

IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

**CA557/2019
[2020] NZCA 222**

BETWEEN

**ANTHONY CANNON BAXTER
First Appellant**

**WILLY LEFERINK
Second Appellant**

AND

**EMMA MARY MURRAY, WAYNE
DEREK ANDERSON and FOUR S TRUST
LIMITED as trustees of the Four S Trust and
CRAIG ROBERT WILLIAM BRYDON,
DARELLE JANISE BRYDON and
JEFFREY HOLLIS STRETTON as trustees
of the Craig & Danielle Brydon Family Trust
and S.A.S. TRUSTEE COMPANY
LIMITED and TRUSTS LIMITED all
former shareholders of JLE Holdings
Limited
Respondents**

Hearing: 19 May 2020

Court: Brown, Venning and Simon France JJ

Counsel: D J Ballantyne for Appellants
C A Murphy for Respondents

Judgment: 8 June 2020 at 11.30 am

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants are to pay the actual and reasonable costs of the respondents on this appeal on an indemnity basis in accordance with cl 2.1 of the Variation Agreement.

REASONS OF THE COURT

(Given by Venning J)

Introduction

[1] Anthony Baxter and Willy Leferink (the appellants) guaranteed the performance of Zeecol Finance LLC (Zeecol) under a Variation Agreement (Variation). The Variation varied an earlier sale and purchase agreement (SPA) and subsequent loan agreement between Zeecol and the respondents.

[2] Zeecol defaulted. The respondents made demand of the appellants. The appellants failed to pay. The respondents applied for summary judgment. Associate Judge Andrew entered judgment against the appellants for USD 713,428.36, together with interest and costs.¹

[3] The appellants say the Judge was wrong to enter summary judgment as they have an equitable set-off to the respondents' claim. Alternatively, they say the Judge should have exercised his discretion not to enter judgment. The appellants seek orders allowing the appeal and setting aside the judgment.

Factual background

[4] The factual background is not in dispute. The appellants accept it is correctly set out in the following passages from the Judge's decision:

[7] The [respondents], in their capacity as trustees of several independent trusts, are the former owners of an electrical services business (the sellers) operated by a company called JLE Holdings Ltd (JLE).

[8] In about mid-2017, the [respondents] decided to sell their shareholding in JLE.

[9] In September 2017, [Zeecol] bought the shares in JLE. The sale of the shares required USD 1,000,000 in vendor finance which was recorded in a sale and purchase agreement (the SPA). The parties to the SPA were Zeecol, [the respondents] and Mr William Farry Mook, as Covenantor. At the time the SPA was signed on 22 September 2017, the [appellants] were not a party to it.

¹ *Murray v Baxter* [2019] NZHC 2444.

[10] Clause 7.1 of the SPA provides for a working capital adjustment that has the potential to require a payment from [Zeecol] to the [respondents] or a payment from the [respondents] to [Zeecol].

[11] Clause 13.18 of the SPA reads:

No right of set-off

Unless this Agreement expressly provides otherwise, a party has no right of set-off, withholding or deduction from or against a payment due to another party.

[12] In December 2017, [Zeecol] indicated that it required further financial assistance of [USD] 220,000 from the [respondents]. The further lending was recorded in an agreement [dated 8 December 2017] (the loan agreement).²

[13] Clause 7 of the loan agreement expressly provided that [Zeecol] was required to make all payments under the agreement without set-off, counterclaim or deduction.

[14] The first [appellant], Mr Baxter, guaranteed [Zeecol's] obligations under the loan agreement.

[15] Between December 2017 and August 2018, [Zeecol] made principal and interest payments of [USD] 804,522.76 to the [respondents]. After that, [Zeecol] began to default on its payment obligations.

[16] On 2 August [2018], the [respondents] and [Zeecol] agreed that the balance of USD 730,000 owing under the finance arrangements would be repaid in instalments with interest accruing at 10 per cent per annum and the default interest rate of 15 per cent per annum.

[17] On 11 August 2018, the [respondents] and [Zeecol] recorded their agreement in a variation to the SPA and the loan agreement (the Variation). Both [appellants] are parties to the Variation; they are described in the Variation as the covenantors.

[18] The background ... to the Variation expressly refers to both the SPA and the loan agreement of 8 December 2017. It also records that the purpose of the capital repayment schedule was to repay the loans. The loans are defined by reference to the SPA and the 8 December 2017 loan agreement.

[19] Clause 1.6 of the Variation provided:

The "Working Capital Adjustment" defined in the SPA remains owing (and shall be paid in accordance with the requirements of the SPA once finally determined).

[20] Clause 1.8 of the Variation reads:

The Parties acknowledge and confirm that they are and continue to be bound by the terms of the SPA which will remain in full force and effect except as varied by this Variation of Agreement.

² The USD 220,000 was to pay the buyer's financier (TCA Global Credit Master Fund LP (TCA's)) legal fees.

[21] Clause 3.1 of the Variation reads:

In consideration of the Seller [the respondents] agreeing to enter into this Variation of Agreement, the Covenantors [the appellants] unconditionally and irrevocably guarantee by way of continuing obligation to the Sellers [the respondents] as primary obligor, and not merely as surety, the due performance by the Buyer [Zeecol] of all of its obligations under this Agreement.³

[22] [Zeecol] repaid USD 30,000 under the Variation and then ceased all [further] repayments.

[23] Despite demand, [Zeecol] and the [appellants] have failed or refused to repay the USD 713,428.36 plus interest at the default rate and costs.

[24] In March 2019, both [appellants] were removed as directors of JLE by Zeecol's funder, TCA Global Credit Master Fund LP. In addition to being removed as directors, JLE was directed to immediately cease taking any directions from them. Since that time, neither [appellant] has had any access to the records of JLE, including steps taken pursuant to the working capital adjustment process and work on construction projects that might impact on that adjustment.

[5] In addition Mr Ballantyne made the following points: at the time Mr Baxter guaranteed Zeecol's obligations under the loan agreement on 8 December 2017, he was not a director of JLE; Mr Baxter and Mr Leferink were appointed directors of JLE on 15 December 2017 and 26 January 2018 respectively; and Mr Leferink was not a party to the loan agreement.

The High Court judgment

[6] Associate Judge Andrew considered the case to be a relatively straightforward debt recovery case. He noted the appellants' defence to the application for summary judgment was that they had a genuinely arguable set-off relating to the quantum of the purchase price. They argued that judgment could not be entered against them until such time as the working capital adjustment had been determined and the final purchase price precisely calculated. That was dependent upon the outcome of legal action being taken by JLE against David Brown Contracting Ltd over the University of Canterbury and the Grey Base Hospital, Greymouth construction projects.

³ The Buyer's obligations were to meet monthly payments from May 2018 as set out in a schedule to the Variation (together with interest). No payments were made after 1 September 2018.

[7] In his affidavit in opposition to the application for summary judgment Mr Baxter referred to cl 7.1 of the SPA which provided for the working capital adjustment and a further provision in the SPA which provided for Zeecol to submit warranty claims against the respondents.⁴ He then referred to an email exchange in early 2018 between Mr Covarrubia who was acting as consultant to Zeecol in relation to its dealings with its financier TCA Global Credit Master Fund LP (TCA) and Mr Palmer who was acting as the respondents' agent for the purpose of negotiating and giving effect to the SPA, which he suggested recorded an agreement regarding the working capital adjustment.

[8] The Judge did not consider that the correspondence between Mr Covarrubia and Mr Palmer amounted to an agreement on a working capital adjustment. But even if it had, he was satisfied it could not affect the appellants' obligations under the Variation.

[9] The Judge identified the two issues arising for determination as: first, whether the relevant contractual provisions excluded the appellants' right of set-off, and second, if set-off was not available to the appellants, whether the Court should, as a matter of discretion, dismiss or adjourn the summary judgment application, or grant a stay of execution on the grounds of injustice.

[10] The Judge rejected the appellants' submissions that the Variation was in the nature of an accord and satisfaction. He held that the Variation expressly provided the appellants' obligations as guarantors were to be construed in light of the obligations under the SPA. He accepted the working capital adjustment was a compromise of some of the arrangements contained in the SPA but considered the inability to raise a set-off continued as a matter of contractual obligation under the Variation. As they were parties to the Variation the appellants were bound by the clause in the SPA which excluded set-off.⁵

[11] The Judge considered his analysis was supported by the United Kingdom Court of Appeal case of *Continental Illinois National Bank & Trust Co of Chicago v*

⁴ The issue of warranty claims was not referred to by the Judge and nor was it pursued by the appellants in their submissions on appeal.

⁵ *Murray v Baxter*, above n 1, at [30].

Papanicolaou.⁶ While he accepted that in *Continental Illinois* the exclusion of the right to set-off was contained in both the loan agreement and the guarantee itself he considered there was a clear implication the prohibition against raising a set-off which was expressly provided for in the SPA also formed part of the obligations of the Covenantors under the Variation.

[12] On the second issue, while the Judge accepted the appellants were in a difficult position, he found they had not discharged the onus on them that to enter judgment would be a miscarriage of justice. He noted there was no evidence of the appellants' financial position. The mere existence of a counterclaim (even if likely to succeed) was not sufficient to order a stay. He declined to exercise his discretion against entering judgment and also declined to direct a stay.

Issues on appeal

[13] Although Mr Ballantyne sought to recast the issues for the Court on appeal, the two principal issues remain those considered by the Judge, namely:

- (a) Are the appellants able to raise an equitable set-off against the respondents' claim?
- (b) Was the Judge in error in not exercising his discretion to dismiss or adjourn the summary judgment application or in declining to grant a stay of execution on the grounds of injustice or abuse of process?

Principles

[14] The applicable principles are not in dispute. The general object of the summary judgment procedure is to enable a plaintiff to obtain judgment where there is no defence to the claim.⁷

⁶ *Continental Illinois National Bank & Trust Co of Chicago v Papanicolaou* [1986] 2 Lloyd's Rep 441 (CA).

⁷ *Pemberton v Chappell* [1987] 1 NZLR 1 (CA).

[15] A counterclaim is not available as a defence to an application for summary judgment.⁸ But a set-off is different and distinct from a counterclaim. A set-off, either legal or equitable, will be regarded as a defence and sufficient to defeat an application for summary judgment. In the often cited case of *Grant v NZMC Ltd* Somers J, in delivering the judgment of this Court, confirmed:⁹

The principle is, we think, clear. The defendant may set-off a cross-claim which so affects the plaintiff's claim that it would be unjust to allow the plaintiff to have judgment without bringing the cross-claim to account. The link must be such that the two are in effect interdependent: judgment on one cannot fairly be given without regard to the other; the defendant's claim calls into question or impeaches the plaintiff's demand. It is neither necessary, nor decisive, that claim and cross-claim arise out of the same contract.

[16] The principle has been applied in a number of applications for summary judgment.¹⁰ While an equitable set-off can provide a defence, the right to raise the set-off may be contractually excluded, either expressly or by clear implication.¹¹

[17] There is no dispute that the wording of cl 13.18 of the SPA is sufficient to exclude the right of set-off in this case. The issue is whether the appellants are bound by it.

Discussion

An equitable set-off

[18] Mr Ballantyne conceded that the appellants are bound by cl 3.1 of the Variation and, pursuant to that clause they agreed to guarantee the due performance of Zeecol's obligations under the Variation. He took no issue with the quantum claimed based on Zeecol's non-performance. Mr Ballantyne's focus was on the defence of set-off based on the working capital adjustment. The appellants' argument is that the working capital adjustment will provide them with a counterclaim or cross-claim which they are entitled to set-off against the respondents' claim against them.

⁸ *Pemberton v Chappell*, above n 7, at 5.

⁹ *Grant v NZMC Ltd* [1989] 1 NZLR 8 (CA) at 12–13.

¹⁰ *M L Paynter Ltd v Ben Candy Investments Ltd* [1987] 1 NZLR 257 (HC); and *Edmonds v Westland Bank Ltd* [1991] 2 NZLR 655 (CA).

¹¹ *Grant v NZMC Ltd*, above n 9, at 13.

[19] As noted, Mr Baxter relied on the email exchange between Mr Covarrubia and Mr Palmer. In an email of 25 January 2018 Mr Covarrubia raised a concern regarding the University of Canterbury project. He believed the outcome of the variation regarding that project could have a negative effect on the working capital. He suggested pushing the working capital adjustment out to the settlement date so that a proper adjustment was made that would not have a negative effect on either party. Mr Palmer replied by email on 13 February 2018 confirming the respondents agreed with the working capital adjustments set out in the completion statement, which he considered obliged the Buyer to pay an additional NZD 209,017.96 by 20 February 2018. Mr Palmer also noted he was not certain what was meant by the settlement date, whether 1 April 2018 or perhaps the date on which all variations were finalised with the University of Canterbury project. But he confirmed the respondents were willing to agree to the latter. He also took the opportunity to raise the issue of payment of USD 220,000 plus interest, which became payable on 13 February 2018, together with an unpaid sum of interest of USD 5,095.89 which had fallen due on 1 February 2018.

[20] While, like the Judge, we see some difficulty with the appellants' reliance on the above exchange of email correspondence as a basis for set-off, it is unnecessary for this Court to comment further on the merits of any proposed claim based on a working capital adjustment. Even assuming for present purposes that there may be an adjustment in the purchase price (in Zeecol's favour), the issue is whether the appellants are able to rely on such an adjustment or whether the right to do so has been excluded by the incorporation of the provisions of the SPA, specifically cl 13.18, into the Variation.

[21] Mr Ballantyne submitted there was nothing in cl 3.1 to suggest that the Covenantors had excluded the right of set-off. We agree that cl 3.1 does not have that effect, but it is necessary to consider the Variation in its entirety and in context.

[22] The Variation was, as Ms Murphy submitted, a variation of the SPA and earlier loan agreement. It was not a standalone document. It modified the terms and obligations of the earlier SPA and loan agreement.

[23] Mr Ballantyne submitted that the Judge fell into error by failing to recognise or consider the discrete nature of the obligations each separate party had agreed to incur under the SPA, the loan agreement, and the Variation. As a result the Judge had mischaracterised the fundamental nature of the obligations the appellants had agreed to incur under the Variation. Mr Ballantyne emphasised that neither appellant was a party to the SPA. He submitted they did not agree to be bound by its terms. Further, while Mr Baxter was a guarantor to the loan agreement, that agreement was limited to USD 220,000 and Mr Leferink was not a party to it.

[24] Mr Ballantyne then submitted the Judge was wrong to rely on cl 1.8 of the Variation as the basis for finding the appellants were bound by the terms of the SPA including the exclusion of the right of set-off. He submitted cl 1.8 did not apply to the appellants.

[25] Mr Ballantyne submitted the Judge's conclusion relied on the fact the appellants were listed as Covenantors under the headings of "Parties" at the head of the Variation but, when viewed in context, Parties (with a capital P) in cl 1.8 of the Variation referred only to the Buyer and Sellers. Mr Ballantyne submitted the reference to "Parties" in cl 1.8 was different to the reference to "parties" in the balance of the Variation.

[26] Mr Ballantyne made the point that cl 1 of the Variation was headed "THE BUYER AND THE SELLERS HEREBY AGREE" and that "Parties" (with a capital P) appeared for the first and only time in cl 1 in subcl 1.8. He submitted it was obvious that the word "Parties" in cl 1.8 was being used as shorthand for the Buyer and the Sellers as defined. There was no reference in cl 1 of the Variation to the appellants as Covenantors. Clause 1 was restricted to obligations between the Buyer and the Sellers.

[27] A major difficulty for the appellants' argument is that the Variation itself defines "Parties" in the heading as:

1. The Parties listed as Shareholders in Part A Schedule 1 of the SPA (Sellers)
2. Zeecol Finance LLC (Buyer)
3. Anthony Channon Baxter and Willy Leferink (Covenantors).

Next, where the relevant provisions of cl 1 deal with issues directly affecting only the Buyer and Sellers, they are referred to in those terms. There is no reason to read down or restrict the more general meaning of Parties in cl 1.8 to exclude the appellants as Covenantors and to read it as only referring to the Sellers and Buyer.

[28] The other references to “parties” in the Variation (in the Background and at cls 5.1 and 6.1) are references to all three parties: the Sellers, Buyer and the appellants. The introductory cl B of the Background to the Variation refers to the parties to the loan agreement. That is consistent with the fact that the respondents as Sellers, Zeecol as Buyer and Mr Baxter were all parties to the loan agreement. Clause 5 confirms the limits of liability (which would be relevant to any potential claim by the Buyer or Covenantors against the Sellers) and cl 6 is a standard jurisdiction clause which is applicable to all the parties’ rights. We accept that where “parties” is used in the balance of the agreement it includes the appellants as Covenantors.

[29] Further, if Mr Ballantyne’s submission that cl 1 only applied to the Buyer and Sellers and did not include the appellants as Covenantors was correct, then cl 1.6 which confirms the “Working Capital Adjustment” defined in the SPA remains owing would only apply to the Sellers and Buyer. There would be no basis upon which the appellants could rely on the working capital adjustment for the claimed set-off.

[30] That highlights the fundamental difficulty with the appellants’ argument. The appellants’ defence to the otherwise undisputed obligation to pay the loan balance in accordance with the schedule to the Variation claim is based on an equitable set-off which arises from a working capital adjustment provided for in the SPA and confirmed in cl 1.6 of the Variation. But the appellants say that neither the SPA nor cl 1 of the Variation applies to them. As Mr Ballantyne pointed out, the appellants are not parties to the original SPA. There are only two ways they could assert or rely on rights arising originally under the SPA, either on the basis the SPA is incorporated into the Variation (which they are a party to) or by subrogation. But if cl 1.6 applies to the Covenantors then so does cl 1.8. The appellants cannot cherry pick which provisions in the SPA and Variation they wish to rely on.

[31] We agree with the Judge's conclusion that on the plain wording of the Variation the terms of the SPA were incorporated into the Variation (by cls 1.6 and 1.8) so that the appellants could potentially rely on the working capital adjustment, but as a corollary to that, the terms of the SPA including cl 13.18 were also incorporated into the Variation.

[32] There must be a legal basis for the equitable set-off the appellants claim. In *Grant* the appellants had a collateral contract with NZMC. There is nothing of that sort here. As Ms Murphy submitted, if the appellants are correct that the terms of the Variation alone govern their relationship with the respondents, they cannot point to any right which absolves them from liability in the event of default by the principal debtor. If, as Mr Ballantyne submits, cl 1 of the Variation only applied to the Sellers and Buyer and not the Covenantors, then there would be no ability for the appellants to rely on the working capital adjustment as a basis for the set-off. Mr Ballantyne was unable to explain on what other basis the appellants could otherwise pursue a counterclaim based on the working capital adjustment.

[33] If the terms of the SPA are not incorporated into the Variation then the only way the appellants could rely on rights arising under the SPA is by subrogation to the rights of the Buyer under the SPA. But the right of subrogation only arises once the principal debt or obligation has been wholly satisfied.¹² In order to be subrogated to the Buyer's rights the appellants would have to pay the claimed amount in full. Once they had done that, the appellants would stand in the shoes of the Buyer and have the right to pursue a claim based on the working capital (or warranty) adjustments.

[34] For completeness we deal with two other points Mr Ballantyne raised.

[35] Mr Ballantyne submitted the only avenue by which the appellants could be made subject to the SPA was by implying such a term into the Variation. He suggested the Judge had incorrectly purported to do that in the following passage:¹³

¹² *Duncan, Fox, & Co v North and South Wales Bank* (1860) 6 App Cas 1 (HL); and *Traders' Finance Corp Ltd v Marks* [1932] NZLR 1176 (SC).

¹³ *Murray v Baxter*, above n 1, at [29].

Construing the terms of the Variation in the context of the SPA and loan agreement, the defendants have, by clear implication, contractually agreed to exclude any right of set-off.

[36] We do not read that as suggesting the Judge was implying a clause into the Agreement as a matter of law, but rather was using the phrase “by clear implication” in its usual grammatical sense, namely a conclusion to be drawn from the surrounding circumstances even if not explicitly stated.

[37] Mr Ballantyne next submitted the case of *Continental Illinois* did not assist. The guarantees in that case specified the right of set-off was excluded and on that basis the case was wholly distinguishable. We agree that the case is different, as the Judge himself acknowledged, but as we read his decision the Judge was relying on it principally to support his analysis that the right of set-off can be excluded by the natural meaning of words.¹⁴

The exercise of the discretion

[38] The second issue is whether the Judge was wrong to exercise his discretion against the appellants in entering summary judgment. The discretion not to enter summary judgment will only generally be exercised to avoid an injustice.¹⁵ The Court also has a discretion to issue a stay of execution if satisfied that the appellants have a counterclaim which ought to be heard.¹⁶

[39] For the reasons the Judge gave at [42] to [46] of his judgment we agree that the appellants have failed to discharge the onus on them to show there was any likelihood of a miscarriage of justice in the entry of summary judgment in this case. As noted, the potential counterclaim is by no means certain. To decline to enter summary judgment would have defeated the commercial purpose of the Variation, which was to ensure that, in the event the Buyer defaulted, the Sellers could require

¹⁴ *Murray v Baxter*, above n 1, at [35], citing *Continental Illinois National Bank & Trust Co of Chicago v Papanicolaou*, above n 6 at 445.

¹⁵ *Pemberton v Chappell*, above n 7; *Waipa District Council v Electricity Corporation of New Zealand* [1992] 3 NZLR 298 (CA).

¹⁶ *Roberts' Family Investments Ltd v Total Fitness Centre (Wellington) Ltd* [1989] 1 NZLR 15 (HC) at 21.

the Covenantors to meet its obligations. As the United Kingdom Court of Appeal said in the *Continental Illinois* case:¹⁷

Indeed the present cases make it the more necessary that the Court should not interfere, for here the parties have specifically provided both in the loan agreement and the guarantees that payment should be made free of any set off or counterclaim. It would defeat the whole commercial purpose of the transaction, would be out of touch with business realities and would keep the bank waiting for a payment, which both the borrowers and the guarantors intended that it should have, whilst protracted proceedings on the alleged counterclaims were litigated. We do not doubt that the Court has a discretion to grant a stay but it should in our view be “rarely if ever” exercised ... Guarantees such as this are the equivalent of letters of credit and only in exceptional circumstances should the Court exercise its power to stay execution.

[40] For the same reasons the Judge was also correct not to direct a stay of execution.

Result

[41] The appeal is dismissed.

Costs

[42] The appellants are to pay the actual and reasonable costs of the respondents on this appeal on an indemnity basis in accordance with cl 2.1 of the Variation Agreement.

Solicitors:
Canterbury Legal, Christchurch for Appellants
Powle & Hodson Ltd, Auckland for Respondents

¹⁷ *Continental Illinois National Bank & Trust Co of Chicago v Papanicolaou*, above n 6 at 445 cited in *Murray v Baxter*, above n 1, at [35].