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IN THE HIGH COURT OF NEW ZEALAND

A. 539/83

AUCKLAND REGISTRY

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BETWEEN M.E. TORBETT LIMITED

FIRST PLAINTIFF

A N D MURRAY EDWARD TORBETT

SECOND PLAINTIFF

A N D KEIRLOR MOTELS LIMITED

FIRST DEFENDANT

A N D HOWARD GASKIN

SECOND DEFENDANT

Judgment: 30 March, 1984

Hearing: 13, 14, 15 and 16 March 1984

Counsel: P.T. Finnigan for Plaintiffs
M.W. Vickerman for Defendants

JUDGMENT OF CASEY J.

In this action the Plaintiffs claim damages from the Defendants for misrepresentation over the sale of a coffee lounge to the First Plaintiff in March 1983 for a total of $115,000, including $47,000 goodwill and $10,000 (subject to adjustment) for stock. As part of the business and run in conjunction with the coffee lounge was a small stationery bar which dealt mainly in greeting cards and cigarettes. The price was to be paid by a deposit of $10,000, with $65,000 in cash on possession and the balance of $40,000 secured by a first debenture to Mr Gaskin for one year at 18 percent. M.E. Torbett Limited took over the business on 18th April 1983 with Mr Torbett in charge. He claimed that a number of misrepresentations were made to him during the negotiations leading up to the sale and these are pleaded as follows:-

"a) That the stationery card bar business had an average turnover of $1,000.00 per week and averaged $1,000.00 per week over the preceding 21 weeks.

b) That the stationery card bar business on an average turnover of $1,000.00 per week made a gross profit of 33%, that is $333.00 per week.

c) That the coffee lounge, on an average turnover of $3,911.00 per week made a gross profit of 60%, that is $2,400.00 per week.

d) That the defendants were taking $1,500 to $1,700 per week nett profit from the combined businesses.

e) That the overheads per week totalled $1,550.00 for the combined businesses."

In addition the Plaintiffs allege breach of warranties in the agreement in respect of the same turnover.

After a number of vicissitudes described in his evidence, Mr Torbett eventually resold the business for $103,500 in November 1983 and his accountant (Mr Ross) calculated the capital and other losses incurred by the Plaintiff company at $46,899. There are alternative causes of action in fraud, breach of warranty, negligent misrepresentation and s.6 of the Contractual Remedies Act, 1979, and various prayers for relief. The allegations giving rise to any such liability are denied by the Defendants. In addition $3,443 is sought as an over-payment of stock which is not disputed, and there is a minor claim of $241 for repairs to plant.

Mr Torbett was introduced to this business by Mr Lambert, a real estate agent familiar with it and indeed a man of wide experience in this field. He had been involved in five or six previous sales. Mr Torbett had sold a motel and was looking for another avenue of investment and income, while Mr Gaskin (Director of Keirlor Motels Limited) had been running the business since his company purchased it in December 1981. I am satisfied that he was in deep financial trouble - either from over-commitment or poor management - and was being pressed for repayment of a debenture to his vendor. Mr Lambert knew he could not refinance, but was not aware of the more immediate financial problems faced by the vendor. He suggested to Mr Torbett that he could get the place at a favourable price with prospects of a good capital gain under proper management. The

latter was certainly interested and there was a meeting between him, Mr Lambert and Mr Gaskin in the coffee lounge where they discussed details of the business for which the asking price was $145,000, although Mr Lambert had indicated that he could probably get it for $125,000.

Not surprisingly, their recollections varied but I am satisfied that Mr Lambert's evidence provided a good account of what took place. I should mention at this stage that Mr Finnigan attacked his credibility on the basis of comment made by another Judge in an earlier case in which he had appeared as a witness. My own impression gave me no reason to doubt his sincerity, although there were instances where I think he relied too readily upon a faulty memory. I also found his comments helpful about general practice and expectations in this field, based on his experience of many years. What came through very clearly on his evidence - and to a lesser extent from Mr Gaskin's - was the absence of any reliable accounting records on which to base an informed commercial judgment. He pointed out that people tend to buy and sell these businesses quickly because the work is very demanding. Accounts are prepared for tax purposes only and there is seldom a continous trading record demonstrating a full history of the enterprise. Furthermore, the almost universal practice of "skimming" part of the takings for private use without putting them through books adds an area of guesswork to the recorded sales. He said his practice was to check the takings record for a period to calculate a weekly average (which could fluctuate seasonally) and he would then add a "skimming" allowance. In Mr Gaskin's case he thought $150 per week would be appropriate, based on his likely domestic needs.

When he came to the meeting with Mr Torbett, Mr Lambert had the weekly turnover figures from Mr Gaskin, and he settled down to a calculation of the likely net return. The first step was to determine the gross profit (i.e. sales less cost of materials) and in line with similar businesses he thought this would be about 60 percent for the coffee lounge and Mr Gaskin concurred. I accept Mr Gaskin's account (supported by Mr Torbett) that Mr Lambert suggested a figure of 33 percent

gross profit for the stationery bar. The average turnover for the coffee lounge was $3,911 and for the stationery bar $1,000 and the average weekly gross profit was therefore about $2,730. From this were deducted the expenses which Mr Lambert then proceeded to list; they included rent, rates, power, telephone etc. and for most of these he said that Mr Gaskin checked the latest receipts or accounts from which the figures were taken.

When it came to wages it happened that Mr Gaskin had just been to the bank to cash the cheque to pay his staff for that week and it was in the vicinity of $750. It was emphasised (and I am quite sure it was understood by Mr Torbett) that the figure could vary from week to week, particularly at peak seasons, and a figure of $750 to $800 - "say $750" was inserted. The total weekly expenses came to $1,535 leaving about $1,200 surplus per week from which, of course, would have to be paid interest on finance. However, this was a healthy result and I can well believe Mr Torbett when he said he was "as keen as mustard" over this figure. He said Mr Gaskin told him he carried on the practice of the previous owner and took between $300 and $500 per week from the till which did not go through the books. Mr Gaskin, whose evidence on this topic was rambling and confused (to say the least) contended that the figure he mentioned was only $100 to $150 per week.

Mr Lambert's immediate and forthright reaction in cross-examination was that the business could not stand anything like $300 to $500 extra per week, and while he confirmed there was a discussion on this point, he did not recall Mr Gaskin mentioning these amounts. He explained how he fixed the figure of $150 as a reasonable estimate of his private takings. From the analysis of takings, recorded cash payments and bankings made by Mr Eliot (a Chartered Accountant called by Mr Gaskin) it is obvious that he did take substantial amounts, which could have approached the weekly figures mentioned by Mr Torbett, but some of these were used for ordinary business expenses, e.g. his son's wages of $115 per week. It is impossible to determine how much of these payments came from unrecorded takings. I think Mr Gaskin had no real idea how much he took in this manner each week and I believe he simply seized on Mr Lambert's calculation of

up to $150 as a likely figure, and said he put up to that amount aside under his system of failing to enter the takings after 3.30 p.m. on normal week days. I think this is the nearest I can get on the evidence to a figure in respect of the representation that there were unrecorded weekly takings. Its addition to the recorded figures yields a proportionate increase in the percentage of gross profit worked out by Mr Lambert and a corresponding increase in the net weekly profits. Although Mr Finnigan submitted that Mr Gaskin was also understating the daily takings which he actually chose to record, I cannot see why he should want to do this when he was achieving a like result by the simple method he described of suppressing takings after 3.30 p.m. The entries he made in the takings book appear to be a proper and consistent record of those transactions which he did enter, and I accept his evidence to the effect that it is a true account of them. It follows that the warranted turnover figures in the agreement were substantially correct - indeed, by reason of the suppressed takings, they were understated.

There is no argument about Mr Lambert's figure of 60 percent gross profit for the coffee lounge. However, Mr Torbett thought his 33 percent for the stationery bar was over-optimistic. I think he believed this part of the business had not been run to its full potential and Mr Lambert mentioned his ideas of building it up and then selling it off as a separate unit to make a capital gain if he could do so. The former was guided by the 35 percent achieved by the previous owner, and Mr Eliot told me that the actual gross profit made by the business over a twelve month period was within $2,000 of the figure produced by Mr Lambert's percentages. It must also be remembered that the 21 weeks on which Mr Gaskin's average takings were based included the August and Christmas holiday periods, recognised as the best trading time. Taking all this into account I accept that the estimates of gross profit were fairly stated and substantially correct.

However, the position is different with the wages estimate of $750 to $800. Mr Torbett said he was not given access to wage records, although he was able to see those for the banking. He learnt from Mr Gaskin that the business might

have been over-staffed as there was one employee away sick and another had been taken on temporarily and was still there. The wages figure which Mr Lambert wrote down in their preliminary discussions is now clearly seen to exclude P.A.Y.E., but this was never stated to Mr Torbett, nor was any additional figure for the monthly payments of that tax inserted in the list, although the proportionate figures for other periodic payments like rent and rates were included. Mr Lambert suggested that the purchaser knew all about this, and said he went to some pains to list the hours worked by each employee so that Mr Torbett could make his own calculations at the award rate of $4.32 per hour. However, the list Mr Lambert pointed to is bracketted by the figure 750/800, which hardly supports his evidence on this point; instead, it lends weight to Mr Torbett's belief that this was the figure for gross weekly wages - precisely what one would expect in calculations of this sort to arrive at a weekly net profit.

The list did not include the "Thursday girls" engaged on that late night, nor did it include the wages for the son, which came straight out of the till. Mr Gaskin says the buyer was given the opportunity to look at the P.A.Y.E. book and could easily have ascertained the true position. I must say he seemed vague in his recollections on this point and he certainly took no active steps to go through the books and point out or discuss these matters. I prefer Mr Torbett's evidence on this aspect. Understandably, he was anxious to ensure the financial information was correct and that concern was shared by his solicitor, who inserted a warranty clause in the offer to the effect that the outgoings had averaged no more than $1,505 per week during the past 21 weeks. Mr Gaskin would not give this, but after a further approach from Mr Torbett he made some minor amendments to Mr Lambert's list of figures and certified them as being correct "within $100 for each item on an annual basis for the past twelve months". This was the best the purchaser could get, and the list still included $750 to $800 for wages.

When he took over, Mr Gaskin stayed with him for the week and arranged payment of the wages due that Wednesday. It was agreed that he should be responsible for three-fifths and Mr Torbett for two-fifths and he gave the latter a calculation covering his share, which again was simply of the net wages he paid the staff. Mr Torbett said he was never shown the calculations Mr Gaskin made for his own share and therefore had nothing to alert him to the true position until he came to pay the full wages in the succeeding weeks. The gross figure came to something like $1,200 and he immediately expressed his concern to Mr Gaskin, who seems to have brushed it aside. The matter was raised by his solicitors in a letter to the other side on 4th May 1983. The only response came in a telephone conversation in which Miss Sibbald passed on Mr Gaskin's advice that the figures he gave were net and did not include P.A.Y.E. and other charges, nor the $100 that he paid himself. I accept Mr Torbett's evidence on this point and find that in its context the estimate of wages amounted to a representation of the full weekly liability. Mr Gaskin's deliberate action in certifying it as part of the total weekly overheads effectively answers his Counsel's submission that this was a simple misunderstanding by Mr Torbett of a statement about net wages only. The true wages were therefore understated by some $400 to $450 per week. There is no evidence suggesting that the other items in the list prepared by Mr Lambert and subsequently certified by Mr Gaskin were seriously astray.

Mr Torbett's expectations about the business were disappointed. During the 33 weeks he ran it the sales from the stationery bar were down $74 per week and in the coffee lounge $433 compared with the turnover figures supplied by Mr Gaskin. However, as I have indicated, this period covered the slacker time of the year over the winter and omitted the very profitable Christmas trading which, for example, had a dramatic impact on the sale of greeting cards. A further complication was the staff problems Mr Torbett encountered (to which I will make further reference) and their effect on the atmosphere of the coffee lounge may have caused a drop in patronage. There is not

enough in these figures to lead me to question the accuracy of Mr Gaskin's warranted turnover or to conclude that he is responsible for any discrepancy.

Shortly after he took over, Mr Torbett attempted to reduce working hours and to dispense with an employee and he ran into increasing opposition, culminating in a strike with picketing by the staff and the distribution of a pamphlet to the public. The outcome of conciliation proceedings was the appointment of Mr Robinson as manager for six weeks at a fee of $200 per week to report on the profitability of the business and the need to reduce staff. He gave evidence and suggested that the enterprise appeared to be over-staffed. Mr Torbett lays all these troubles at Mr Gaskin's door and says that if he had not understated the wages so drastically, he would not have been forced to take these steps in an effort to maintain profitability. However, the evidence suggests that he already knew the business was over-staffed and Mr Robinson said this was what Mr Torbett told him when he assumed control about August. I also gained the impression that he felt Mr Torbett may not have been as personally involved in the running of the business as he (Mr Robinson) was accustomed to. I think it is pure speculation to blame Mr Gaskin for these staff difficulties in the face of reductions which I am satisfied that Mr Torbett was planning in any event. There are also obvious matters like personality differences and the ability to relate to and control staff which would make it quite unsafe to accept the Plaintiff's submissions on this aspect.

The upshot of all these difficulties was that Mr Torbett decided he had had enough and put the place on the market at $110,000 about October, giving it to two agents, one of whom was Mr Lambert. It was eventually sold for a total of $103,500 cash on 11th November 1983 and although there was some criticism of the price, I am satisfied that it was a reasonable one in all the circumstances. Mr Lambert thought he should have waited until after the Christmas holiday period but when one considers that this was all-cash offer negotiated up from the original figure of $90,000, and that the buyer was the only

prospect who appears to have displayed any interest in the business, I think Mr Torbett would have been foolish to turn it down. On top of everything else, he had to contemplate the menacing possibility of MacDonald's opening up virtually next door. These proceedings had been issued in June and he was careful to consult his solicitors and acted on their advice in accepting the offer.

I am not prepared to hold that the difference betwe what he paid and what he received for the business ($6,500) and the agent's commission are capital losses resulting from the Defendants' misrepresentations. What emerged with total clarity out of the financial confusion in this case was the fact that traditional methods of assessing goodwill for these enterprises have no practical relevance in the market. The goodwill figure inserted in these agreements represents the balance above that allocated to plant and equipment, and is usually fixed to meet the wishes of the parties' accounting or legal advisors. The professional witnesses made it quite clear that the price depends entirely on what a vendor thinks he can make of the business, usually in the knowledge that there are nc proper accounting records, and that most buyers intend to turn it over at a hopeful capital gain in a relatively short time. Mr Ross used the term "amazed" at what people will pay, and felt that on any normal commercial basis there was no goodwill at all. I have mentioned a number of factors which led me to believe the sale price was reasonable, and it is also relevant that the business was in the middle of the price freeze which may well have affected profit margins on some items. Looking at all this, I am not prepared to say that the difference of $6,000-odd was due to anything other than the normal fluctuation one could expect in the market at the time of sale for businesse of this type.

I agree with Mr Vickerman that the representations about turnover and gross profit applied only to the previous 21 weeks and were not intended nor understood to be representations or warranties about what the business would achieve in the futur and Mr Finnigan did not dispute this. It would be quite unreasonable of any purchaser to expect otherwise, having regard

to the differences in experience and individual effort which each new proprietor can put into such a business, and its dependence on his buying and organisational skills. Each buyer hopes to do better than his predecessor and Mr Torbett was no exception. As I have just explained, I cannot hold Mr Gaskin responsible for his results in these areas of turnover and gross profit or for the slight drop in sale price. However, I regard the understatement of wages as being more than a representation of past history; implicit in the figure for wages certified by Mr Gaskin was the assertion that this item would continue at that level if the business was run in the same way and with the same staff, and if (as turned out) there was no wage increase affecting it. Mr Torbett's legitimate expectation of a net return based on the figure given to him was quite clearly frustrated. He did take steps to reduce the staff. I accept Mr Ross' calculation of $375 per week as the resulting reduction of the net figure he could otherwise have expected from the gross profit if this representation had been true. Mr Ross arrived at a total of $12,322 under this heading for the period of nearly 33 weeks that Mr Torbett ran the business.

Notwithstanding the numerous causes of action alleged by the Plaintiffs, I agree with Mr Vickerman that this case is covered by s.6 of the Contractual Remedies Act, 1979 and the First Plaintiff, having been induced to enter into the contract by the misrepresentation about wages is entitled to damages from the vendor company "in the same manner and to the same extent as if the representation were a term of the contract that had been broken". The sale agreement contained the common exclusion clause to the effect that the purchaser acknowledged inspecting the assets and records and relied solely on his own judgment and not upon any representation or warranty made by the vendor or his agent. It does not apply to fraud, and even if I had not made such a finding against Mr Gaskin later in this judgment, this would have been an appropriate case for the application of s.4(1) of the Act. Subsection (c) excludes the operation of this clause unless the Court considers it is fair and reasonable that its provision should be conclusive between the parties "having regard to all the circumstances of

the case, including the subject matter and value of the transactions, the respective bargaining strength of the parties, and the question whether any party was represented or advised by a solicitor at the time of the negotiations or at any other relevant time."

The subject matter was important and there was a large amount of money involved. Although it is clear that Mr Gaskin had to sell because of his personal financial problems, the account I heard of the negotiations does not lead me to believe he was under any disadvantage; in any event these problems could furnish no justification for what I can only conclude was a quite deliberate misrepresentation of the wages paid. Both parties had solicitors acting for them, but this did not help Mr Torbett because he was unable to get Mr Gaskin's agreement to the warranty his solicitor wanted, and they had to be satisfied with Mr Gaskin's certificate. In my view this is precisely the type of case that the Contractual Remedies Act was intended to cover and in all the circumstances I am satisfied it would be unjust for the First Defendant to rely on the exclusion clause in the contract. The First Plaintiff is therefore entitled to have damages assessed on a contractual basis for the failure of the business to achieve the net result which could have been expected if the representation had been true.

In his calculations Mr Ross allowed for the reduction in wages resulting from the changes in staff and working hours actually made by Mr Torbett, who was thereby acting responsibly to mitigate the loss. But it is apparent that even as late as August Mr Robinson thought there could have been a further reduction in hours. The almost unprecedented experience of a strike and picketing points to a total breakdown in Mr Torbett's staff relations and must have made it difficult - if not impossible - for him to take full remedial action, some of which he saw as necessary even before he assumed control. I think some allowance from Mr Ross' total is indicated to take into account these problems generated by Mr Torbett and which were not experienced by Mr Gaskin, or by Mr Robinson in the latter's short tenure. I therefore propose

discounting his figures and award damages of $11,000 to the First Plaintiff. I find the small claim for repairs to the milk shake machine and steriliser proved. The former broke down on the first day Mr Torbett took over, while repairs to the latter were needed to comply with Health Department requirements only a few days later. Neither could have been in the state warranted in the agreement, and I allow the agreed amount of $220.

Although Mr Torbett was joined as a Second Plaintiff I cannot see how the benefit expected if the representation had been true could have been passed to him as a shareholder in the company, which in its accounts for the period showed a loss of over $16,000, after allowing for $15,000 paid to him as Director's salary. This brings me to Mr Gaskin's position as Second Defendant. He is sued only as agent, and s.6(1) of the Contractual Remedies Act would not appear relevant to his position, since it deals with the parties to the contract. I am satisfied that his certified understatement of wages was a deliberate falsehood; at the very least it was a reckless assertion and in either case amounts to fraud. The measure of damages against him would normally be the difference in the value of the business. As I have already held that the small drop in resale price was not attributable to the Defendants' conduct, this prima facie measure of damages in tort would be inapplicable. Counsel did not distinguish between the liability of Mr Gaskin and that of his company, and argued the case as if it was the same. However, Mr Finnigan referred me to an unreported judgment of Speight J. (Hemmingway v. Strom and Graham Auckland A.1825/79; 15th April 1980) dealing with a fraudulent misrepresentation about turnover in a business sale. After considering a number of cases, including Doyle v. Olby Ltd (1969) 2 QB 158 in which the question of consequential loss was also discussed, he felt justified in allowing trading losses as "actual damage directly flowing from the fraud", and the same situation prevails here. As I have noted, the First Plaintiff's loss was $16,000, after allowing for the Director's salary of $15,000. I think the latter is too high having regard to the actual performance of the business and,

for the purpose of assessing damages, should be reduced to a more realistic figure. After doing so, and taking the broad approach usually adopted in tort damages, I think Mr Gaskin could be held fairly responsible for the same loss in tort as the damages his company is liable for in contract. Such a result accords with the approach taken by Counsel in not differentiating between their respective liabilities. However, I do not see how he can be liable for the small item of repairs to the plant.

There will be judgment for the First Plaintiff against both Defendants for $11,000 together with scale costs, plus disbursements and witnesses' expenses to be fixed, and I allow three extra days at $300 each. It will have judgment against the First Defendant only for the additional $220. Counsel were agreed that no judgment was necessary for the overpaid stock.

M L Casey J.

Solicitors:

J.T.H. Buxton, Auckland, for Plaintiffs
Keegan Alexander Tedcastle & Friedlander, Auckland, for Defendants

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discounting his figures and award damages of $11,000 to the First Plaintiff. I find the small claim for repairs to the milk shake machine and steriliser proved. The former broke down on the first day Mr Torbett took over, while repairs to the latter were needed to comply with Health Department requirements only a few days later. Neither could have been in the state warranted in the agreement, and I allow the agreed amount of $220.

Although Mr Torbett was joined as a Second Plainti I cannot see how the benefit expected if the representation had been true could have been passed to him as a shareholder in the company, which in its accounts for the period showed a loss of over $16,000, after allowing for $15,000 paid to him as Director's salary. This brings me to Mr Gaskin's position as Second Defendant. He is sued only as agent, and s.6(1) of the Contractual Remedies Act would not appear relevant to his position, since it deals with the parties to the contract. I am satisfied that his certified understatement of wages was a deliberate falsehood; at the very least it was a reckless assertion and in either case amounts to fraud. The measure of damages against him would normally be the difference in the value of the business. As I have already held that the small drop in resale price was not attributable to the Defendants' conduct, this prima facie measure of damages in tort would be inapplicable. Counsel did not distinguish between the liability of Mr Gaskin and that of his company, and argued the case as if it was the same. However, Mr Finnigan referred me to an unreported judgment of Speight J. (Hemmingway v. Strom and Graham Auckland A.1825/79; 15th April 1980) dealing with a fraudulent misrepresentation about turnover in a business sale. After considering a number of cases, including Doyle v. Olby Lt (1969) 2 QB 158 in which the question of consequential loss was also discussed, he felt justified in allowing trading losses as "actual damage directly flowing from the fraud", and the same situation prevails here. As I have noted, the First Plaintiff's loss was $16,000, after allowing for the Director's salary of $15,000. I think the latter is too high having regard to the actual performance of the business and,

for the purpose of assessing damages, should be reduced to a more realistic figure. After doing so, and taking the broad approach usually adopted in tort damages, I think Mr Gaskin could be held fairly responsible for the same loss in tort as the damages his company is liable for in contract. Such a result accords with the approach taken by Counsel in not differentiating between their respective liabilities. However, I do not see how he can be liable for the small item of repairs to the plant.

There will be judgment for the First Plaintiff against both Defendants for $11,000 together with scale costs, plus disbursements and witnesses' expenses to be fixed, and I allow three extra days at $300 each. It will have judgment against the First Defendant only for the additional $220. Counsel were agreed that no judgment was necessary for the overpaid stock.

M.C. Casey J.

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