IN THE HIGH COURT OF NEW ZEALAND

AUCKLAND REGISTRY A. 338/83

BETWEEN: STERLING ENGINEERING LIMITED
a duly incorporated company
having its registered office at
Auckland, Engineering Company

Plaintiff

A N D: HILLCREST SERVICES LIMITED
a duly incorporated company
having its registered office at
Auckland, Motor Repairers

Defendant

Hearing: 2 April 1984

Counsel: Mr G. Harrison and Miss Tarrant for Plaintiff
Mr Asher for Defendant

Judgment: 7 May 1984

RESERVED JUDGMENT OF CALLEN, J.

In 1981 a Mr Thomas Blythen and a Mr Brian Gilman, who were then working for Air New Zealand, were considering early retirement. They had in mind pooling their financial resources to purchase a business to provide both income and occupation on retirement. Both Mr Blythen and Mr Gilman were at the time flying in and out of New Zealand, but when they were practically able to do so, they looked at the possibility of acquiring several businesses and eventually they became particularly interested in a business known as Stirling Engineering Limited.

It is not entirely clear from the evidence how they first became aware this particular business was available, but it

does seem that Mr Gilman may have seen an advertisement, as a result of which Messrs Blythen and Gilman got in touch with the agent for sale, a Mr John Hunt of John Hunt Associates. The advertisement, if there was one, was not produced to me and there was no evidence as to the original terms on which the business was offered.

It is also not entirely clear how the business was described in any advertising or by the agent. The business had been started in 1973 by a Mr Darby and Mr Darby described the business as being one holding itself out as specialists in transmission, selling parts and servicing transmissions. It seems clear, however, that the bulk of the business related to clutch repairs and servicing, with some work being done on gear boxes by Mr Darby himself, who was described by Mr Blythen as a very competent mechanical engineer. The business was then operated on the basis that one mechanic was employed to carry out the clutch work. Mr Darby attended to most of the rest of the affairs of the business, assisted by Mrs Darby who was a part time employee of the company.

The extent of the work in relation to gear boxes is disputed. A document seems to have been prepared and available for the purposes of sale, which puts a clear emphasis on the clutch work and which states that only a very small proportion of the time devoted by Mr Darby to the business related to gear boxes In evidence, however, Mr Darby stated in the last year of operation under his management, the gear box side of the work shop accounted for 13% of total workshop jobs. In that last period, he carried out 54 jobs.

Mr Cannons, the mechanic employed by both Mr Darby, and ultimately the plaintiff, was called to give evidence for the plaintiff and although in his initial evidence he indicated on one or two gear boxes were worked on in a month, he finally agreed that the figures contended for by Mr Darby could be right. After some negotiation, Messrs Blythen and Gilman offered the sum of $145,000 for the business, including parts. This was not accepted and negotiations continued. Eventually the parties agreed on a price of $145,000 with an additional sum for stock which was estimated at $60,000 in the agreement, but which was subject to the actual value of the stock being calculated in accordance with the formula contained in the agreement. It seems that more than on agreement was actually prepared before one was signed and the discussions seem to have been extensive and to have extended over a period.

Clause 10 of the agreement dated the 17th April 1982 is in the following terms:

> "The Vendor hereby warrants that the turnover exclusive to the business hereby agreed to be sold has averaged the sum of not less than $3,500 per week for a period of 12 months immediately preceding the date of execution hereof. The Purchaser acknowledges that he has inspected the assets and records pertaining to the said business and that he purchases the same solely in reliance upon his own judgment and not upon any representation or warranty made by the Vendor or any agent of the Vendor except as expressed in this agreement. This provision shall not however operate to relieve the Vendor or any agent of the Vendor from liability for any fraudulent misrepresentation.

The first matter at issue relates to this. The plaintiff company took possession of the business on 29 May 1982 and began to operate with the assistance of Mr and Mrs Darby over th first four or five weeks of operation. The purchasers became

concerned that the turnover was not reaching the figure which they expected and since there was a responsibility to pay substantial funds in respect of monies advanced by the vendor by way of debenture, the failure of the business to produce the amounts anticipated was of great concern to Messrs Blythen and Gilman. The actual average turnover in this earlier period appears to have been as low as $2,700 per week, which was an insufficient sum to enable the business to generate the payments required to satisfy their obligation under the debenture. Not surprisingly, the purchaser considered that the Warranty should be investigated and the accountant for the vendor produced figures for submissions to the accountant for the purchaser. These figures showed an average turnover for the previous twelve months at $3,508.27 per week during the period.

Mrs Edwards, the accountant for the purchaser, gave evidence and referred to four areas of the accounts with which she did not agree.

The first of these was an amount of $2,307.83 included in the total turnover and which resulted from a payment in respect of an insurance claim. Quite properly, Mrs Edwards indicated that in her view such a payment would not normally constitute a part of turnover.

In evidence, Mr Darby explained that there had been a fire at some time previously as a result of which a number of parts held in stock for sale had been damaged. The damage did not mak the parts unsaleable, but reduced their value and in fact during the period under consideration, they sold at a reduced

value. The amount included from the proceeds of the insurance claim, represented the difference between the original sale value and that for which they were ultimately sold. Mr Darby's point is that if damaged parts had not been sold during this period, undamaged parts would and therefore the total amount properly represents a part of turnover. This is a question of fact and no evidence to contravert that put forward by Mr Darby was produced and accordingly I am obliged to conclude that his contention is factually correct and that the amount is properly included in turnover.

The second head of objection raised by Mrs Edwards related to certain sales which she considered did not properly represent turnover. In particular, she referred to invoices for the sale of stock sold in the last week of business totalling $5,446.61. These were all genuine sales, but one in particular was for a much larger amount than was normally purchased by the particular customer and was also purchased on the basis of a more substantial discount than was normally given to the customer concerned. This sale took place on the last day before the business changed hands. The sale was certainly unusual. It was accepted that no sale of this kind had been made to the particular customer before. Clearly enough, the Warrant referred to ordinary rather than unusual turnover. I believe Mrs Edwards was right to query it and although Mr Morton, the accountant for the vendor, referred to it as being a sale of stock and therefore part of turnover, I do not think this met the particular point raised by Mrs Edwards. The sale concerned was to Butland Truck Services and the invoices were numbers SP4667 and SP4668. The total involved was $3,462.24.

I consider this figure should be deducted from the total turnover for the period, but I do not accept that the other items so selected by Mrs Edwards are sufficiently unusual to justify their deduction in the absence of additional evidence.

I do not overlook that one of the disputed items was a sale to the plaintiff, but in the absence of proof that this wa not a normal turnover sale, the fact that it was to the plainti does not of itself, in my view, stamp it as a non-turnover item

Mrs Edwards also referred to an item of $450 which related to sales at what is described as a "vintage swap meet". Mr Darby indicated that this was an annual event attended by enthusiasts and that he had made sales of this kind over a peri Under those circumstances, the amount may properly be described as turnover.

Mrs Edwards also drew attention to the fact that included in turnover were sales made to staff. There is nothing, however, to indicate that those sales were other than genuine. Mr Darby stated that they were part of an established pattern and involved the vendor company making a profit on the transaction. Under those circumstances, I think that there is insufficient evidence to justify removing the figures concerned from turnover.

However, the deduction of the sale to Butlands, which I consider to be a proper deduction, would have the effect of reducing the total turnover to a sum which would result in the average weekly turnover being less than $3,500 per week. The Warranty contained in the agreement is absolute.

Mr Asher submitted that the de minimis principle would apply and that if any failure to achieve the total warranted were insignificant, then the plaintiff would not be entitled to recover. Insignificance is a question of degree. I cannot accept that a sum of $60 per week in excess of $3,000 over a yea bearing in mind the obligations of the plaintiffs, is insignificant. In my view, the plaintiff is entitled to succeed in respect of this contention.

The plaintiff is therefore entitled to damages in respect of the breach of warranty, but the figure is hardly likely to be large.

Mrs Edwards drew attention to the fact that the transaction involved a payment for goodwill of $45,000. This sum was not too far from the profit which could have been expected and she made the assumption from this that the goodwill had been calculated in relation to net profit. There is no evidence that this was so and Mr Darby denied it, saying that the goodwill figure was a matter for negotiation and not related to any particular calculation or formula. Goodwill is, in circumstance such as these, an unfortunate term. A purchaser pays a price in respect of a transaction and although there may be rules of thumb or even patterns available over a number of transactio in the end the amount which a particular purchase is worth depends on many considerations. If Mrs Edwards' formula were correct, applying it to the altered figures, there would be a short-fall in net profit which would calculate out in the vicinity of $1,872 per annum. Mr Morton was not prepared to accept the formula or basis of calculation put forward by

Mrs Edwards, but using her figures, which incidentally he did not accept, he arrived at a figure of $2,315 for reduction.

Since the parties did not themselves indicate a formula, there is a certain amount of guess work involved in any calculation. Having regard to all the circumstances, I consider an appropriate figure to be $1,872.

The plaintiff's second major claim relates to the sum paid in respect of the purchase of gear box parts. The stock summary indicates that the total amount paid in respect of thi part of the purchase was in the vicinity of $50,000. The plaintiff effectively says that it purchased these as a result of a misrepresentation and further that the parts were not wort the price which was paid for them. The misrepresentation was, according to the evidence of Mr Blythen, an alleged statement by Mr Darby that the gear box parts were necessary in respect o the clutch side of the business. Mr Blythen accepted that to a very limited degree some gear box parts did have a value in relation to the clutch assembly work, an example being seals, but that this was minute in proportion to the total number of parts purchased, many of which could have had no application whatever to clutch assemblies or work in connection with clutch

These contentions can only be considered in relation to th background, reference to which has already been made. Even whe the business was conducted by the vendor, the proportion which related to gear box work was comparatively small and in any eve this was dependant on the special skills and interest of Mr Darby. Messrs Blythen and Gilman were not qualified to carr on this work and could not have done so unless they had employe

a specialist qualified mechanic. It is clear that from an early stage they had decided that they would run the business as a clutch repair business.

A considerable emphasis was placed on the highly scientific and organised system adopted by Mr Darby in relation to the storage and cataloguing of parts. Mr Blythen at least had had some experience in relation to mechanical work since he had begun his career as an apprentice motor mechanic when he left school. I cannot think that he would have been unaware that the vast proportion of parts relating to gear boxes could not have been usable in connection with the clutch business. Mr Darby completely denies that the representation was made. It seems likely to me that some comment was made, but the evidence falls short of establishing that anything sufficiently definite to amount to a misrepresentation was made.

There is a further consideration which reinforces this conclusion.

The transaction as originally contemplated did not involve the plaintiffs purchasing all of the stock. The evidence relating to this is clear that only approximately half the stock of the business was to be purchased, but the evidence is quite unclear as to what stock was to be retained by the vendo It may have been proportionate; it may have been selected in relation to age; it may have been a subject of dispute between the parties. In the circumstances, it is difficult to see how any representation or misrepresentation sufficiently strong to give rise to legal consequences, could have been made or acted

upon. But further, the decision to increase the amount of stock purchased was the decision of the purchasers and it appears in the evidence of Mr Blythen that the reason for making this decision was the possibility that they might be faced with competitive sales at a discount by the vendor trading in the same field if the vendor were to retain stock, and that as a matter of business sense, the decision was taken to acquire the whole of the stock in order to protect the trading position. If this is so, then the motivation would discount any real reliance on any representation which may have been made.

I am not without sympathy for the purchasers in this situation. Mr Blythen impressed me as a genuine witness, doing his best to recount the situation as he recalled it. The onus of proof, however, is on the plaintiff. In all the circumstances I am left in doubt and come to the conclusion that the plaintiff has not discharged the onus.

The situation with regard to value is different. The plaintiffs called the evidence of a Mr Larkem to the effect that the gear box parts were of very little saleable value. He would have been prepared himself to purchase them at a total figure in the vicinity of $2,500. Mr Darby disputed this and I think the evidence establishes that the approaches of the two men to the value of the items concerned was entirely different and not necessarily inconsistent. Whether this is so or not, however, the method for valuation prescribed by the agreement is clear. It is fixed by Clause 24 as the current trade price of the items concerned, less certain discounts.

The figures so placed on them were accepted by the purchasers and I do not think that they are now entitled to re-open these transactions. If the method of valuation had been different, a different result might have been achieved, but the real point of issue between the parties is not so much the value placed upon the items, but the difficulties of sale of them. Many of them are items for which there is a very limited sale, and this was the basis for the discounted value which Mr Larkem placed upon them as a whole.

I think this is a case of caviat emptor and the fact that the purchasers may have got, in commercial terms, a bad bargain is not sufficient to justify re-opening the transaction or a claim for damages.

In my view, the plaintiff does not succeed in respect of this head of claim.

The plaintiff also claimed against the defendant that the purchase of certain clutch covers valued for the purposes of the agreement at $25 in respect of some and $15 in respect of others was based on a misrepresentation. The total amount paid for these clutch covers was $18,790. There were 790 of them and the plaintiff contended that the true value was only $1.00 per cover so that the amount which should have been paid should have been no more than $790. The misrepresentation expressed was as to value. The clutch covers were part of the clutch assembly and the transaction in respect of these can only be understood in relation to the use to which they were put and the way in which the business operated. When a vehicle with a defective clutch came in for repair, there were three methods normally adopted in dealing with such situations. In each case,

the clutch assembly was removed. In some cases, it was replac with new parts. This clearly was a very expensive procedure, not appropriate in every case.

In other cases, what is known as a reconditioned clutch assembly was fitted. This was a cheaper job and there appears to have been a third method known as a 'budget job' when secondhand clutch parts from stock which were considered to be suitable were fitted.

In the case of reconditioned assemblies, the general practice in the trade was to require a replacement assembly to be used in some sense as a trade-in for the reconditioned part The owner of the vehicle could in some cases produce such an assembly. In others, the business itself was required to produce such an assembly to the supplier of the reconditioned unit. In either case, if no parts were available, then the sur of $20 was paid as an alternative to the trade-in and in some sense as a deposit. It was therefore important to the business to have available a certain number of used clutch assemblies to make available to suppliers of reconditioned assemblies. It was also necessary to retain a number of these assemblies for the budget jobs and also as stock for the less available parts required by older model vehicles which supplier do not necessarily continue to keep in stock. It is possible to see the desirability of retaining a sufficient number of par to meet these requirements.

The evidence of Mr Darby was that the number transferred and the total price was by no means excessive. The evidence of Mr Blythen was directed more to the question of value.

He considered
/it was possible to obtain parts,when required, from car wreckers at $1.00 and that in the circumstances a purchase at $25 or $15 was excessive.

There was some supporting evidence available for this contention from, in particular, Mr Ushaw. Mr Darby agreed that it was possible to buy clutch assemblies as indicated by Mr Blythen, but that this was only possible in unsatisfactory circumstances. He referred to them being available from mechanics, possibly illicitly, and suggested that they were not available in large numbers. He considered that such a method of acquisition was unsuitable.

It was also pointed out that the deposit value of clutch assemblies tended to fix their value at $20 and evidence was also given that the charge out price would have been much higher in each case than the figure fixed. Mr Darby also stated that the figure of $25 was arrived at in respect of those parts for which a higher charge out rate could be expected and the reduced figure of $15 for those which had not been checked or might have been less available for use.

The plaintiff agreed to purchase the parts at the value set out in the agreement. Again, I think that the evidence falls short of establishing actionable misrepresentation. There is evidence which justifies the position taken by Mr Darby and I do not think that the evidence as to the availability of lower priced articles is sufficiently strong or conclusive to establish the plaintiff's claim.

The plaintiff bought a business which had been establishe on a particular basis and the stock in trade of that business was transferred on that basis. It may be that the plaintiff could now change the method of operation and acquire stock in a different and cheaper way, but this is not sufficient to establish the plaintiff's contention in respect of the stock which was purchased in relation to this business. I think it is important, also, to bear in mind in connection with this part of the claim as well as with others, that there was a substantial and unapportioned discount given which would have a bearing on the reasonableness of the approach adopted by the parties. Further, the decision of the plaintiff to acquire additional stock to prevent or avoid competition referred to earlier is significant. In my view, the plaintiff fails in respect of this cause of action.

The plaintiff also claimed that there was substantial obsolete stock purchased, that this was purchased on the basis of a misrepresentation to the effect that all the stock was required for the purposes of the business and that some $7,000 worth of stock was purchased, which has no real sale value or which will have to be held in stock for so long before a use is found for it, that for all practical terms it is to be regarded as dead stock.

Once again, there is a conflict of evidence. Mr Darby considered that the stock was not obsolete. I think that the difference between the parties may, to some extent, have arisen because of a different emphasis in the conduct of the business. Mr Darby seems to have thought it desirable to

maintain a specialised business, able to provide parts for almost any vehicle; whereas the plaintiff is adopting the more commercially attractive system of endeavouring to confine the stock as far as possible, to parts which could be turned over reasonably quickly. Again, I cannot find that there is sufficient evidence to justify that there was an actionable misrepresentation on behalf of the defendant.

The question of absolescence is in the end one of degree and relates to the type of business. I note, again, that the plaintiff made a conscious decision to acquire additional stock, and I note too that there was a large and unapportioned discount. It is also clear that there was no charge made for a number of parts. The plaintiff has not convinced me that it entitled to succeed in respect of this head of claim.

The defendant has counter-claimed. Its counter-claim cove a number of small items and also includes a substantial claim in respect of a debenture entered into between the parties. Some of these items are readily dealt with.

The defendant claims that the apportionment on sale leaves an amount owing by the plaintiff to the defendant. In the circumstances, I think that this is a matter which should be resolved by the solicitors to the parties. Clearly it is eithe payable or it is not. The answer is a matter of calculation.

The defendant seeks half the legal costs on the debenture amounting to $217.50. The correspondence clearly indicates that the defendant agreed to accept the responsibility for the legal costs on the debenture. This claim fails.

The position regarding a small claim for tolls is not clear. The Post Office records would no doubt indicate what tolls were payable and by whom and I believe this should be resolved by the parties' legal advisers.

The defendant also claims in respect of an alleged share purchase in Partco Ltd. The plaintiff says it never agreed to purchase these shares and they were never transferred. The defendant says there was an agreement and the plaintiff should be held to it. The evidence in respect of this transaction is, to some extent, confused, which is understandab bearing in mind the minor part which it presumably played in th dispute between the parties. Although there is some recognition in the evidence of Mr Blythen that there was a transaction of this nature, I am left in doubt and therefore consider that the defendant fails in respect of this claim.

The defendant also claims a substantial sum in respect of unpaid interest on the debenture. The conclusions already expressed in this judgment should allow the parties to arrive at a figure which properly represents the amount owing. Interest will be payable on this in accordance with the terms agreed by the parties and set out in the agreement. I do not propose to carry out the calculations which would be necessary to arrive at the appropriate figure. There is no reason why this should not be done by the parties themselves, and their advisers.

There will therefore be judgment for the plaintiff as set out above, in respect of the goodwill claim; and judgment for

for the defendant in respect of the other matters dealt with. Costs will follow the event. Leave is reserved to any party to apply in respect of any of the matters not finally resolved.

R.A. Ballin

Messrs Simpson, Grierson & Co
Solicitors, Auckland

Messrs Kensington, Haynes & White
Solicitors, Auckland