IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

A.505/85

[redacted]

BETWEEN: DAVID GLASS HERBISON and GRANT ALASTAIR GOODARE both of Auckland, Company Directors

First Plaintiffs

AND PARIS VENTURES LIMITED a duly incorporated company having its registered office at Auckland and carrying on business as a Video Hirer

Second Plaintiff

A N D: PAPAKURA VIDEO LIMITED a duly incorporated company having its registered office at Auckland and carrying on business as a Video Hirer

First Defendant

AND PATRICK ANTHONY DARBY of Auckland, Company Director

Second Defendant

AND NORAH ANNE DARBY of Auckland, Company Director

Third Defendant

Hearing: 2, 3, 4, 5, 6, 9 and 10 March, 1987

Judgment: 24 March 1987

Counsel: J G Miles and N S Gedye for Plaintiffs
R J Asher and Mrs Wendy Galvin for Defendants

INTERIM JUDGMENT OF HENRY, J.

In this action the Plaintiffs seek to recover damages from the Defendants in respect of an agreement for sale and purchase of a video cassette recorder sales and hire business carried on at Papakura. The agreement in question is dated 21 December 1984 and is between the First Defendant as vendor and the First Plaintiffs as purchasers. Following settlement of the sale and purchase the Second Plaintiff was incorporated and took over the running of the business. The Second and Third Defendants are the shareholders in the First Defendant

The brief background is that the First Defendant (Papakura Video) was formed in 1983 for the purpose of setting up a video business. The Second Defendant (Mr Darby) was the person primarily concerned, and he reached a decision that the best way to do this would be by setting up as a franchise holder in a network controlled by Video Station Limited, which operated through a number of licensed outlets throughout New Zealand. Premises at 113 Great South Road, Papakura, were leased, a franchise agreement with Video Station Limited entered into, and the business set up commencing operation on 8 September 1983 under the name or style of "The Video Station, Papakura". The nature of the business consisted of the retail sale of video cassette recorders, television sets, and all associated items and equipment, and the hiring of pre-recorded video cassettes.

In 1984 Mr Darby decided he would place the business on the market for sale, and for that purpose instructed a local Papakura real estate agent, Mr Hunt, who was trading as John Franklin Hunt Associates.

Mr Goodare and Mr Herbison were at that time looking for a business to purchase, in particular one with a good cash flow and which would show a pre-tax profit of about $150,000.00. They had in mind investing a total of about $300,000.00 in such a business. Mr Hunt advised Mr Goodare that the Video Station, Papakura, was for sale, and provided him with what has been described as a resume of the business. Negotiations then commenced with both parties having the assistance of their respective solicitors, and eventually on 21 December 1984 terms of agreement were settled and the formal documentation completed. The agreement recited a total purchase price of $345,000.00 payable by way of a deposit of $35,000.00, the sum of $180,000.00 on settlement, and the balance of $130,000.00 three months after settlement, to be secured by way of first debenture over the assets and undertaking of a company to be formed by the purchasers. Settlement was duly effected on 5 February 1985, the Second Plaintiff (Paris Ventures) duly formed, and the security documents completed.

Within a short time after taking over the business, Mr Goodare (who was the person primarily concerned with the business operations) became concerned as to the turnover figures the business was achieving. As a consequence, in April 1985 a chartered accountant, Mr Collins, who had previously been instructed by the Plaintiffs to report on financial aspects of the business before the agreement for sale and purchase was executed, was instructed to analyse the figures again in further detail.

Following detailed investigations by Mr Goodare and the receipt by him of the further report from Mr Collins, the Plaintiffs' solicitors wrote to the Defendants' solicitors on 1 May 1985 alleging misrepresentation. The present proceedings were then instituted on 13 May, and involved the seeking of an interlocutory injunction to restrain Papakura Video from exercising any rights under the debenture. That application was heard by Hillyer J. and resulted in the making of an order, on terms, on 12 June 1985 the details of which are not relevant for present purposes. The business is still being operated by Paris Ventures, although since the issue of these proceedings Mr Goodare has sold his shareholding in the companies concerned with that operation and he is now no longer actively engaged in the business.

The Statement of Claim, as now amended, pleads four causes of action. Two of these are based on separate allegations of pre-contractual misrepresentation incorporated as express terms of the agreement. The third cause of action is based on a further pre-contractual misrepresentation but which was not included as an express term. These three causes of action are directed against all three defendants. The fourth cause of action is directed only against Mr Darby and is framed in negligence on his part in making representations as to the trading performance of Papakura Video. It is alternative to the other three causes of action.

All causes of action, being concerned with the pre-contract negotiations and the terms and construction of the contract, can conveniently be considered against the same background.

The business was a new one, which was set up by Mr Darby, and commenced operations on or about 8 September 1983 as a franchise holder from Video Station Limited. The franchise agreement required the business to purchase all its video equipment, whether for retail sale or hire, from Video Station or its nominated supplier. One of the major, indeed the most important, aspect of the business was the hiring of pre-recorded video cassettes. Mr Darby leased as well as purchased these tapes from Video Station, initially the numbers leased (some 62%) being far greater than the numbers purchased. Over the ensuing period of his operations this ratio was changed so that as at February 1985 in excess of 85% of the tapes were owned. The business also sold video cassette recorders and associated items, and to a small and probably insignificant extent television sets and associated equipment. All these items were referred to by the general term "hardware" as compared with the tape hiring side of the business which was referred to, again by way of general description, as "software". As is usual, the sale of more expensive items such as recorders was frequently on terms, those credit sales being on hire purchase with the agreements being discounted to a company known as Hillcrest Services Limited of which also Mr and Mrs Darby were the shareholders.

The business had some operational problems in the financial sense in its early stages, and the accounts for the period ended 31 March 1984 show a net trading loss of $51,611.00. The brief breakdown of the trading account to that date shows total sales of $270,870.00, cost of sales $241,731.00, and a gross profit of $29,139.00. Further revenue from membership fees (persons who hire tapes), insurance, warranties and rental of tapes gave a total of $140,435.00 as against expenses of $192,046.00. Mr Darby, conscious of the problem and obviously a meticulous person who kept a close and regular check on the financial performance and aspects of the business, took steps to correct what he saw as the main problems. These steps included, in particular, a change of emphasis from leasing to owning tapes for hire, stocking more popular titles of cassettes for hiring, renegotiating arrangements for purchase of recorders to allow an increased mark-up, and increasing the hiring side of the business both generally and in proportion to the sales hardware side.

Although the sale now in question did not come under negotiation until December 1984, it seems that as early as May of that year Mr Darby was contemplating selling because on 15 May he signed an authority to sell in favour of John Franklin Hunt Associates, with an asking price of $350,000.00. Nothing apparently eventuated at that time, and then in November 1984 Mr Hunt again had the business on his books for sale.

For the purposes of sale, Mr Hunt prepared a document which became known as the resume, which contains some seven typewritten pages.

It sets out the nature of the business, the market serviced, the location, and other relevant information including some financial details and what is described as a sales history. Under the last-mentioned heading the following details appear :

> "<u>SALES HISTORY</u>
>
> For 12.5 months ending 30th September 1984 :

Video Cassette (Hardware)	$280,423.00
Membership Fees, Hire of Library Films, etc., (Software)	<u>$343,577.00</u>
	$<u>624,000.00</u>

Under the heading "Financial" reference is made to a balance sheet and income statement, noted as attached, which form part of the resume. The former is described as "Balance Sheet as at 30th September 1984"and shows a profit from trading of $212,540.00, that figure being noted as including interest on borrowed capital as well as 25% first year depreciation but not including shareholders' wages amounting to $50,000.00. The second document is headed "Trading for the 12.5 months ended 30th September 1984". It reads as follows :

"<u>TRADING FOR 12.5 MONTHS ENDED 30th SEPTEMBER 1984:</u>

INCOME..	$624,000.00
LESS Cost of Sales	<u>225,602.00</u>
GROSS PROFIT..	$398,398.00

Carried Forward...		$398,398.00
Less EXPENSES..		
Accountancy	$1,000.00	
Advertising	12,480.00	
Alarm Monitoring	648.00	
Electricity	804.00	
General	1,300.00	
Insurance	2,124.00	
Management Fee	15,600.00	
Motor Vehicle Exps.	4,200.00	
Stationery & Postage	4,300.00	
Rates	15,000.00	
Telephone	1,235.00	
Wages to staff including working Shareholders	79,716.00	
TOTAL EXPENSES..		139,405.00
NET PROFIT (before interest on borrowed capital and depreciation but after proprietors' wages of $50,000)..		$258,913.00

PRICE:

Total Purchase Price is made up as follows :

Franchise Fees	$ 30,000.00
Plant, Fixture & Fittings	40,000.00
1,000 Movies	140,000.00
Hardware Stock	20,000.00
Reimbursement of Initial Formation and Promotional Costs, Goodwill, Key Money etc...	155,000.00
TOTAL PRICE:	$385,000.00

"

Following what were fairly intensive negotiations, final terms of the agreement were settled on 21 December. The agreement as executed contains the following important special term :

"1. THE Vendor hereby warrants that the turnover exclusive to the business hereby agreed to be sold has averaged the sum of not less than $11,000 per week for the period from 8/9/83 to 30/9/84. The Purchaser acknowledges that he has inspected the assets and the following documents relating to the business :

(a) Schedule of Members
(b) Monthly Analysis of Receipts
(c) Hardware Records Book
(d) Bank statements deposit books
debtors ledger draft set of accounts and any other document furnished to the Purchaser's Accountant.

The truth of the representation as to turnover is essential to the Purchaser and he purchases the business in reliance upon such turnover figures. The Purchaser relies also on the accuracy of the documents referred to in paragraphs (a) (b) (c) and (d) hereof the truth and accuracy of such representations all being essential to him. Otherwise the Purchaser enters into this agreement relying upon his own judgment and not on any representation or warranty made by the Vendor except as expressed in this agreement PROVIDED THAT the Vendor in disclosing the information contained in the said documents is neither expressly or impliedly giving a warranty that the turnover of the business is in excess of $11,000 per week."

The schedule of members refers to the membership of the video library, being those who hire cassettes for home viewing. A membership fee of $25.00 per annum was then currently in force. This schedule has no particular relevance to the proceedings.

The monthly analysis of receipts referred to is annexed to the agreement, and it shows a month by month analysis for the months of September 1983 to September 1984 inclusive under the following heads :

Receipts	Received from Hillcrest Services Limited	Cash Sales Hardware	All Other

The form of agreement as typed originally referred in clause 1 (b) of the Special Terms to "a schedule of income on a monthly basis of video hire (cassettes), a copy of such schedule being hereto annexed for the purposes of identification". The relevance of that provision I will refer to later. It was however struck out and replaced by the item "monthly analysis of receipts". It is common ground that that analysis in its typed form did not appear probably until the day the agreement was executed and was appended to the agreement in the last stages of negotiation.

The hardware records book lists details of purchases and sales of video cassette recorders. The documents referred to in clause 1 (d) were not further identified.

In addition to those documents, by letter also dated 21 December the Defendants' solicitors wrote to the Plaintiffs' solicitors in these terms :

> "We attach a copy of our clients trial account for the period ending 30th September 1984. We confirm that this document is to be included as a term of the Agreement for Sale and Purchase executed between our respective clients as if it were a document listed under clause 1 of the Special Terms. It is agreed that all the provisions contained in clauses 1 and 11 relating to warranties shall be applicable in respect of the information contained in this document."

The reference to clause 11 relates to a deed of covenant whereby Mr and Mrs Darby undertook personal responsibility for the warranties in the agreement. The trial account referred to in that letter is in exactly the same form as the trading account in the resume except that the words "trial account" have been added to the top of the document and the references to "Price" at the foot of the document have been deleted. It has the appearance of being a photocopy of the resume document with those two amendments.

The Trial Account

The first representation incorporated into the express terms of the contract and relied upon by the Plaintiffs is that the details contained in the trial account were true and accurate. It is now common ground that these figures do not accurately record the historical trading figures of Papakura Video for the relevant period. Although the parties are not in agreement as to what those actual figures are, it is also common ground that both gross and net profit were very substantially less than the stated figure. Mr Collins calculated a net profit before interest on capital and depreciation of $83,510.00, and although no similar calculation was proffered on behalf of the Defendants, the accounts for Papakura Video for the year ended 31 March 1985 (effectively to settlement on 5 February) seem to show a net profit of $63,963.00 after allowing for interest.

The case for the Defendants and deposed to by Mr Darby is that the trading account was presented to the purchasers as and known by them to be a reconstruction by him of the actual accounts after having made a series of adjustments to compensate for changes he had made and which were effective as at November-December 1984. The trial account, he said, was a reflection of what the business would have achieved had those changes been operative during the whole of the 12.5 month period. Mr Darby said he explained to both Mr Goodare and Mr Herbison he had, in what he termed his "projection" increased the library income and decreased the revenue from sales, and explained that the expenses represented what should have been the figures if the business had run without the earlier problems. He said both purchasers appeared readily to understand what he was telling them. The Plaintiffs deny having been given any such explanation and contend that at all times the document was put forward as an historical record of the trading of the business. Obviously credibility is critical.

For the purchasers, Mr Goodare was the main negotiator and of the two he was the person who actively undertook the investigatory work leading up to the decision to purchase. He was formerly a project manager for Green and McCahill (Contractors) Limited with a background qualification in civil engineering. In July 1984 he commenced a business association with Mr Herbison, and after looking at the possibility of undertaking civil engineering contracts they decided first to embark on a business venture with a high cashflow and good level of profit so as to build up the cash resources necessary to become involved in the type of commercial development projects they contemplated.

Mr Goodare first saw the real estate agent, Mr Hunt, in respect of the Papakura Video Limited business and was provided by him with a copy of the resume I have previously mentioned. This showed a net return excluding interest on borrowed capital and excluding depreciation of $258,913.00 on a sale price of $385,000.00. An item in the resume which assumes importance is the breakdown of the turnover figure of $624,000.00 into the two general categories of hardware (or sales) at $280,423.00 and software (or hiring) at $343,577.00.

There followed a number of meetings, involving mainly Mr Goodare and Mr Darby, when the business and its financial aspects were discussed. It was at one of these meetings Mr Goodare says he was handed by Mr Darby a typewritten sheet headed "Monthly Sales (Library Only)". The reference to library is to the hire of pre-recorded video cassettes, and the schedule proceeded to set out monthly figures for April to September 1984 inclusive. Mr Darby could not recall the document and said he had not prepared it in connection with this negotiaton and suggested it may have been prepared in January or February of 1984 as a projection for some purpose which he was now unable to recall. Mrs Darby confirmed that the document was probably typed by her, but could be no more specific about it.

I think it an inescapable conclusion that Mr Goodare received the document in the circumstances to which he deposed. There can be no other logical explanation for it coming into his possession, and it must obviously be a reference to the returns for hire of video cassettes over the period April to September 1984. I conclude that it must also have been given to Mr Goodare as part of the financial information pertaining to the business. According to Mr Goodare he later asked Mr Darby for the figures for the full period of trading down to 30 September, which he said were detailed to him by Mr Darby over the telephone and recorded by him on a sheet of notepaper. That record discloses a month by month figure for both what is noted as hardware and what is noted as rentals, covering the period September 1983 to 17 November 1984. It also records what appear to be total figures in the following way :

"$624,000	
280,423	
111,343	Membership
231,743	Rentals "

Mr Darby denied that any such telephone conversation took place, and denied that he had ever given those monthly figures or totals to Mr Goodare. I have no hesitation in finding that the figures were provided by Mr Darby. It is significant first, that the figures then given for April to September coincide exactly with those contained in the earlier typewritten document; second, the figure of 280,423 is the apparent total of the hardware details for September to September (they actually total 280,428) and equates the hardware figure quoted in the resume; third, the $624,000 equates the turnover figures in the resume; and fourth, the total for rentals and membership closely approximate the equivalent figure in the resume. I do not think there is any possibility Mr Goodare obtained these twelve month figures from another source. There is nothing in the evidence to indicate that Mr Hunt would have had them, precise as they appear to be, and even if he did his only source in turn could have been Mr Darby. I am therefore satisfied that the figures contained in this document were provided by Mr Darby as part of the business financial information.

As part of his own preliminary investigation, Mr Goodare prepared two graphs from this information, one depicting revenue from sales of hardware and one depicting revenue from hire of video cassettes. The latter graph was used to make a forward projection of likely revenue from hiring, showing on the calculation a figure of the order of $30,000.00 per month. Mr Goodare was not cross-examined on the preparation of these graphs nor on his stated purpose in preparing them.

The next relevant step was for Mr Goodare to instruct a chartered accountant, Mr Collins, an employee of De Loitte Hoskins and Sells, to undertake a verification exercise of the financial records, in particular the proportion of cassette hiring revenue to revenue from sale of hardware.

The relevance of the proportionate figures is that the hiring revenue represents the more profitable part of the business having a substantially less cost component involved compared with the sale of hardware which is dependent on mark-up and requires the purchase of expensive stock.

There is here a further direct conflict of evidence as to what was provided to Mr Collins for this purpose. It is apparent that Mr Darby is a meticulous methodical man who kept very detailed business records which he was constantly analysing and reviewing. I also found him to be very careful, and in general very precise, in giving his evidence, and that he displayed a very deep knowledge of the details of the business. The records which he had were full, well maintained, and included :

Hardware (video cassette recorder) sales book containing full detals as to purchase and sale
Bank deposit books
Cheque butts properly filled in on a code system
Code Index
Till tapes
Daily sales record books
Weekly summary of sales book
Inward invoices filed alphabetically
Bank statements
Weekly returns to Video Station Limited.

In his evidence, Mr Collins stated that he had requested from Mr Darby all relevant documentaton, in response to which he received bank deposit books, bank statements, cheque butts, current cheque book, some creditors' invoices and debtors ledger cards. Mr Collins was assured, he said, that there were no other records available. Mr Darby, to the contrary, said that much more documentation was made available to Mr Collins. In his affidavit in the injunction proceedings (which, as with other affidavits filed in that connection formed part of the evidence at trial) he referred in particular to till tapes, the hardware record book, and the Video Station Limited weekly returns. In his <u>viva voce</u> evidence Mr Darby said that Mr Collins also had access to the daily sales records, the weekly summary sales book and the inward invoices from Video Station Limited, all of which was denied by Mr Collins.

The answer to the disputed question of what documents Mr Collins had lies, I think, in looking at what he actually did by the way of analysis, his description of which was not challenged. From the deposit books he added the cash receipts for the period September 1983 to March 1984, the bank statements not then being available. For the period April 1984 to September 1984 bank statements in conjunction with the deposit books were used to reconstruct sales and turnover. Having calculated a total turnover figure of $619,415.00, he then attempted a breakdown into hardware sales and hiring of software revenue. This was determined by allocating larger items of approximately $1,000.00 or more to hardware sales, and adding to that the amount received from Hillcrest Services Limited for discounting hire purchase agreements. This gave a total hardware figure of $315,775.00 and a figure by deduction of $303,640.00 for hiring.

In his handwritten note making these calculations dated 19 December 1984 and obviously made at the time, Mr Collins has recorded :

"Turnover: There are no formal sales records. Turnover was established by adding th cash receiptd for th period from the deposit books for the period Sept. '83 to March '84 and from the bank statements for the period April '84 to Sept. '84. Allowance was made for unpresented cheques rebanked.

- Debtors are held on cards and the balances at 30 Sept. '84 was added to the cash receipts to give an estimated turnover.

Video Equipment Sales: Two thirds of these transactions are on h.p. which are discounted to Hillcrest Services Ltd. These transactions plus cash sales obtained from the deposit books were used to estimate Video Equipment sales."

It is not credible that Mr Collins would have carried out that exercise in the way he did in an attempt to verify sales figures or turnover if he had access to the daily record book, the weekly summary and the Video Station returns. He denied ever having had those items when he carried out his analysis, and I accept his evidence on that point.

Mr Collins also went on to look at the elements of cost of sales and of net profit. He made a handwritten copy of a net profit calculation being figures he said he obtained from Mr Darby. The details are in fact identical to a typewritten schedule identified by Mr Darby as coming from his file and being one given by him to Mr Hunt.

That document is document no.21 of Exhibit 1 and was headed "Trading for the period ended 30 September 1984". It is obviously the source of the trading account set out in the resume, and like that shows income of $624,000.00 and cost of sales of $225,602.00. The net profit there is shown as $212,540 compared with the resume figure of $258,913.00, the difference being due to deletion of figures for depreciation, interest, and an amendment to motor vehicle expenses: it is also identical to that shown as the net profit in the balance sheet contained in the resume. In the course of his verification exercise, Mr Collins asked for stock records for confirmation of cost of sales, and said that he was told by Mr Darby that he did not have any but that the cost of sales was a standard 75% of retail sale price. Mr Collins applied that percentage to his hardware sales figure of $315,775.00 to give a cost of sales figure of $236,832.00. This compared favourably with the trading account figure of $225,832.00. Mr Collins also carried out an overview of expenses and was not able to find any significant variation from the resume figures. He thus felt able to confirm a net profit of the order of $212,540.00 after depreciation and interest on capital.

Mr Darby contended that he had discussed the trial account with Mr Collins at great length and how he had adjusted the sales and other figures by reference to percentages. Mr Collins was adamant that no such discussion took place between them.

Mr Goodare, Mr Herbison, their solicitor Mr Miller who was involved in the final negotiations, and Mr Collins all stated their belief and understanding that the trading account headed "trial account" in the final contractual documentation was a trading account in the true sense, namely an historical record of actual performance. In particular Mr Goodare, Mr Herbison and Mr Collins each deny ever having been told by Mr Darby anything at all which would indicate something to the contrary. Mr Darby on the other hand says he made it quite clear to those three persons that it was his "projection" of what the business would have achieved had his changes as they were in force in November and December 1984 been operative over the full period in question.

I found Mr Goodare to be a truthful and reliable witness who did not attempt to embellish his evidence. Mr Herbison, who played a comparatively minor role in the negotiations, also impressed as an honest witness. Mr Collins I had no reason to doubt on the general substance of his evidence, although perhaps a little uncertain on some details by the time of the hearing. The adequacy of his verification exercise in December 1982 is not in question and I make no comment upon it. Mr Miller was not challenged in his evidence and I have no hesitation in accepting what he had to say on the negotiations in which he was involved.

Having given careful consideration to what I believe are all relevant matters, I cannot accept that Mr Darby disclosed what he says is the true nature of the trading account, and I am satisfied that right through until execution of the agreement it was held out as an historical record of the performance of the business. In conjunction with my assessment of the credibility of the witnesses involved, there are a number of factors which have brought me to this firm conclusion.

1. The exercise carried out by Mr Collins can only be viewed as relating to historical accounts. No adjustments or amendments to actual figures was ever made or attempted by him. Yet the exercise related directly to the "trial" account.

2. Had Mr Collins been aware the account was an adjusted or reconstructed one, particularly if based only on November and December 1984 performances, he would undoubtedly have taken other steps and reported far differently to Mr Goodare. In particular he would have examined closely and reported upon the basis for the adjustments.

3. Mr Collins was not given the documents which would have alerted him to the position.

4. Mr Goodare would undoubtedly have sought further accounting advice as to the appropriateness of the basis upon which the trading account had been prepared.

5. The inclusion of the trial account as a warranted document would otherwise be meaningless. There is no benefit to a purchaser in receiving an assurance from a vendor of a business that the vendor has carried out on an unstated basis a theoretical exercise as to trading of which the document is the result.

6. The letter from the Defendants' solicitors enclosing the trial account, and the trial account itself, contain no hint that the account is other than historical. No reservations or qualifications are expressed and the basis of adjustment is completely absent. The use of the word "trial" is in the circumstances of no real significance, its only indication being that the accounts are not in their final form. It does not, in context, connote they are only experimental, and is quite consistent with their being historical.

7. The resume can only be read as detailing sales history, containing as it does a trading account and a balance sheet including in it the net profit from trading as would be expected in normal accounts. I am also satisfied that the breakdown into hardware and software in that document initiated from Mr Darby.

8. The lack of any convincing explanation from Mr Darby as to how his figures were calculated.

In his evidence-in-chief, Mr Darby said he had started with a total turnover figure of $718,775.00, made up of $222,624.00 for library or video cassette hiring, $54,243.00 for interest charges on hire purchase agreements, and $441,908.00 being the sale price of all items actually sold. These sums he took as being the actual turnover figures for the period in question. For the library component of $222,624.00, Mr Darby said :

> "I took that figure and increased it by 20%, coming to a library estimated income of $269,300. I should correct myself, sir, and say "approximately 20 per cent". the reason I increased that library portion by 20% follows from where we were a short time ago regarding the improvement to the titles that had been made to the movie stock. The titles were showing an increase of usage of 340% and I considered a 20% increase for the purpose of my projection was being responsible and moderate."

Two difficulties arise from that explanation. First, the selection of a 20% increase seems to have no basis at all. The increase relied upon as shown by his survey was as high as 340%, and no reason for using 20% emerged. Indeed, later in his evidence Mr Darby expressed the view that the increase could have been "100%, 150% any figure we chose...". The second difficulty is that the actual percentage increase is 20.96% - 20% would yield $267,148.00. Mr Darby spoke of rounding off to the nearest $100.00, but there is no calculation to which his adjusted figure can be related in that way. It is not possible to adjust one figure by applying an "approximate percentage" - some definable arithmetical exercise must be carried out, and it was that which Mr Darby could not or would not explain.

Under questioning from the Bench he did say:

> "I have started with the figure $269,200) and then decided, after having the figure, I've decided for my own benefit that the percentage increase was a reaonable one. I didn't start with a percentage and then see what figure it would come to".

This I found not only confusing but inconsistent with his earlier explanation. It was confusing because it indicated that the $269,300 figure had no basis othr than an arbitrary assessment made by Mr Darby himself. It was inconsistent because he had earlier said he had applied a percentage figure. My conclusion is that he has not even now disclosed the real basis of the reconstruction.

The next step referred to was in relation to the total sales figure of $441,908.00. Mr Darby stated that he reduced that figure by 28% and said :

> "The reason I did this is because I calculated that had we not been labouring under the previous difficulties, our total sales would have been smaller in dollar terms because in many cases I found myself in the situation of holding stock that was not good stock to hold, and I would advertise it cheaply with give-aways with it, sometimes below cost, etcetera etcetera, and it would not have been realistic to make a projection with a sales figure the same as it had been, because if one wasn't trading with those difficulties one wouldn't have gone about creating sales in these ways."

The logic behind that reasoning I found a little difficult to follow. A similar reduction by 28% was made to the interest charge of $54,243.00, that component being directly associated with hardware sales. The same two difficulties again arise.

A reduction of 28% to his sales figure yields $318,175.00 and bears no real relationship to Mr Darby's figure of $315,600.00 which is a true reduction of 28.58%. The interest charges of $54,243.00 if reduced by 28% yields $39,055.00, which is very close to the adjusted figure of $39,100.00 and could possibly be a rounding-off, but the actual percentage figure is not 28.58 as with the hardware, but 27.91.

A further explanation given by Mr Darby during cross-examination was that he had told Mr Goodare, Mr Herbison and Mr Collins that he had estimated a reduction of 30% and it was the later survey he had carried out which showed the figure of approximately 28% as being correct. What is clear is that the adjusted figures were not a 30% reduction, as he says he advised those persons they were, nor can they be made to fit any other base in a sensible way.

Difficulties also arise in respect of the adjustment to the important component of cost of sales. According to Mr Darby, the starting point was the adjusted hardware sales figure of $315,600.00 to which he applied a gross mark-up figure of 28.5%, to yield $225,602.00. But that exercise gives an answer of $225,654.00 which on any rational basis is difficult to reconcile with $225,602.00 Again the reason given for applying a reduction of "about 28.5%" is less than convincing. Mr Darby related it to the actual mark-up figures as analysed by him for the months of November and December 1984.

However, the trial account was completed in early December at the latest, when the actual trading figures for that month would not have been known. Further, Mr Darby acknowledged at another stage of his evidence that the analysis of those sales and gross profit figures had been carried out about May 1985. The basis for the adjustment as carried out in December 1984 could not have resulted from that exercise, and what it really was is therefore unclear.

In the course of his evidence Mr Darby did say that he had started off with what he called actual figures, and as he made a policy change he would change each figure to reflect the change he had made; and that this was a continuing process as various policy changes were introduced. I believe that the trial account, so called, is the December version of that continuing exercise, that it was constructed by Mr Darby having adjusted all actual revenue figures on a month by month basis. This, I believe, gave the totals for library and hardware as shown in the resume and as broken down in the figures telephoned to Mr Goodare and recorded by him.
Mr Darby apparently no longer has the product of his continuing exercise, but if it were available I surmise that is what would be revealed. The precise nature of each adjustment in the series of adjustments is not now known, which is why no logical explanation for the final figures can be given. The same applies, I believe, to the cost of sales calculation.

It may be that in some ways Mr Darby justified to himself the validity of his approach to the sale of the business, and that somehow he saw this as a true reflection of its financial status at the time. Whatever be the truth or the reasoning behind it, I am left in no doubt that the trial account as included in the contractual documents is to be and was meant to be construed as an historical record, the truth and accuracy of which was expressly warranted and became a term of the contract. As I have said, it is common ground that as such the term was breached, and I so find.

<u>Monthly Analysis of Receipts</u>:

It is relevant to note how this document came into existence and formed part of the contractual documentation, this again being in an area of dispute. According to Mr Darby, it was completed at the request of Mr Collins during his visit to the business premises on 19 December, the request being for a list of video cassette recorders sold for cash and a list of payments made by Hillcrest Services Limited to Papakura Video, with those two items being isolated from total receipts. He also said that when he asked Mr Goodare for a copy of the monthly schedule of video cassette tape hiring referred to in the agreement as originally drafted, it was not able to be found and that subsequently in a telephone conversation Mr Goodare said it wasn't too important, and requested the monthly analysis prepared for Mr Collins be put in instead. It was then typed up and taken to Mr Darby's solicitor on 21 December. Mr Collins denied having made a request for any such document, and I have difficulty in seeing why he would require it.

His exercise, as recorded by him at the time, shows the total of the Hillcrest Services Limited payments and also details the video cassette recorder tapes figure, so he would have had no need for the analysis. Mr Goodare denied having requested the change and stated he did not see the monthly analysis until it had been included in the agreement at Mr Darby's request, and then only immediately before execution. I find that the analysis was prepared by Mr Darby at his own instigation and that it was his suggestion it should replace the monthly hire schedule originally referred to. The reason I infer was to avoid the disclosure of detailed hire figures which would be markedly different from those in the resume and given to Mr Goodare verbally, a fact which would have led to further enquiry and throw doubt on the true extent of that important side of the business.

The important question here is as to the meaning of the analysis in the context of the agreement. That is really the primary issue under this head of claim because the evidence establishes that the analysis does accurately record the total receipts of the business month by month, it accurately records the amounts received from Hillcrest Services Limited, and it also accurately records, although marginally overstated, receipts for cash (as opposed to credit) sales of hardware. It follows that as a matter of arithmetic the final column of receipts from "All other" must also be accurate. The question of construction involves the meaning and intent of the columns headed "Cash sales hardware" and "All other" respectively.

They are ambiguous - the former could refer either to cash received from hardware sales, or as the Defendants' contend receipts from cash sales of hardware. The meaning to be adopted consequently affects the meaning of "All other". Because of the ambiguity, it is permissible to have recourse to extrinsic evidence to resolve the matter. The relevant factual background to which I have regard for that purpose is :

1. The nature of the business and the accepted breakdown of it into two main components, generally described as hardware and software.

2. The division of turnover as shown in the resume was hardware of $279,423.00 and software of $343,577.00.

3. The provision of monthly figures given to Mr Goodare, broken down specifically into rentals and hardware sales, showing a similar division.

4. The way in which I have found the analysis came to be included in the written agreement, namely as a replacement for the monthly hire schedule.

5. The importance of the relationship between software and hardware revenue.

Viewed in that light, the analysis itself is to be construed as showing a general breakdown as between hardware and software, with the hardware being further divided so as to detail the discounting component. I have also reached the conclusion that that was the intention behind its compilation and that the effect conveyed and sought to be conveyed was that software accounted for some $353,00.00 of receipts, and hardware for some $306,000, giving the ratio of approximately 53:47 in favour of software. No breakdown of the "all other" receipts was given in evidence and it is difficult to know just what those figures represent. What is clear is that if it was intended to show software, as I hold it was, it must be inaccurate and misleading. The sales of library, according to Mr Darby, was $222,624.00 and according to Mr Collins $217,176.00. It is apparent that receipts for the same period, although not necessarily equating sales, must have been substantially less than the $353,589.00 which is the total of the "all other" column of the analysis. In its form and in its context the monthly analysis of receipts was a misleading document. It was not true and accurate. There was therefore under this head of claim a breach of an express term.

<u>The Monthly Hire Figures</u>:

This allegation relates to two matters, the first being a typewritten document (by Mrs Darby) headed "Monthly Sales (Library Only)" and giving figures for April to September 1984, handed to Mr Goodare in the early negotiations.

The second is the schedule verbally dictated by Mr Darby to Mr Goodare over the telephone which details monthly rentals, monthly hardware sales, and their totals, membership totals and a grand total.

I am satisfied that the figures were provided as figures of the actual turnover of the business, and as such were false. However, the detailed representation of the month by month figures did not find its way into the written agreement and must therefore be considered on a different basis from the other two misrepresentations earlier discussed.

I have earlier referred to clause 1 of the special terms of the agreement. The important part of the clause for the purposes of this head of claim is the following, which occurs immediately after the reference to the reliance of the purchaser on the truth and accuracy of the specified documents:

> "Otherwise the Purchaser enters into this agreement relying upon his own judgment and not on any representation or warranty made by the Vendor except as expressed in this agreement."

If applied, that provision precludes the Plaintiffs from relying upon the pleaded misrepresentation. Reliance, however, is placed on s. 4 (1) of the Contractual Remedies Act 1979 which provides :

> "4. Statements during negotiations for a contract -
>
> (1) If a contract, or any other document, contains a provision purporting to preclude a Court from inquiring into or determining the question -

(a) Whether a statement, promise or undertaking was made or given, either in words or by conduct, in connection with or in the course of negotiations leading to the making of the contract; or

(b) Whether, if it was so made or given, it constituted a representation or a term of the contract; or

(c) Whether, if it was a repreenation, it was relied on -

the Court shall not, in any proceedings in relation to the contract, be precluded by that provision from inquiring into and determining any such question unless the Court considers that it is fair and reasonable that the provision should be conclusive between the parties, having regard to all the circumstances of the case, including the subject-matter and value of the transaction, the respective bargaining strengths 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."

In deciding whether it is fair and reasonable that the disclaimer should be conclusive, the following factors are to be taken into account :

<u>In favour of conclusiveness</u>:

1. the transaction involved the sale of a business at the reasonably substantial figure of $385,000.00.

2. there was no disparity between the respective bargaining strengths of the parties.

3. both parties were in receipt of competent legal advice at the time of critical negotiation

4. the precise wording of the special terms, included in which was the disclaimer, was the subject of detailed negotiation before being finalised

5. the very schedule which comprises the misrepresentation was included as a warranted document in a draft of the agreement and was then deliberately and knowingly replaced by the monthly analysis of receipts

6. both Mr Herbison and Mr Goodare were experienced in business and had taken the precaution of employing specialist accounting assistance before agreeing to purchase.

7. the disclaimer is not part of a standard form of agreement but is contained in the body of a clause specially drafted with particularity which carefully sets out the representations upon which the purchasers rely and expressly excludes all others.

<u>Against conclusiveness</u>:

8. the purchasers in fact placed reliance on the accuracy of the monthly figures

9. the hire component as a proportion of turnover was an aspect important to the purchasers

10. the monthly figures bear a close relationship to material included in the contractual documents.

Looked at overall, I have reached the conclusion that the balance is weighted, quite strongly, in favour of the vendor and that in all the circumstances the provision should be given effect and be conclusive as between the parties. The result of this is that the misrepresentation is of no effect and cannot afford the Plaintiffs a ground for relief.

Fourth Cause of Action:

Having regard to my findings under the first two causes of action this plea need not be considered further, the provisions of s .6 (1) (b) of the Contractual Remedies Act 1979 precluding any right to recovery of damages in negligence.

Conclusion:

In accordance with the order for directions as to trial earlier given, and in the light of the above findings which establish liability in favour of the Plaintiffs, the action will stand adjourned sine die for a further hearing on the issues relating to damages, if that be necessary. Counsel should confer with the Senior Deputy Registrar as to the allocation of a suitable date, the question of priority requiring consideration.

The counterclaim also stands adjourned sine die.

Henry J.
....
J S HENRY, J.

<u>Solicitors</u>:

Bell Gully Buddle Weir, AUCKLAND, for plaintiffs
Kensington Wallace, AUCKLAND, for defendants