IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2008-485-2799

BETWEEN	TELECOM NEW ZEALAND Applicant
AND	LANDMARK TECHNOLOGIES LIMITED Respondent

Judgment: 26 August 2009 at 3.00 pm

JUDGMENT OF ASSOCIATE JUDGE D.I. GENDALL

This judgment was delivered by Associate Judge Gendall on 26 August 2009 at 3.00 p.m. pursuant to r 11.5 of the High Court Rules.

Solicitors: DLA Phillips Fox, Solicitors, PO Box 2791, Wellington
Anthony Harper Lawyers, PO Box 2646, Christchurch

Introduction

[1] On 4 December 2008, Landmark Technologies Corporation ("Landmark") served Telecom New Zealand Limited ("Telecom") with a statutory demand under s 289 of the Companies Act 1993, requiring payment of US$244,088. On 18 December 2008, Telecom applied for the demand to be set aside. The demand was withdrawn on or about 23 December 2008.

[2] Telecom now seeks indemnity costs or, in the alternative, increased costs against Landmark in relation to this demand.

Factual Background

[3] Telecom contracted with Landmark to develop software. The head contract included an arbitration clause. When the relationship between Landmark and Telecom deteriorated, and Telecom proceeded to terminate the contract, between 22 October 2008 and 26 November 2009, Landmark issued about eleven invoices claiming a total of US$5,502,444.10.

[4] Included in these were two invoices for $US806,750, issued by Landmark on 22 October 2008 demanding immediate payment. Telecom was served with a statutory demand only two days later, on 24 October 2008. This demand is not the subject of the present dispute. It was withdrawn on 6 November 2008, following payment of US$495,533 by Telecom.

[5] On 28 October 2008, Landmark sent to Telecom an invoice for $US139,400 (invoice 9255), which required a final payment under the parties' Solutions Architect Agreement ("SAA"). The invoice also included a request for payment of US$65,600, which had previously been paid by Telecom, but was then deducted by set-off against amounts due to Landmark following termination of the SAA.

[6] On 4 November 2008, Telecom informed Landmark that this invoice was invalid, and that it was in fact Landmark that owed money to Telecom. By letter dated 28 November 2008, Telecom again warned Landmark against issuing a

statutory demand, stating that there was a genuine dispute in relation to invoice 9255, and that the dispute may fall within the arbitration clause of the head contract.

[7] On 4 December 2008, Landmark served Telecom with a second statutory demand (the demand here in question), claiming US$244,088 in total. The demand related to four invoices, including invoice 9255, and to two allegedly wrongful set-offs by Telecom (amounting to US$65,600 and US$11,088 respectively). Invoices 9101 (dated 29 September 2008), 9103 (dated 2 October 2008) and invoice 11256 (dated 26 November 2008) were issued for US$28,000 in respect of employment of Landmark staff by Telecom.

[8] On 8 December 2008, Telecom warned Landmark that the amounts claimed in the demand were genuinely disputed. When Landmark persisted, Telecom applied for the demand to be set aside.

[9] The parties subsequently entered into without prejudice discussions. On 23 December 2008, it was agreed that Telecom would pay a portion of the demand, and that the remaining balance would be submitted to arbitration. The issue of costs, however, was specifically excluded from the arbitration agreement.

[10] It appears that Telecom agreed to the following payments:

- US$21,000 in full and final settlement of Landmark's claims for payments for transfer of personnel, including claims under invoices 9101, 9103 and 11256;
- US$11,088 in full and final settlement of Landmark's claim of wrongful set-off by Telecom in respect of equipment and services allegedly supplied by Telecom to Landmark;
- US$65,600 for the allegedly wrongful set-off in respect of the final payment under the SAA, but without prejudice to Telecom's position that this set-off was legitimate.

[11] Although Telecom agreed to a total payment of US$97,688, only US$32,088 was paid in full and final settlement of Landmark's respective claims, with the remaining US$65,600 being paid on the basis that Telecom continued to maintain the legitimacy of its set-off claim. It follows that the parties effectively submitted their dispute relating to a total claim of US$205,000 to arbitration.

[12] Landmark subsequently withdrew its statutory demand, with the issue of costs remaining strongly contested. Provision was made for memoranda as to costs to be filed and detailed memoranda have now been filed both for Telecom and for Landmark.

[13] Notwithstanding this, by letter dated 22 June 2009, Landmark proposed that Telecom's application for costs be withdrawn, with each party bearing its own costs. Telecom declined the offer.

[14] It appears that an order for costs on a 2B scale basis would total about $4,160 plus disbursements, but that Counsel for Telecom has indicated that Telecom's actual costs amount to much more than that.

Counsel's Submissions and My Decision

[15] Telecom submits that the 4 December 2008 statutory demand should have never been issued because the alleged debt was founded on a disputed contract, and in any event because Landmark knew that Telecom was solvent.

[16] Telecom disputes the debt on several grounds. First, it submits that a share of the demand, namely $14,000 for invoice 11256, was merely a future liability that had not yet fallen due. This portion was later paid in part-settlement of the dispute. It appears that the invoice was issued only eight days before service of the demand, but that the contract may have provided for payment within 20 days of receipt. The respondent did not address this particular issue, but merely contended that all debts were due and owing at the time the demand was issued.

[17] Secondly, Telecom submits that the remaining settlement payments of US$18,088 were made in settlement of potential disputes beyond the subject matter of the demand and were "pragmatic 'split the difference' type concessions to secure the arbitration agreement…". In other words, Telecom maintains that there was a genuine dispute with respect to these claims despite its willingness to settle them.

[18] Thirdly, Telecom argues that it was in fact Landmark that owed Telecom money under the SAA and that the Invoice 9255 for $US139,400 was therefore invalid. The main question is essentially one of contractual interpretation, and appears to be whether Landmark is entitled to any payments under the SAA following early termination of the head contract.

[19] Lastly, Telecom contends that the SAA was subject to the arbitration clause in the head contract and that the parties were therefore obliged to resolve the respondent's claims by arbitration.

[20] The main thrust of Telecom's argument is that it is an abuse of the process of the Court to pursue liquidation proceedings if it is known that the alleged debt is disputed, and that there was never a genuine basis for establishing a sound evidential foundation for issuing the demand. It is further emphasised that the statutory demand procedure is not a legitimate device for applying leverage to a listed company with a significant public presence, and that there is a risk that it will become such a device unless Landmark's behaviour is answered with an adverse costs award.

[21] Following on from these submissions, and concluding that Landmark issued the demand in wilful disregard of the known fact that the debt was genuinely disputed, Telecom maintains that this is a situation where indemnity costs are justified: *Hedley v Kiwi Co-operative Dairies Limited* (2002) 16 PRNZ 694. Alternatively, it is submitted that an award of increased costs with an uplift from scale of at least 50% would be appropriate.

[22] Landmark, on the other hand, submits that it would never have withdrawn its statutory demand if Telecom had not agreed to part payment of the debt claimed in combination with an agreement to submit the balance of the demand to arbitration. It

therefore concludes that it is appropriate for the parties here to bear their own costs in relation to the statutory demand. Because Telecom refused to accept this offer, Landmark now claims costs in respect of this present application for costs.

[23] In response to the applicant's submissions, Landmark also argues that:

- the SAA was a separate agreement and thus not subject to the arbitration clause contained in the head contract;
- the amount claimed under the SAA was due and owing despite early termination of the head contract;
- the mere fact that Telecom claimed solvency did not preclude Landmark from issuing the statutory demand;
- there are no "truly exceptional circumstances" that justify an award of indemnity costs;
- an award of increased costs is equally unjustified because Telecom did not establish any substantial dispute in respect of the statutory demand, and because in any event Telecom made a significant payment in respect of the amount claimed.

[24] As noted previously, Landmark also seeks costs on a 2B basis in relation to this application for costs on the basis that, on 19 June 2009, it made a "without prejudice save as to costs offer" that each party bear its own costs. It appears that, since that date, there have been two case management conferences that would have been avoided if Landmark's offer had been accepted.

[25] Various arguments were raised with respect to the issue as to whether the SAA indeed required Telecom to pay to Landmark US$139,400 and US$65,600 and whether some of the affidavit evidence for Landmark was inadmissible on the basis that it referred to without prejudice communications. Given the context of the present application, and the fact that the claim with respect to these payments is still to be resolved in arbitration, I do not propose to deal with these issues in any depth.

[26] For the purposes of a costs cosnideration, a statutory demand that is withdrawn is commonly equated to a discontinued proceeding, requiring the

withdrawing party to pay costs: *Furnz Limited v Goode Industries Limited* HC AK CIV-2008-404-1024 13 October 2008 at [6], r 15.23 of the High Court Rules and *North Shore City Council v Local Government Commission* 9 PRNZ 182. There is a presumption that a discontinuing party will be liable for costs.

[27] This rule is of course subject to the Court's general discretion as to costs in r 14.1. It may be, for example, that the creditor acted reasonably in issuing the statutory demand, and that the demand is merely withdrawn because it is rendered futile by the alleged debtor's subsequent actions: McGechan at HR15.23.01, citing *Olive Francis Retirement Home Ltd v Director-General of Health* HC AK CIV-2005-404-1367 13 July 2005. Landmark accordingly argues that costs should lie where they fall because it only withdrew the statutory demand once Telecom agreed to pay a substantial part of the amount claimed in the demand and to submit the remaining claims to arbitration.

[28] Generally, the Court will not inquire into the merits of a case it never heard, unless the answer is clear and obvious: *Furnz Limited v Goode Industries Limited* at [6]. In my view, however, the present case is far from obvious. It involves protracted contractual arguments as to the legitimacy of various claims by Landmark. It follows that it is clearly inappropriate in the circumstances to resolve this application for costs on a comprehensive assessment of the merits, and I must therefore limit my analysis of the substantive issues to a minimum.

[29] Despite Telecom's willingness to pay a share of the demand, Landmark's position that costs should lie where they fall must be rejected here. It appears that only US$32,088 of the respondent's total demand for US$244,088 was paid in full and final settlement of the parties' respective claims, and that the majority of the alleged debt was submitted to arbitration in order to resolve the dispute. In the general run of events, as I see the position, it is unlikely that, in the absence of a genuine dispute, Landmark would have been willing to withdraw its demand, receiving in return the sum of US$32,088, payment of US$65,600 on a "without prejudice" basis, and an agreement to submit the contested sum of US$205,000 to arbitration. This arrangement in my view would tend to indicate that, contrary to Landmark's submissions, there may in fact have been a genuine dispute with respect

to the remainder of the demand. In any case, it would have been prudent for Landmark to insist on an agreement as to costs which it did not do.

[30] Landmark goes on to submit however that it is significant that Telecom's statement of defence, which was filed pursuant to the arbitration agreement, does not in fact include any claim for set-off of the US$65,600. It appears to suggest that Telecom's failure to do so must be understood as an acknowledgement that the sum is not genuinely disputed. It does not seem appropriate in the present case however to speculate about the reasons for the apparent abandonment of Telecom's claim in set-off. Here, the focus must instead be on the settlement and arbitration agreement, and on the reasonableness of Landmark's decision to issue the statutory demand in the first place.

[31] Regardless of Landmark's motivations to resolve the matter by arbitration, however, it must be emphasised that its reliance on the SAA is vigorously contested. I make no judgment as to the strength of Telecom's challenges, save as to say that the nature and the complexity of counsel's arguments may well point to the existence of a genuine dispute here. Based on the affidavit evidence before me, it is clear at least that there is an issue as to whether the parties reached agreement on what would happen if the head contract was terminated early, but performance of the SAA had not yet come to an end.

[32] It is also uncertain whether it was reasonable to issue the statutory demand with respect to the alleged debts that Telecom was willing to pay in settlement. Telecom obviously disputes that it was reasonable to do so, relying on various arguments to show that none of the relevant debts were due and owing at the time the demand was issued. More particularly, it is argued that US$14,000 related to a future liability, that the claims were covered by an arbitration clause, and that the remaining payments were made in settlement of potential disputes beyond the subject-matter of the demand. While these submissions may not be particularly strong, in my view they support my earlier conclusion that in general terms Landmark may not have acted reasonably when issuing its statutory demand, and that the presumption that a withdrawing creditor is liable for costs should not be displaced.

[33] I now turn to Telecom's claim for indemnity or increased costs. Telecom argues that the statutory demand should have never been issued, and that it is an abuse of the process of the Court to pursue liquidation if it is known that the alleged debt is disputed.

[34] The jurisdiction for an award of increased costs or indemnity costs is conferred by r 14.6 High Court Rules which provides:

> "14.6 **Increased costs and indemnity costs**
> (1) Despite rules 14.2 to 14.5, the court may make an order—
> (a) increasing costs otherwise payable under those rules (increased costs); or
> (b) that the costs payable are the actual costs, disbursements, and witness expenses reasonably incurred by a party (indemnity costs).
> (2) The court may make the order at any stage of a proceeding and in relation to any step in it.
> (3) The court may order a party to pay increased costs if—
> (a) the nature of the proceeding or the step in it is such that the time required by the party claiming costs would substantially exceed the time allocated under band C; or
> (b) the party opposing costs has contributed unnecessarily to the time or expense of the proceeding or step in it by—
> (i) failing to comply with these rules or with a direction of the court; or
> (ii) taking or pursuing an unnecessary step or an argument that lacks merit; or
> (iii) failing, without reasonable justification, to admit facts, evidence, documents, or accept a legal argument; or
> (iv) failing, without reasonable justification, to comply with an order for discovery, a notice for further particulars, a notice for interrogatories, or other similar requirement under these rules; or
> (v) failing, without reasonable justification, to accept an offer of settlement whether in the form of an offer under rule 14.10 or some other offer to settle or dispose of the proceeding; or
> (c) the proceeding is of general importance to persons other than just the parties and it was reasonably necessary for the party claiming costs to bring it or participate in it in the interests of those affected; or
> (d) some other reason exists which justifies the court making an order for increased costs despite the principle that the determination of costs should be predictable and expeditious.
> (4) The court may order a party to pay indemnity costs if—
> (a) the party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing, continuing, or defending a proceeding or a step in a proceeding; or
> (b) the party has ignored or disobeyed an order or direction of the court or breached an undertaking given to the court or another party; or
> (c) costs are payable from a fund, the party claiming costs is a necessary party to the proceeding affecting the fund, and the party claiming costs has acted reasonably in the proceeding; or
> (d) the person in whose favour the order of costs is made was not a party to the proceeding and has acted reasonably in relation to it; or
> (e) the party claiming costs is entitled to indemnity costs under a contract or deed; or

(f) some other reason exists which justifies the court making an order for indemnity costs despite the principle that the determination of costs should be predictable and expeditious."

[35] Telecom which is the party here claiming increased or indemnity costs carries the onus of persuading the Court that their award is justified – McGechan on Procedure HR 14.6.01. And a high threshold must be passed before any order for indemnity costs is made – *Paper Reclaim Ltd v Aotearoa International Ltd* [2006] 3NZR 188.

[36] Turning to the present case, it is well established that creditors need to be cautious before issuing statutory demands that there is in fact no genuine dispute as to the debt: *Keystone Ridge Limited v City Sales Limited* HC AK M549-IM02 19 July 2002 at [10]; *Furnz Limited v Goode Industries Limited* at [5]. The recipient of a statutory demand is subjected to a stringent procedure if it wishes to avert the danger of being placed into liquidation. It must act promptly and show that the debt in issue is genuinely disputed, if it wishes to avoid the real risk of being placed in liquidation with all the major consequences that follow.

[37] A statutory demand therefore should only be issued in cases where there is a "genuine basis for establishing the evidential foundation so that an application can ultimately be made to appoint a liquidator": *International Airline Training (NZ) Ltd v Rohlig NZ Ltd* HC AK CIV-2003-404-3464 23 February 2004 at [16].

[38] It is not disputed here that Telecom warned Landmark on several occasions to abstain from issuing a statutory demand, explaining that it considered the debt to be genuinely disputed. In *Summer Construction Limited v Bakker* HC WN CIV-2006-485-1499 10 November 2006 at [35], I concluded that the Court views seriously any decision taken by a party to proceed with an inappropriate statutory demand in the face of a warning issued by an applicant company. In that case I made an order for increased costs on that basis.

[39] In the present case, however, I am not satisfied that the statutory demand was clearly inappropriate. As I have noted above, it is possible that there may have been a genuine dispute with respect to the majority of the alleged debt, but I am not willing, within the context of this application, to ultimately decide that issue. It also

appears that at least a small part of Landmark's demand related to debts that were due and owing. Based on my necessarily limited understanding of the merits of the case, an order for increased, let alone indemnity costs, is thus hardly warranted.

[40] Moreover, as rightly pointed out by Landmark, the fact that it knew Telecom to be solvent did not necessarily render the statutory demand inappropriate: *AMC Construction Limited v Frews Contracting Limited* [2008] NZCA 389 at [7].

Conclusion

[41] The applicant's claim for indemnity or increased costs is consequently declined. Telecom, however, is entitled to costs on a category 2B scale basis plus disbursements. At para. [15] of the submissions put before me by counsel for Telecom these 2B costs are calculated at $4,160.00.

[42] As a result, Landmark's claim for costs on the present costs application must obviously be dismissed. Although Telecom's application has contributed to both parties' costs, Landmark's offer that costs should lie where they fall was less beneficial to Telecom than the award it has secured today.

[43] An order is now made that category 2B costs totalling $4,160 are to be paid by Landmark to Telecom on the withdrawn application to set aside the statutory demand together with disbursements as fixed by the Registrar.

'Associate Judge D.I. Gendall'