

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

**CIV-2017-404-1195  
[2017] NZHC 2465**

UNDER the Companies Act 1993  
BETWEEN SECURITY SYSTEMS LIMITED  
Applicant  
AND SMART CONTROLS LIMITED  
Respondent

Hearing: 2 October 2017

Appearances: L Turner for the Applicant  
A Swan for the Respondent

Judgment: 2 October 2017

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**ORAL JUDGMENT OF ASSOCIATE JUDGE R M BELL**

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***Solicitors:***

Whaley Garnett, Auckland, for the Applicant  
Auckland Property Legal Service, Auckland, for the Respondent

***Copy for:***

Lewis Turner, Auckland, for the Applicant  
Andrew Swan, Auckland, for the Respondent

[1] Security Systems Ltd applies to set aside a statutory demand of Smart Controls Ltd dated 29 May 2017 requiring payment of \$36,688.09 as the balance owing to it for its work under a contract to install CCTV in a security system. Security Systems Ltd says that the debt is subject to a substantial dispute under s 290(4)(a) of the Companies Act 1993. As well as disputing the debt it also alleges that Smart Controls Ltd has overcharged it by some \$32,000.

[2] There is no dispute as to the principles the court applies on applications under s 290 of the Companies Act 1993 to set aside statutory demands. Statutory demands under s 289 of the Companies Act are used to create a presumption of insolvency for the purpose of s 288 of the Companies Act. If a company does not comply with a statutory demand within 15 working days of service, the company is presumed to be insolvent. That is a rebuttable presumption and lasts for only 30 working days after the last day for complying with the demand.<sup>1</sup>

[3] Section 290 allows statutory demands to be set aside on three grounds: two particular, and one general. The overall purpose of s 290 is to prevent an injustice arising from the presumption of insolvency. In the case of applications under s 290(4)(a), if there is a genuine dispute whether a debt is owed, it would be unjust to hold that the company is insolvent for not paying on demand. The company must show that there is a genuine and substantial dispute as to the debt. It is not sufficient merely to assert the existence of a dispute. Some material, falling short of proof, is required to support the claim. If that material is produced, the dispute should normally be resolved by means other than liquidation proceedings. When an applicant relies on a cross-claim or set-off, it is necessary to show that the cross-claim or set-off is reasonably arguable.

[4] In most cases it will not be possible or appropriate to resolve disputes of material facts on such applications, particularly where issues of credibility arise. On the other hand, the court is not required to accept unequivocally any or every allegation of a disputed fact. It can and will assess whether facts being advanced as constituting a dispute pass a threshold of credibility, often by reference to contemporary documents or other statements of a witness. The court's task is not to

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<sup>1</sup> Companies Act 1993 s 288(1).

resolve the dispute but to determine whether there is a substantial dispute whether the debt is due or not, or whether there is a reasonably arguable basis for a counterclaim or set-off which exceeds the demand, or whether there is some other factor making it plainly unjust for liquidation proceedings to ensue.

[5] The statutory demand was served on 29 May 2017. The present application was filed on 13 June 2017. The last day for complying with the statutory demand was 20 June 2017. The 30 working days for the presumption under s 288 of the Companies Act expired on 1 August 2017. Smart Controls Ltd has not issued any liquidation proceedings. At the first call of an application to set aside a statutory demand it is standard practice to make an order under s 290(3) extending the time for compliance with the demand. In this case the Associate Judge made orders on a joint memorandum of counsel without making an order extending time for compliance. Instead, both sides have proceeded with the application on the basis that there needs to be a determination as to the merits of the statutory demand, regardless whether the statutory demand can still be relied upon.

[6] It is appropriate to take a benevolent view of the procedure taken in this case. Once Security Systems Ltd filed its application, both parties have proceeded on the basis that the merits of the statutory demand need to be determined. While there was not an express ruling that the time for complying with the statutory demand was extended, the parties have acted as if there had been. I cannot help thinking that if Smart Controls Ltd had filed a liquidation application, Security Systems Ltd would have protested. While an application to set aside a statutory demand is pending, the court is likely to stay the liquidation proceeding pending a determination of the application under s 290.

[7] On that basis, it would be pointless for me to refuse to decide the merits of the statutory demand on the grounds that the presumption had expired. In that event Smart Controls Ltd could issue a fresh demand and there would have to be a fresh application. That would be inefficient.

[8] Security Systems Ltd and Smart Controls Ltd both carry on business installing security systems. The people behind Security Systems Ltd are Mr and

Mrs Bingley. The people behind Smart Controls Ltd are Mr and Mrs Hares. Both sides acknowledge that they had a good working relationship in the past. Unfortunately they have fallen out over the job both were working on in this case.

[9] Smart Controls Ltd worked for Security Systems Ltd as a sub-subcontractor on a job to provide security services under a sub-contract to Fletcher Construction Company Ltd for the Fletcher Campus at Penrose, Auckland. Fletcher Building Ltd was the principal. Mr Hares of Smart Controls Ltd found out about the job as his brother worked for Fletchers and asked him for a quote. Mr Bingley of Security Systems Ltd says that Mr Hares told him that he did not want to do the complete project, but only the CCTV portion. They agreed that Security Systems Ltd would tender for the job as a sub-contractor, with Smart Controls Ltd working for it as the CCTV sub-contractor. Mr Bingley describes the arrangements with Smart Controls Ltd as back-to-back with Security Systems Ltd's contract with Fletcher Construction.

[10] The Fletcher Construction invitation to tender says that the general conditions of contract are NZS 3910. There are, of course, other contractual documents including plans, designs and specifications. The parties have so far not put NZS 3910 in evidence. Given the assertion by Security Systems Ltd that the terms of contract between Fletchers and itself were also applied to it and Smart Controls Ltd, it may be necessary to have NZS 3910 to understand the complete terms of the contract between Smart Controls Ltd as subcontractor and Smart Controls Ltd as sub-subcontractor.

[11] In June 2015 Smart Controls Ltd submitted a quote to Security Systems Ltd for the CCTV part of the contract. That was for \$130,861.40 exclusive of GST or \$150,490.61 inclusive of GST. Security Systems Ltd's tender was successful and Smart Controls Ltd became its CCTV contractor. Work began in late 2015. The contract between Security Systems Ltd and Fletchers is apparently not yet complete, but work by Smart Controls Ltd came to an end in December 2016, with Security Systems Ltd terminating the contract in February 2017.

[12] Smart Controls Ltd says that as at 5 February 2017 the amount owing to it under its contract was \$29,893.05. Its calculation of that sum can be seen in a spreadsheet attached to its evidence. It has listed 21 invoices. They total \$196,934.46. It has been paid \$166,041.41. That leaves an unpaid amount of \$29,893.05. It has charged \$59,251.84 for variations. When those variations are taken into account, it has billed Security Systems Ltd \$136,582.52 out of its original quote of \$150,490.61. In its words, there was \$13,807.99 left in the job. Those figures are all inclusive of GST. Smart Controls Ltd has not relied on the Construction Contracts Act 2002. It has not issued any payment claim under that Act.

[13] A significant part of the \$29,893.05 is for retentions. Both sides agree that retentions of 10 per cent could be withheld until the end of the defects liability period – 12 months after the issue of a certificate of practical completion. Smart Controls Ltd says, however, that it is entitled to be paid the retentions now, given the termination of the contract by Security Systems Ltd. Security Systems Ltd says, for its part, that it is liable to pay the retentions only at the end of its defects liability period under its contract with Fletcher Construction. It says that the defects liability period has not yet started to run because no certificate of completion has been given to Security Systems Ltd for its contract. On the information I have at present, I am unable to give a definitive ruling on the merits of that retentions issue. I am wary of giving a ruling on it in the absence of full contractual terms. NZS 3910 may have something to say about the point.

[14] Apart from the unpaid retentions, there is one particular invoice which Security Systems Ltd has not paid. That is Smart Controls Ltd's invoice no.177 dated 13 December 2016 for \$15,037.35. I will come to the particular issues relating to that invoice later.

[15] Both sides agree that Smart Controls Ltd had not completed its work under its contract when Security Systems Ltd terminated. Both recognise that the termination was effective. I suspect that each would say that the other was in the wrong. There is disagreement as to the amounts owing on termination, the extent of work left to be carried out, and the value of that uncompleted work.

[16] On its side, Security Systems Ltd claims credits. It claims that it has overpaid Smart Controls Ltd by \$23,498.44 plus GST. Those details are set out in paragraph 33 of Mr Bingley's affidavit sworn on 4 August 2017. He claims that Smart Controls Ltd has claimed for items it has not supplied or has short-supplied. His evidence is that, putting variations to one side, he has compared charges by Smart Controls Ltd for labour on particular portions of work and with the original quote, and found that there are over-claims for labour. He also says that there is a charge for wiring and other materials not supplied. He says that Smart Controls Ltd is not entitled to charge under its invoice no.67 for \$730.25 because that was not an authorised variation. He says that invoice 96 for \$80.26 has been paid. He says that a charge under invoice no.178 is not payable because the original work was not done correctly and this invoice was for remedial work.

[17] The dispute leading to the termination of the contract came from the refusal by Security Systems Ltd to pay Smart Controls Ltd's invoice no.177 for \$15,037.35. Smart Controls Ltd says that the work charged for in that invoice was for a variation ordered by Fletcher Construction, – a contractor's instruction no.75. Under this instruction, additional cameras were to be installed. Security Systems Ltd acknowledges that the Fletchers did issue the contractor's instruction for what seemed to be additional cameras, but it says that when the original designs were checked, it was found that the work to be carried out under the instruction was already required under the original contract. Its case is that the variation was not necessary. It therefore says that the work done under invoice 177 was not the subject of a genuine variation of the contract.

[18] It turns out that Security Systems Ltd has been paid under that variation, but it put in evidence correspondence with Fletchers' contract manager showing that Security Systems Ltd was regarded as having a credit on account of that payment, which Fletchers would take into account in a final wash-up. At the same time, Smart Controls Ltd refers to other emails with Fletchers' contract manager which seem to accept its side of the story. I simply note that there is conflicting information in relation to Fletchers which makes it difficult to determine where the rights of the matter may lie. And on the non-payment of that invoice, I find that there is a

genuine dispute whether Security Systems Ltd is under a legal obligation to pay Smart Controls Ltd under this variation.

[19] Mr Hares was upset about not being paid under invoice no.177. He made an angry phone call to the Bingleys. They recorded it. The phone message was unfortunate. Mr Hares was obviously disappointed at not being paid and expressed his disappointment in strong and even foul terms. Security Systems Ltd took alarm at what he said. The Bingleys say that they feared for their own safety and the safety of their staff. That led to their decision to terminate the contract. They sent an email message to Mr Hares on 2 February 2017, making it clear that he was no longer to work on the contract and he and his company were barred from the site.

[20] I comment that it appears that Mr Hares went no further than expressing frustration and disappointment at not being paid. Although he expressed that in very strong terms, it is not clear to me that that in itself amounted to repudiatory conduct within s 7(2) of the Contractual Remedies Act. He was not showing that he did not intend to fulfil the contract. In other words, the termination decision was made by Security Systems Ltd, not by Smart Controls Ltd. Smart Controls Ltd has accepted the termination, although it had little choice. That is because Security Systems Ltd made sure that Smart Controls Ltd could no longer have access to the work site.

[21] Establishing the parties' respective rights and liabilities after cancellation of a contract, whether it is justified or not, is not always a straightforward matter. I do not regard it as straightforward in this case. I do note that Smart Controls Ltd is entitled to enforce contractual rights that had accrued until termination of the contract.<sup>2</sup> I also note that even if Security Systems Ltd was not justified in terminating the contract, Smart Controls Ltd's entitlements are to be paid according to the contractual rates. It cannot claim on a general charge-out or quantum meruit basis.<sup>3</sup>

[22] Mr Hares runs an argument that Fletchers made so many variations that he is no longer bound by his original quote. I regard that argument as disputable. Each

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<sup>2</sup> See *Brown v Langwood's Photo Stores Ltd* [1991] 1 NZLR 173 (CA); *Garratt v Ikeda* [2002] 1 NZLR 577 (CA) and Contractual Remedies Act 1979 s 8(3)(a).

<sup>3</sup> *Brown & Doherty Ltd v Whangarei County Council* [1990] 2 NZLR 63 (HC).

variation may generate its own entitlement to be paid for extra work according to contractual rates. But it does not give Smart Controls Ltd a right to abandon its quote altogether and to charge on a quantum meruit basis generally. The fact that Smart Controls Ltd may be held to its quote and its contractual rates does provide some basis for Security Systems Ltd to examine the charges to see whether there has been over-charging. I cannot determine the merits of the over-charging claims at present.

[23] In summary I find that there are genuine differences between the parties as to the entitlements of Smart Controls Ltd on termination of the contract. Those differences cannot be readily resolved at a hearing to determine the merits of the statutory demand. Those differences need to be decided in some other forum. I find that Security Systems Ltd has established that there is a genuine dispute as to the amount claimed in the statutory demand.

[24] Even before Security Systems Ltd began its application, Smart Controls Ltd was aware that Security Systems disputed its liability for the amount claimed in the statutory demand. On 19 April 2017, a lawyer instructed by Smart Controls Ltd wrote to Security Systems Ltd making demand. It replied on 26 April 2017, giving reasons for disputing the debt. It included its own invoice claiming credits for over-payments. Smart Controls Ltd no longer used that lawyer but went to a debt collecting agency that sent the statutory demand on 29 May 2017, apparently without any prior demand. It also sent letters threatening District Court proceedings while relying on the statutory demand at the same time. Lawyers for Security Systems Ltd wrote to the debt-collecting agency pointing out that the debt was disputed. Judges have said on many earlier occasions that it is improper to use the statutory demand process when the debt is known to be subject to a genuine dispute.

[25] While Smart Controls Ltd says that the amount owing under the contract is \$29,893.00, it has charged an additional \$6,795.00 for collection costs, service fees and costs of issuing the statutory demand. I can see no basis for Smart Controls Ltd to claim those additional sums. There is nothing in the evidence to show any term under which Smart Controls Ltd could recover debt-collecting costs. Its invoices do have words referring to recovery of costs and default interest charges. Words on

invoices issued after a contract has been entered into are ineffective as contractual terms. Smart Controls Ltd has not shown that there was any contractual term under which it could recover its collection costs.

[26] I have noticed that some debt-collecting agencies issue statutory demands including demands for collection costs, even without any contractual basis for them. That practice is undesirable. It adds to the oppressiveness of a statutory demand. Under s 289 of the Companies Act, statutory demands can only be for a debt owing by the company. It is not possible to claim under s 289 for a debt that has not fallen due or one that may only fall due in the future – for example an order for costs when a company is put into liquidation. This practice by debt-collecting agencies is to be discouraged, given the intimidatory effect of statutory demands.

[27] These factors, issuing and relying on a statutory demand when the debt was disputed, and claiming collection costs when there was no basis for them, make this a case for increased costs under r 14.6(3)(b)(ii) of the High Court Rules. In the circumstances, I make an order for increased costs. Security Systems Ltd is entitled to costs under category 2. In addition, I order costs of the extra amounts claimed in the statutory demand of \$6,795.04.

[28] I make these orders:

[a] I grant the application and set aside the statutory demand of 29 May 2017.

[b] I order Smart Controls Ltd to pay Security Systems Ltd costs under category 2, with an increase of \$6,795.04. If counsel cannot agree costs, memoranda may be filed.

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**Associate Judge R M Bell**