005-404-3656, Associate Judge Abbott, 23 December 2005); *Freemont Design & Construction Ltd v Nature's View Joinery Ltd* (Unreported, High Court Hamilton, CIV-2006-419-269, Associate Judge Faire, 26 July 2006); and *Kizer Builders Ltd v OEC Construction Ltd* (Unreported, High Court Wellington, CIV- 2006-485-2287, Associate Judge Gendall, 16 November 2006).

20 *Silverpoint International Ltd v Wedding Earthmovers Ltd* (Unreported, High Court Auckland, CIV-2007-404-104, Associate Judge Doogue, 30 May 2007).

21 See also *Re Capon ex parte TUF Panel Construction Ltd* (2005) 18 PRNZ 105 in relation to bankruptcy proceedings.

Associate Judge Doogue adopted the analysis of John Ren who has persuasively argued that the decision in *Volcanic* is wrong.[22] As did Ren, Associate Judge Doogue focussed primarily on the wording of s 79 and the nature of liquidation proceedings. He considered that, while liquidation proceedings are *de facto* used to exert pressure on a company to pay its debts, the primary object of liquidation is to collect and distribute assets. He concluded that the three steps in liquidation proceedings (the issue of a statutory demand, the application to set the demand aside and the application for an order to liquidate), viewed as a whole or independently, do not fall under 'proceedings for recovery of a debt' as that phrase is used in s 79 and that there were no clear policy reasons to justify an expansive interpretation of s 79 to extend it to liquidation proceedings. Thus, on this analysis there was no conflict between s 79 of the *Construction Contracts Act* and the *Companies Act*, and the counterclaims against WEL could be taken into account when considering the application to set aside the statutory demand.

By taking a narrow approach to the issue and focusing on the application to set aside a statutory demand and whether the winding up procedure is a debt recovery procedure, the conclusion of the court was always going to be that clearly it is not. Section 79 applies to *any proceeding* before *any court* for the *recovery of a debt* created under the *Construction Contracts Act* regime.[23] The issue of a statutory demand by a creditor is a 'proceeding' in the sense that it is a preliminary step that usually accompanies a winding up proceeding, but it is not a proceeding before any court for the recovery of a debt. While an application to set aside the statutory demand is a proceeding before a court, it is not a proceeding to recover a debt. It is, in fact, the opposite: it is a proceeding initiated by the debtor to resist the payment of the debt. Similarly, an application by the creditor for an order to liquidate the debtor company is clearly a proceeding before a court but it is not, a debt recovery proceeding. While an objective of the creditor might be to exert pressure on the debtor company to pay its debts, the creditor is not seeking an order for payment of a debt, rather the creditor is seeking an order that the company be liquidated. If a company is liquidated, the creditor may ultimately receive a payment but strictly speaking any payment received is not recovered 'in the proceedings' which led to the order placing the company into liquidation.

However, while statutory demands (and bankruptcy notices for individuals) are the first step in assessing the solvency of a debtor, the reality is that they are used overwhelmingly as a means of debt recovery. It is this point which seems to have been overlooked in *Silverpoint* and recognised in *Volcanic*. While insolvency purists may have flinched, *Volcanic* was seen at the time as a decision which reflected this commercial reality and it was this practical approach that the Court of Appeal recognised in *Laywood*.

The facts in *Laywood* are different from *Volcanic* and *Silverpoint* in that *Laywood* involved the setting aside of a bankruptcy notice rather than a statutory demand. However, while the wording of s 17 of the *Insolvency Act*

22 John Ren, 'Enforcing Payment Obligations Under the Construction Contracts Act 2002' (2006) 12 *NZ Business Law Quarterly* 336.

23 See *Construction Contracts Act 2002*, s 59(2)(a).

2006 (and previously s 19 of the 1967 Act) is different from s 290 of the *Companies Act 1993*, the reasoning process involved in both is the same. Thus, the principles espoused by the Court of Appeal in *Laywood* will have application to the interrelationship between *Construction Contracts Act* and the statutory demand process.[24] In fact, the decision of the Court of Appeal in *Laywood* has recently been applied by the High Court in the context of s 290 of the *Companies Act*.[25]

IV. *Holmes Construction v Laywood*

Background

The case has occupied considerable judicial time at all levels. It arose out of a construction contract between Willis Trust Company Ltd and Holmes Construction Ltd for the redevelopment into residential apartments of a substantial building in Wellington. The appellants, Laywood and Rees, were the directors of Willis Trust and had guaranteed the obligations of the company. Difficulties arose during the project and ultimately Holmes Construction submitted a final claim for payment in terms of the *Construction Contracts Act*. When payment was not made, Holmes Construction referred the matter to adjudication, as it was entitled to do under the Act, and the adjudicator found Willis Trust liable to Holmes Construction for $1,324,165 and the appellant's liable for $322,387, their maximum liability under the guarantee. Willis Trust and the appellants brought an application in the High Court for judicial review of the adjudicator's determinations. Interim orders were made prohibiting Holmes Construction from taking steps to enforce the adjudication until the review had been determined providing Willis Trust paid the amounts owing under the determination to a stakeholder.[26] The payments were not made and so the order in favour of Willis Trust lapsed. Holmes Construction then applied to the District Court under s 73(2) of the *Construction Contracts Act* to enforce the adjudicator's determination against Willis Trust by entry as a judgment. Willis Trust was subsequently placed into liquidation by shareholders' resolution on 28 June 2006. The interim order in favour of the appellants remained in force to allow the application for judicial review of the adjudicator's determination to be determined.

Harrison J in the High Court eventually dismissed the application for judicial review, apart from correcting a miscalculation in relation to interest and GST, and in June 2006 Holmes Construction applied to the District Court to enforce the adjudicator's determination, on the recalculated amount, against the appellants by entry as a judgment. The appellants filed a notice

24 The Court of Appeal *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [63], noted, obiter, that the same conclusions would apply in an application by a company to set aside a statutory demand.

25 *Greys Avenue Investments Ltd v Harbour Construction Ltd* (Unreported, High Court Auckland, CIV-2009-404-2026, Wylie J, 12 June 2009); *Gills Construction Company Ltd v Butler* (Unreported, High Court Wellington, CIV-2009-406-203, Judge Mallon, 12 November 2009).

26 *Willis Trust Company Ltd v Green* (Unreported, High Court Auckland, CIV-2006-404-809, Harrison J, 1 March 2006).

of opposition under s 74(1) of the Act but on 5 July 2006 Judge Wilson QC in the District Court granted Holmes Construction's application on the papers.[27] On 13 July 2006, the appellants filed an appeal against Wilson DCJ's decision in the High Court. A week later Holmes Construction issued bankruptcy notices against the appellants based on Wilson DCJ's judgment. The appellants filed an application to set aside the bankruptcy notices on the basis that they had a counterclaim, set-off or cross demand which equalled or exceeded the amount of the debt, that that counterclaim could not be set up in the action in which the judgment was entered and further that the *Construction Contracts Act* did not prevent them from relying upon a counterclaim, set-off or cross demand in an application to set aside a bankruptcy notice. The appellants also argued that the court should use its inherent jurisdiction to set aside or stay the bankruptcy notices pending the decisions of the High Court appeal against Wilson DCJ's decision and of the Court of Appeal in respect of the judicial review proceeding. In response, Associate Judge Faire issued an interim judgment on 9 February 2007 adjourning the application to await the outcome of the appeals.[28]

There matters stood until December 2007, when Asher J dismissed the appellants' appeal against the entry of the adjudicator's determination as a judgment.[29] However, he later granted leave to appeal to the Court of Appeal.[30] In the meantime, the application to set aside the bankruptcy notice came again before Associate Judge Faire on 3 March 2008.[31] At this hearing, a further ground for setting aside the bankruptcy notices was argued: that the judgment obtained by the creditors was not a final judgment as required by s 19(1)(d) of the *Insolvency Act 1967*.[32] Given that the Court of Appeal was to consider the issues relating to the decision upon which the bankruptcy notices were founded, Associate Judge Faire removed the question of whether there was a final order or judgment to the Court of Appeal for decision at

27 *Holmes Construction Ltd v Rees* (Unreported, District Court North Shore CIV-2006-044-1112, Judge Wilson QC 5 July 2006).

28 *Holmes Construction Wellington Ltd v Rees* (Unreported, High Court Auckland, CIV 2006-404-004219; CIV 2006-404-004220, Associate Judge Faire, 9 February 2007).

29 *Laywood v Holmes Construction Wellington Ltd* [2008] 2 NZLR 493 (High Court).

30 The four points on which Asher J granted leave were: (i) whether the District Court had no jurisdiction to enter judgment under s 73 of the *Construction Contracts Act 2002* because the amount involved exceeded the jurisdictional limit of $200,000 in s 29 *District Courts Act 1947*; (ii) whether the District Court was required, under the principles of natural justice, to give an oral hearing; (iii) whether the *Construction Contracts Act* prevents an enquiry into whether amounts found to be payable by the adjudicator have been paid where such payments arose prior to the adjudicator's determination; and (iv) in holding that the District Court failed to consider payments made before the adjudicator's determination, whether there was a breach of natural justice with the result that the District Court judgment was irregularly obtained and should be set aside.

31 *Re Holmes Construction Wellington Ltd ex parte Rees (No 2)* (Unreported, High Court Auckland, CIV 2006-404-004219; CIV 2006-404-004220, Associate Judge Faire, 3 March 2008).

32 Because the bankruptcy notices were issued before 3 December 2007, the *Insolvency Act 1967* continued to govern the case (see further, above n 8). However, as said above, s 19(1)(d) of the *Insolvency Act 1967* is in similar terms to s 17 of the *Insolvency Act 2006*. In fact the decision of the Court of Appeal in *Laywood* on the effect of s 79 of the *Construction Contracts Act* on applications to set aside bankruptcy notices has subsequently been applied in the context of s 17 of the *Insolvency Act 2006*: see *Re Plimmerton Courtyard Ltd ex parte Franklin* (Unreported HC Wellington, CIV-2008-485-2613, Associate Judge Gendall, 2 April 2009).

the same time.[33] It was in the context of determining this question that the Court of Appeal resolved the issue on the interplay between s 79 of the *Construction Contracts Act* and insolvency provisions of the *Companies Act* and the *Insolvency Act*.

The Court of Appeal

Counsel for the appellants argued before the Court of Appeal that the adjudicator's determination entered as a judgment simply created 'a provisional judgment for the purposes of cashflow'[34] and as such it was not a final order or judgment as required by s 19(1)(d). It was argued that, for the order or judgment to be final, there must be a final determination of the parties' rights and an opportunity to raise any cross claim and/or setoff in reaching the judgment must have been available.

Arnold J, in delivering the judgment of the Court noted that, while the adjudicator's determination was binding on the parties, it was not final in the sense that it does not necessarily finally resolve all issues of a dispute between them.[35] The Court recognised that it may not have been possible for a party to have raised a counterclaim, set-off or cross claim in the course of the adjudication and s 79 prohibits the raising of a counterclaim, set off or cross demand in proceedings for the recovery of a debt. Such a dispute would have to be pursued in separate proceedings.[36] However, according to the Court, even though an adjudicator's determination for the payment of money which is entered as a judgment is temporary and incomplete, it does not mean that it is unenforceable.[37] Section 77 provides that 'for the avoidance of doubt' an adjudicator's determination maybe enforced by execution in accordance with the District Court Rules 1992.[38] There are also 'for avoidance of doubt' provisions for the making and enforcement of charging orders under the Act.[39] The Court considered that:[40]

33 The issue of whether an adjudicator's determination under the *Construction Contracts Act* is a final judgment or order for the purposes of the *Insolvency Act* would not arise in the context of a statutory demand. A statutory demand can be issued provided the debt is due and payable as at the date on which the statutory demand is served. It is not necessary for a judgment to be obtained before service of the demand. On the other hand, where the bankruptcy notice process is to be used the bankruptcy notice must be founded upon a 'final judgment or order from a Court', thus a *Construction Contracts Act* creditor would either have to first obtain summary judgment or, as in *Laywood v Holmes Construction*, go through the adjudication process in the Act and then have the adjudicator's determination entered as a judgment of the District Court pursuant to s 73.

34 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [50].

35 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [52].

36 Sections 25 and 26 of the *Construction Contracts Act* recognise that other dispute resolution processes, for example, court, tribunal, mediation or arbitration, may be used despite the reference of the matter to adjudication.

37 Compare an adjudicator's determination about rights and obligations under ss 48(1)(b) and 48(2) which are not enforceable in the same way as a determination for payment of money under s 48(1)(a).

38 Section 79 of the *District Courts Act 1947* identifies several enforcement possibilities, for example garnishee proceedings.

39 See *Construction Contracts Act 2002*, ss 29, 49, 76, 78.

40 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [53]. In *Greys Avenue Investments Ltd v Harbour Construction Ltd* (Unreported, High Court Auckland, CIV-2009-404-2026, Wylie J, 12 June 2009) [47] Wylie J rejected the argument that Laywood applies

> [w]hile there is no similar 'for avoidance of doubt' provision in relation to the *Insolvency Act*, we consider that the same principle applies. Accordingly we consider that a judgment entered under s 74 is a final judgment for the purposes of s 19(1)(d).

Importantly, in deciding the question of the finality of an adjudication, the Court of Appeal resolved the conflict in the High Court by expressly endorsing the view of Randerson J in *Volcanic*. While accepting that bankruptcy and liquidation proceedings have broader purposes in relation to liquidity and asset worth, the Court nevertheless held 'bankruptcy notices and statutory demands are, in a practical sense, important enforcement mechanisms'.[41] Arnold J said that to take any other view would undermine the efficacy of the enforcement procedures in the Act.[42] He acknowledged that such an approach may produce hardship to a debtor, but he considered that there had to be a balance between the hardship which could be caused by the prohibition against raising a counterclaim or set off against the hardship which maybe caused by preventing a creditor from its entitlement under the *Construction Contract Act* and thus frustrate its purpose of enhancing cashflow.

The Court noted, obiter, that the same would apply in an application by a company to set aside a statutory demand under the *Companies Act 1993*.[43] It also emphasised that the Court was only being asked to consider the position in relation to an application to set aside a bankruptcy notice and in other contexts a different result might be reached:[44]

> It may be that different considerations arise at the point that the court must determine whether it will exercise its discretion to adjudicate a judgment debtor bankrupt or order the liquidation of a company

Thus, the Court of Appeal held that the judgment was a final determination in respect of the payment claim to which it related despite the fact that it did not determine the rights of the parties under the construction contract as a whole. The Court of Appeal also declined the appeal against the judgment of Asher J with the effect that the judgment of Judge Wilson QC, on which the bankruptcy notice was based, remained in force.[45]

Supreme Court

The appellants applied to the Supreme Court for leave to appeal the decision of the Court of Appeal. The Supreme Court dismissed the application on the basis that while the appeal raised matters of general practical significance and would otherwise meet the criteria for leave, the Court found the judgment below compelling and considered that the proposed appeal had no prospect of success on any of the grounds advanced on behalf of the applicants.[46]

only to the enforcement of an adjudicator's determination as a judgment under s 73 saying the Court of Appeal did not draw this narrow distinction and neither does the *Construction Contracts Act*. See also *Gills Construction Company Ltd v Butler* (Unreported, High Court Wellington, CIV-2009-406-203, Judge Mallon, 12 November 2009) [20].

41 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [62].

42 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [63].

43 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [62].

44 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [65].

45 See above n 30 above for the grounds of the appeal.

46 *Laywood & Rees v Holmes Construction Wellington Ltd* [2009] NZSC 44, [2].

Back to the High Court

Inherent Jurisdiction

The application to set aside the bankruptcy notice finally came again before Associate Judge Faire in July 2009, where the debtor conceded that there was now no remaining challenge in respect of the judgment on which the bankruptcy notice was based and no basis for advancing a claim that there is or was improper conduct on the part of the creditor in seeking to enforce the judgment by issue of the bankruptcy notice. However, the debtor continued to argue that the Court should exercise its inherent discretion to set aside or stay the bankruptcy notice on the basis that there are possible claims against the creditor.[47]

The High Court has long accepted that it does have an inherent jurisdiction in the context of an application to set aside a bankruptcy notice under s 19(1)(d) of the *Insolvency Act 1967* (and now under s 17 of the 2006 Act). The three possible grounds for the exercise of the jurisdiction were laid down by Master Kennedy-Grant in *Re Wise, ex p Benecke*[48] and have been accepted in numerous cases since.[49] The first two grounds call into question the judgment itself by alleging either a procedural defect in the obtaining of the judgment on which the bankruptcy notice is based and/or the existence of arguable grounds of defence to the claim for which judgment was given which, for example, could not have been identified at the time of the underlying judgment or which had emerged since. The third possible ground identified in *Re Wise* is that there is something in the circumstances of the judgment on which the bankruptcy notice is based which creates a potential injustice.

However, Associate Judge Faire in *Laywood* refused to exercise the Court's inherent jurisdiction to set aside or stay the bankruptcy notice. He said that the 'factual foundation on which the Court is being asked to exercise its inherent jurisdiction is, at best, weak'.[50] Moreover, even if there was proper factual foundation for the invocation of the Court's inherent jurisdiction, Associate Judge Faire considered that the debtor had a major problem with

47 *Re Holmes Construction Wellington Ltd ex parte Rees* (Unreported, High Court Auckland, CIV 2006-404-004219, Associate Judge Faire 17 July 2009).

48 *Re Wise, ex p Benecke* (Unreported, High Court Auckland, B227/95; B228/95, Master Kennedy-Grant, 21 June 1995).

49 See, for example, *Re Stansfield; Stansfield v Gould* (Unreported, High Court Auckland, B1378/01, Master Faire 3 December 2002); *Halifax Finance Ltd v McFarlane* (Unreported, High Court Wellington, CIV-2007-485-1377, Associate Judge Gendall, 12 November 2002; *Re Winther ex p Ucorp Pty Ltd* (Unreported, High Court Auckland, B1194-im00, Master Kennedy-Grant, 25 October 2000); *Holloway v Darby* (Unreported, High Court Hamilton, CIV-2005-419-1085, Associate Judge Faire, 8 December 2005); *Re Herron ex p Speirs Group Ltd* (Unreported, High Court Auckland, CIV-2007-404-4645, Associate Judge Doogue, 19 February 2008); *Re Sadler ex parte Insite Design & Development Limited* (Unreported, High Court Auckland, CIV-2006-404-4528, Associate Judge Sargisson, 27 April 2007); *Re Solicitor-General ex p Alice* (Unreported, High Court Wellington, CIV-2007-454-791, Associate Judge Gendall, 14 February 2008); *Re Saker ex p Blackler* (Unreported, High Court Wellington, CIV-2008-485-124, Associate Judge Faire, 26 May 2008).

50 *Re Holmes Construction Wellington Ltd ex parte Rees* (Unreported, High Court Auckland, CIV 2006-404-004219, Associate Judge Faire 17 July 2009), [23].

pursuing his claim. The matters that the debtor was arguing were premised on the basis that they were claims against the creditor which fall within the definition of counter-claim, set-off or cross demand referred to in s 19(1)(d) if the *Insolvency Act 1967*. As discussed above, the Court of Appeal had previously held that s 79 of the *Construction Contracts Act* prevailed over s 19(1)(d) of the *Insolvency Act 1967* and thus the Court could not take into account a counterclaim, set off or cross claim when dealing with an application to set aside the bankruptcy notice. Thus, Associate Judge Faire said:[51]

> The judgment debtor is therefore inviting the Court to do precisely what the Court of Appeal has ruled cannot be done under the Insolvency Act 1967. In my view this has nothing to do with the processes of the Court, but is an attempt by the judgment debtor to have the Court produce a result which is expressly excluded by the current statute law as interpreted by the Court of Appeal.

Residual Discretion

Finally, counsel for the debtor argued that the court has a residual discretion to set aside a bankruptcy notice and it should exercise it in the circumstances of this case. Generally the court has held that, unlike the wide statutory discretion given to the court when considering an application for adjudication under s 37 of the *Insolvency Act 2006* (previously s 26 of the 1967 Act), there is no residual discretion at the application to set aside a bankruptcy notice stage.[52] However, counsel argued, and Associate Judge Faire appeared to agree, that the case of *Re Taylor*[53] indicates there is an exception to this general rule so that if the Court considered that it was clear from the circumstances that a later court would not adjudicate a debtor bankrupt, it would be appropriate to stay the proceeding at the application to set aside the bankruptcy notice stage, rather than to wait until an application is filed for adjudication.[54]

51 *Re Holmes Construction Wellington Ltd ex parte Rees* (Unreported, High Court Auckland, CIV 2006-404-004219, Associate Judge Faire 17 July 2009), [29].

52 See, for example, *In Re Murphy, ex p Trotter Quirke & Lewis* (Unreported, High Court Palmerston North, B118/90, Heron J, 14 February 1991; *Singh v Commissioner of Inland Revenue* (2002) 20 NZTC 17,660 (HC).

53 *Re Taylor* (1992) 4 NZBLC 102,875 (HC).

54 In *Re Taylor* the debtor applied to set aside a bankruptcy notice based on summary judgment against him for unpaid rent and outgoings which the debtor was liable for under a lease of premises occupied by his business. Thomas J found that there was no counterclaim, set-off or cross demand which could serve to negate or nullify the bankruptcy notice and therefore the opposition to the notice was, according to Thomas J, 'doomed from the outset' and must fail. However, Thomas J went on to say that 'I do not regard that as the end of the matter. The Court still has an inherent jurisdiction to stay the bankruptcy proceeding should it be in the interests of justice to do so. It is this possibility that I must seriously consider.' (102,878). Thomas J accepted that, on the facts before him, if an application was made under s 26 of the *Insolvency Act 1967* to adjudicate the debtor bankrupt, the Court was likely to exercise its statutory discretion to not make an order of adjudication. In light of this, Thomas J considered that it was appropriate to stay the proceeding now rather than to wait until an application is filed for adjudication under s 26. Support for this 'practical' approach can also be found in *Halifax Finance Ltd v McFarlane* (Unreported, High Court Wellington, CIV 2007-485-1377, Associate Judge Gendall, 12 November 2007); *Holloway v Darby* (Unreported, High Court Hamilton, CIV-2005-419-1085, Associate Judge Faire,

However, Associate Judge Faire held that there was no foundation for applying the *Re Taylor* exception because there was insufficient evidence before the Court to enable it to predict the outcome of any application for adjudication. He therefore dismissed the application to set aside the bankruptcy notice.

V. Conclusions from the Decisions

The Court of Appeal and the subsequent High Court decisions resolved important but narrow issues on the interrelationship between the *Construction Contracts Act* and the *Insolvency* and *Companies Acts*. Of particular importance is the resolution of the vexed issue of the proper interpretation of s 79 and its reconciliation with the provisions of the *Insolvency Act* and *Companies Act*. While it may seem unjust that a debtor who has a genuine counterclaim, set off or cross demand may not raise it in the context of an application to set aside a bankruptcy notice or statutory demand, the decision is likely to be seen as both upholding the statutory intention of the *Construction Contracts Act* and also reflecting the commercial reality that statutory demands and bankruptcy notices are frequently used as a debt recovery tool.

Moreover, the debtor is not left without rights. The issuing of a statutory demand or bankruptcy notice is only the preliminary stage in liquidation or bankruptcy and they merely form the basis for bringing liquidation or bankruptcy proceedings. While the Court in *Volcanic* suggested that a liquidation application is also a 'proceeding for recovery of a debt' and thus also affected by s 79 of the *Construction Contracts Act*, both the Court of Appeal[55] and the subsequent High Court decision[56] emphasised the distinction between an application to set aside a bankruptcy notice or statutory demand on the one hand and an adjudication of bankruptcy or order to wind up a company on the other, and that the Court was only being asked to consider the former. The court has a wide overriding discretion as to whether it will make an order appointing a liquidator in the event it is satisfied that one or more of the grounds set out in s 241(4) of the *Companies Act* have been established. The court has a similarly wide discretion when faced with an application for adjudication under s 37 of the *Insolvency Act 2006*. Thus, at that point (or possibly even subsequently on the adjudication of bankruptcy or the appointment of the liquidator) any counterclaim or set off or cross demand could be dealt with.

An application to appoint a liquidator or to adjudicate a debtor bankrupt is usually defended on the ground that the debt upon which an application is founded is the subject of a substantial dispute. While s 79 of the *Construction Contracts Act* prohibits the arguing of a counterclaim in any proceeding for recovery of the debt, the debtor is not prevented from pursuing recovery

8 December 2005); *Re Saker ex p Blackler* (Unreported, High Court Wellington, CIV-2008-485-124, Associate Judge Faire, 26 May 2008); *Solicitor-General ex p Alice* (Unreported, High Court Wellington, CIV-2007-454-791, Associate Judge Gendall, 14 February 2008).

55 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243, [65].

56 *Re Holmes Construction Wellington Ltd ex parte Rees* (Unreported, High Court Auckland, CIV 2006-404-004219, Associate Judge Faire 17 July 2009), [30].

in other proceedings. As part of its inherent jurisdiction to prevent an abuse of process, the court will not usually make an order adjudicating a debtor bankrupt or appointing a liquidator if the debtor can make out this ground, because it would be unjust for liquidation or bankruptcy to occur while issues remained outstanding between the parties.[57] A factor that may ultimately influence a court in the overall exercise of the jurisdiction under s 241 or s 37 is whether payment is able to be made or secured in some way and whether a properly framed counterclaim or set-off is before a court awaiting determination.[58]

Furthermore, s 79 only prohibits the arguing of a counterclaim, set off or cross demand in any proceeding for recovery of the debt. Thus, in an application to set aside a statutory demand, the section only affects s 290(4)(b); it does not affect 'other grounds' in s 290(4)(c) nor does it prevent the exercise of the court's inherent jurisdiction to prevent an abuse of its processes in the context of an application to set aside a bankruptcy notice. However, as the High Court in *Laywood* made clear in the context of the now revoked s 19 of the *Insolvency Act*, the court cannot exercise its inherent jurisdiction on the ground that the debtor has an arguable defence to the claim as this is seeking a result which the Court of Appeal has ruled is expressly excluded by s 79 of the *Construction Contracts Act*.[59] A similar conclusion is likely under s 290(4)(c) of the *Companies Act* where it is clear from the wording of s 290(4)(c) that the 'other grounds' upon which an applicant may rely on are other than those set out in s 290(4)(a) or (b).[60]

However, in order to prevent an abuse of process, a statutory demand or a bankruptcy notice may be set aside under s 290(4)(c) or using the court's inherent jurisdiction where the demand or notice procedure is being used for a purpose which is not contemplated by the respective Acts.[61] Solvency of the debtor company has been successfully argued in a number of cases as one such ground and solvency as a defence is not barred by s 79 of the *Construction Contracts Act*.[62] It should be noted, however, that the Court of Appeal has recently stated in *AMC Construction Ltd v Frews Contracting Ltd*[63] that, while not discounting that solvency of the debtor may never be relevant

57 See, for example, *Morph Enterprises Ltd v Marple Investments Ltd* (Unreported, High Court Wellington, CIV-2005-485-1574, Associate Judge Gendall, 30 November 2005). The court may, at any time before a debtor is adjudicated bankrupt or a liquidator is appointed, stay or restrain an application or proceeding (*Companies Act 1993*, s 247; *Insolvency Act 2006*, s 38).

58 See comments to this effect in *Delta Roofing & Manufacturing Ltd v Kiwi Steel New Zealand Ltd* (Unreported, High Court Hamilton, CIV-2009-419-619, Associate Judge Faire, 25 August 2009).

59 *Laywood v Holmes Construction Wellington Ltd* [2009] NZLR 243.

60 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA); *Siteworks Ltd v IH Wedding & Sons Ltd* (1998) 8 NZCLC 261,704 (High Court).

61 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (Court of Appeal).

62 See, for example, *Medisys Ltd v Getinge Castle Ltd* (Unreported, High Court Auckland, M1426-im00, Master Kennedy-Grant, 9 February 2001); *Resource & Hire Ltd v Page Vivian Motors Ltd* (Unreported, High Court Wellington, CIV-2008-454-416, Associate Judge Gendall, 7 November 2008).

63 *AMC Construction Ltd v Frews Contracting Ltd* (2009) 10 NZCLC 264,450 (CA). Applied in *Gills Construction Company Ltd v Butler* (Unreported, High Court Wellington, CIV-2009-406-203, Judge Mallon, 12 November 2009).

at the s 290 stage, it would be extremely rare that solvency of a company could constitute a stand alone ground for setting aside a statutory demand. Moreover, it seems that the reasoning in those cases that support solvency as a standalone ground was based on the view that statutory demands should not be used as a mechanism for a creditor to obtain payment of a debt. Arguably it is this reasoning that is the root of the conflict between *Silverpoint* and *Volcanic*.

There has been a wide range of views taken on the issue by both courts and academics.[64] Insolvency purists uphold the principle that a statutory demand is not to be used as a means of debt recovery but only as a precursor to an application for liquidation or bankruptcy. Others recognise, and accept, the reality that statutory demands are almost always used as a means of recovering debts. However, there is a line of recent Court of Appeal decisions that have taken the view that obtaining payment of a debt is a legitimate purpose of the statutory demand and bankruptcy notice procedures and is not an abuse of process.[65] By adopting the view of Randerson J in *Volcanic*, and therefore recognising the importance of using statutory demands and bankruptcy notices as a means of obtaining payment of a debt, the Court of Appeal decision in *Laywood* adds further weight to that view.

Thus, while the Court of Appeal resolved an important issue on the interplay between the construction contracts legislation and insolvency legislation, in reaching its conclusions, the decision can also be seen on a broader level to reinforce the trend of courts to adopt a pragmatic view of insolvency proceedings rather than the view of the insolvency purists who flinch at the use of statutory demands and bankruptcy notices for 'debt collection'. This will assist those who are assessing the true purpose of a statutory demand or bankruptcy notice and, in particular, whether using them to claim a due debt is crossing the line of acceptable conduct.

64 See, for example, Ren, above n 21 and Brookers, *Insolvency Law & Practice*, CA289.07 and the cases cited therein. Compare Andrew Beck, 'Enforcing Construction Debts' (2005) *New Zealand Law Journal* 225.

65 In *Pioneer Insurance Company Ltd v White Heron Motor Lodge Ltd* [2009] NZCCLR 14; (2008) 19 PRNZ 286 [24], the Court of Appeal considered that the purpose of a statutory demand is to obtain payment for a debt, with the secondary purpose to provide a basis on which the debtor's inability to pay its debts as they fall due maybe proved in liquidation proceedings. Similarly, in *Commissioner of Inland Revenue v Central Equipment Co Ltd* (2006) 22 NZTC 19,891 [29] the Court of Appeal stated that 'it cannot be improper for a creditor to make a statutory demand on a debtor in order to apply pressure to realise assets to pay a due debt. It will only be improper if some ulterior purpose that is improper and which might amount to an abuse of the Court's processes that the Court would be justified in setting a statutory demand aside'. In *Link Electrosystems Ltd v GPC Electronics (New Zealand) Ltd* (2007) 18 PRNZ 946 (discussed by Andrew Beck, 'Editorial: Statutory demands and debt collecting' (2008) *Company & Securities Law Bulletin* 11) the Court of Appeal suggested that creditors should not be criticised for using a statutory demand to collect a debt unless to do so is 'oppressive.'