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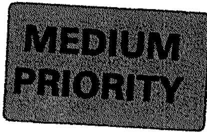
IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CP No. 396/86

1544



BETWEEN PETER RICHARD HARDING

Plaintiff

AND RICHARD PETER SNELL

Defendant

Resumed Hearing 26, 27 September 1989

Counsel D I Jones for Plaintiff
D W Parker for Defendant

Judgment 24TH OCTOBER 1989.

JUDGMENT OF HARDIE BOYS J AS TO DAMAGES

In my judgment delivered on 21 March 1988 I held the defendant Mr Snell entitled to succeed on his counterclaim, which alleged that Mr Harding had misrepresented the turnover of the business of Juke Box Distributors Ltd. I found the misrepresentation to have been twofold: that it was incorrect to say, as Mr Harding had said, that the turnover for the year to 31 March 1985 was "approaching the $100,000 mark"; and that it was also incorrect to forecast, as he did, that the turnover to 31 March 1986 would be $100,000. I had however been asked to determine only the issue of liability; and if I found for Mr Snell, to direct an inquiry into damages. I therefore invited counsel to indicate how they considered such an inquiry should be undertaken.

Counsel then agreed that Mr W G Cox, a chartered accountant, be appointed if he were willing (and he was), and that Mr Snell, being obliged to establish his loss, should quantify his claim for Mr Cox and provide him with all relevant and necessary material for his task. I had indicated in my judgment that the matter being covered by s 6 of the Contractual Remedies Act 1979, damages were to be assessed as if the representations were a term of the contract that had been broken; and I referred to the discussion of the principles by Barker J in <u>N.Z. Motor Bodies Ltd</u> v <u>Emslie</u> [1985] 2 NZLR 569. The brief which I prepared for Mr Cox, and in which counsel concurred, stated that the damages to which Mr Snell was entitled were the difference between the price paid, $100,000, and the actual market value of the shares at the date of the contract, 25 September 1985. On that basis I did not think it appropriate to require Mr Snell to quantify his claim, for that would be tantamount to him doing his own valuation, but he was still to supply all information Mr Cox needed.

Mr Cox reported on 22 March 1989 but Mr Harding contended that some of the factual material upon which his report had been based, which had been provided by Mr Snell, was incorrect. In consequence, counsel attended in Chambers on 4 August 1989 and agreed that the question of damages should be the subject of a further hearing, at which Mr Snell must prove his loss; that Mr Cox's report should form part of the Record; and that viva voce evidence would have to be given.

On 14 August Mr Harding obtained from the Master an order that Mr Snell produce details of his alleged loss, together with supporting documentation, details of sales of assets, and all other documents on which he intended to rely in support of his claim. The terms of this order were not complied with, and so the resumed hearing had to be adjourned. When finally Mr Snell did comply, one part of the material he produced gave the impression that his claim was for $30,000, which was in round figures the difference between his total cash outlay on the business and his total recoveries in the disposal of its assets, all of which were itemised. He stated that he had undertaken this particular exercise at the request of his solicitors. I take it that they made that request because earlier there had been clear intimations from Mr Harding's side that Mr Snell had lost nothing, in that he had been able to sell the assets for more than the value upon which his purchase had been based. However Mr Snell also made it clear in his material that he relied on the contents and conclusions of Mr Cox's report.

When the matter finally came to hearing, it was immediately apparent that the parties were entirely at odds as to how the question of damages should be approached. Indeed, Mr Jones at times seemed to go so far as to reargue the very finding that there has been misrepresentation; although when challenged he appropriately disclaimed such an intention. Obviously I must assess damages on the basis first of the misrepresentations that I held to be

established, and secondly of the actual turnover for the 1985 and 1986 years as disclosed in the accounts prepared for Mr Harding in the first year and for Mr Snell in the second, which was $81,975 and $83,543 respectively.

On one thing counsel were agreed, and that was that Mr Cox was incorrectly instructed as to the measure of damages. For the correct approach in contract is to ascertain "the value of the promised benefit which the plaintiff has not received": per Cooke P delivering the judgment of the Court of Appeal in Walsh v Kerr (CA 123/87, 7 June 1989, at p 7). See also the earlier discussion by Barker J in Emslie at p 596. (Amongst the authorities to which he refers is the 14th ed of McGregor on Damages. In the 15th, the appropriate paragraph is 26. Note also para 29, where the matter is put thus:

> " If one party makes default in performing his side of the contract, then the basic loss to the other party is the market value of the benefit of which he has been deprived through the breach. Put shortly, the plaintiff is entitled to compensation for the loss of his bargain.")

Compensation assessed on this basis means that the wronged party cannot profit from a bad bargain, or be penalised for a good one. The damages are not governed by the price paid and so the measure is not necessarily the same as the difference between the price paid and the fair value at the time of purchase. Walsh v Kerr itself illustrates that, in a rather unusual way. The present case illustrates it too, but not entirely in the way contended for by Mr Jones, who particularly relied upon that authority.

Mr Cox had at an early stage appreciated the difficulty presented by his brief, because on what he regarded as the appropriate basis of valuation the shares were worth so very much less than the $100,000 Mr Snell paid for them that the difference between their value and the price was quite out of proportion to the value of the shortfall in the promised turnover. He therefore approached the Court for directions. After conferring with counsel, I directed that he proceed as originally instructed. He did so, but as a result produced no comparative figures. He simply valued the business, as it was, as at the date of the contract. However the information he assembled enabled Mr Parker, who called him as a witness, to develop his case for damages consistently with Walsh v Kerr, and in accordance with the approach taken by Doogue J in his unreported judgment in S D & L C Paltridge Ltd v Iles (Hamilton, CP 91/88, 28 July 1989).

Mr Snell set about disposing of the assets fairly early in 1986, when he realised that the business was not producing the returns he had expected. It will be necessary to say more about that later in this judgment. I mention it now because Mr Cox used the information as to sale proceeds supplied to him by Mr Snell as the basis for the second of the two valuation methods he employed: the first being the earnings or capitalisation of profits method and the second the notional liquidation method.

Using the earnings method, Mr Cox arrived at a value of $25,000. Because he had no earlier figures, and because of the changes in the 1986 year, he thought it appropriate to average earnings for only the three years 1983, 1984 and 1985. This resulted in a tax paid figure of $5,000. And because of the nature of the business he took a capitalisation rate of 20%. Hence the value of $25,000.

With the notional liquidation method, using the figures supplied by Mr Snell and a purchaser's profit allowance of 25%, Mr Cox arrived at a value of $27,000. It was the information upon which this value was based that Mr Harding contended was incorrect. And so it was. On one view some values were overstated. On another, they were understated. This too is a topic to which I return later.

Mr Cox reported that in the particular circumstances, he thought the notional liquidation method the more appropriate for the purpose given to him. Whilst he thought this method had its disadvantages, he considered these to be outweighed by the difficulties in verifying the takings from the juke boxes, and in determining what would be a fair management remuneration.

Quite plainly the value of the promised benefit which Mr Snell did not receive is not the difference between $25,000 or $27,000 and $100,000. Rather, Mr Parker

submitted, it is the value of the difference between a business with the actual turnover and one with a turnover of $100,000. Taking the actual turnover at the 1985 figure of $81,975, Mr Parker demonstrated that additional net profit of $7,400 would have been derived had the turnover been $100,000, which at 20% capitalises at $37,000. This sum, Mr Parker submitted, is the true measure of Mr Snell's loss.

Mr Jones, on the other hand, submitted that Mr Snell had in fact suffered no loss; alternatively, that if there was a loss, it was attributable solely to mismanagement on Mr Snell's part.

It is convenient to dispose of the second of these submissions first. Mr Jones contended that the failure of the business to achieve the desired turnover was because the money from the juke boxes was not being accounted for by Mr Snell's staff. This is a different matter from the concern expressed by Mr Cox, which, on the evidence before me, can properly be discounted. On the other hand, there is every reason to suspect that throughout this singularly strange transaction Mr Madden, upon whom Mr Snell was relying to protect his interests, was in fact advancing his own. Mr Madden had been involved in the purchase of the business by Mr Snell, and then took an increasing role in its management. But until at least mid-February 1986 the collection of money from the juke boxes, which made up almost the entire income, was largely the responsibility of

a Mr Thomas, who had worked for Mr Harding for many years, and whom the latter regarded as a trusted employee. Neither Mr Jones nor Mr Harding suggested that Mr Thomas might have been dishonest. And there is no evidential basis for the assertion that, assuming Mr Madden was guilty of misappropriation, he had begun to offend before the end of the 1985/86 financial year. Indeed, in cross-examination Mr Harding disclaimed any suggestion of a failure to account before 31 March 1986. In any event, to allege now that the shortfall in expected turnover in the 1986 year was the result of factors beyond the area of Mr Harding's responsibility is to re-litigate an issue on which I have already made my findings.

If, as is quite likely, there was misappropriation by staff after 1 April 1986, this is irrelevant for present purposes. Mr Snell's case does not depend on what happened after 31 March 1986. It is based on misrepresentations concerning the two years up to that date. He is entitled to receive what he was promised as at the date of the contract. The fact that he later allowed his investment to be dissipated is beside the point. For it was then his to do with as he chose. Mr Harding's obligation was to ensure that he received it in the first place.

Mr Jones' submission that Mr Snell had sustained no loss was based on evidence as to the disposal of the assets of the business, coupled with Mr Snell's own approach to the

assessment of his loss, which as I have mentioned, appeared to be based on a recovery of outlay calculation, together with a remark he made in the course of cross-examination, to the effect that had he recovered the purchase price from the sale of the assets he "would have been happy".

Mr Madden appears to have played a duplicitous role in the disposal of the assets. As early as February 1986 Mr Snell had told him that he wanted his money back. Mr Madden seems to have told a Mr Chaston, who without Mr Snell's authority began to offer to finance people into the business. But nothing came of that. Then later in the year Madden negotiated a transaction whereby Mr MacAffer, then the licensee of the Royal George Tavern, would acquire 35 of the company's 39 juke boxes (some other games were included as well, in this and later transactions, but it is unnecessary to separate them out) in exchange for the Tavern's chattels and licence. Mr Snell stated that the agreed value of the juke boxes for the purpose of this transaction was $45,000. (He at first gave a figure of $63,500 which was the amount used by Mr Cox in his notional liquidation method valuation; but it became apparent that that was the agreed value of 39 juke boxes, whereas finally MacAffer was to take only 35.) Of the other 4 juke boxes, 3 were sold to one Brown for $11,500, and one remains, in need of servicing, and it is agreed it is worth $1,000. Brown also purchased the other equipment for $2,800. The only other asset, a van, was traded in at a value of

$11,995. Thus these transactions resulted in a total realisation of $70,745, or $71,745 in all including the one remaining juke box. Mr Snell's calculation of a shortfall of $30,000 took into account not only these items but also other expenditure he had incurred, together with income he had received.

By reason of the ephemeral nature of the transaction with MacAffer, and the machinations of Madden, the matter is not at all as simple as the foregoing figures suggest. Mr Snell did not become the licensee of the Tavern, nor did he acquire the chattels. The Brewery, he said, wanted Mrs Madden to be the licensee and so it was arranged that she would hold the licence, and acquire the chattels, on trust for him. But this came to nothing, because the licensing authority refused to accept Mrs Madden. Thereupon MacAffer sold the chattels to the Brewery, the proceeds being set off against money he owed to it. MacAffer, Mr Snell said, then "left the country hurriedly" and is now in Scotland. I was not informed who was granted the licence, but it was not Mr Snell.

Evidence was given by a Mr Williams that in July 1986 he and his partner, the same Brown I gather, arranged with Madden, representing himself to be Mr Snell's agent, to purchase 35 juke boxes for $80,000, of which $20,000 was to be paid in cash and the balance to be satisfied by "boats caravans and cars" owned by Mr Brown. The money was paid,

and the chattels transferred, to Madden, but the purchasers received only 26 juke boxes. They operated them until December 1986 when they sold them to Canterbury Amusements Ltd. The sale included video games as well as juke boxes. According to Mr Loughnan, a director of the purchaser, there were 29 not 26 juke boxes, and of the total price $105,000 was for them.

These transactions are to some degree evidenced by a written agreement dated 27 July 1986 between MacAffer, Brown and Mrs Madden. By that agreement, MacAffer was to transfer to Mrs Madden the plant, fittings and stock of the Tavern; she was to transfer to him 35 juke boxes; he was to transfer those juke boxes to Brown; and Brown was to pay MacAffer $20,000 and assign to him his interest under a chattels security over a fishing boat. Mr Snell became aware of the agreement soon after it was signed, but apart from protesting that the juke boxes were not Mrs Madden's to sell, did nothing more.

Madden did not give evidence nor did Brown nor, naturally, MacAffer. Whether the truth would have been more apparent had any of them done so may be open to question. As it is, much is unexplained. What is clear, however, is that great advantage has been taken of Mr Snell's naivete and muddle-headedness. Madden as his agent has sold 35 juke boxes and has not accounted for the proceeds. Nonetheless, it is the amount for which they were sold that

must be brought to account in determining what the sale of the company's assets realised. On this basis, the total realization was $107,295, more than the purchase price of the shares.

It was this fact that enabled Mr Jones to submit that Mr Snell has suffered no loss; and to seize upon his statement that he would have been happy had he recovered his investment. However, it would be wrong to give that statement any significance, for in reality Mr Snell has recovered only a small part of his investment. Doubtless he could take action against Madden, although that may prove fruitless, but nonetheless Mr Snell's comment must be assessed in the context in which it was made, namely that he has in fact retrieved only $27,295 from the disposal of the company's assets. The point also needs to be made, for what it is worth in this connection, that Mr Snell bought shares in a company, not its assets, and the value of the assets on their own is not the same thing as the value of the shares.

As an alternative means of showing that there had been no loss, Mr Jones led valuation evidence from another chartered accountant, Mr J R Thomson. It was Mr Thomson's thesis that both the capitalisation of profits method and the notional liquidation method are inappropriate in this case, and that instead the shares should be valued on the basis of the value of the assets sold as a going concern. On that basis there would be no deduction for the items normally

associated with the notional liquidation method, such as liquidation costs, purchaser's profit allowance, and tax on distribution. On the assumption that the juke boxes sold were worth $114,200, Mr Thomson arrived at a net assets value of $104,961. The figure of $114,200 was taken from a schedule of 39 juke boxes and their values which Mr Thomson had assumed formed part of the written agreement of 27 July 1986. That assumption was however mistaken. The source and purpose of that schedule is unclear; and it has no evidential value. The only other evidence of the value of the juke boxes was first that at the time of Mr Snell's purchase Mr Harding put a sum of $105,850 on them; secondly that as between Mr Snell and MacAffer the agreed value for 35 was $45,000 and for 39 $63,500; Mr Williams' figure of $80,000 for 35; and Mr Loughnan's of $105,000 for 29. There can be no doubt that much of the value of these machines lies in their earning capacity and so the price at any given time will depend on what they are, or are represented as, earning. It is not necessary for me to decide the point, but I think it likely that Mr Williams' figure is the most reliable for the purpose of the present dispute, fixed as it was on a proper market, and being closer in time to the Harding-Snell transaction than the sale to Canterbury Amusements Ltd. If this figure were adopted, Mr Thomson's valuation would fall below $100,000.

Mr Thomson rejected the capitalisation of profits method for two reasons: first, because he understood that

the parties had arrived at the rather arbitrary purchase price of $100,000 on the basis of the value of the assets and not with any real regard to profitability (which of course is not the same thing as turnover); and secondly because Mr Snell purchased the business with the intention of carrying it on, and not of liquidating it. Clearly, and understandably, Mr Thomson has approached the matter on the basis of the original direction to Mr Cox. He has sought to establish the actual market value of the shares at the time of purchase, in order to compare it with the price paid. As he himself acknowledged, this approach has not put a value on the benefit that was promised but not received. Therefore his conclusions are of little assistance.

It is accordingly unnecessary to consider whether in an assets value exercise it is ever permissible not to assume a liquidation. There is strong authority that it is not permissible: see for example Hatrick v Commissioner of Inland Revenue [1963] NZLR 641, 662, and Emslie at p 597; but the point can be left open for the purposes of this judgment.

It is however necessary to comment upon Mr Thomson's view that a capitalisation of profits approach is inappropriate in the present circumstances because of the basis upon which the parties contracted. I consider that this view is not open to the plaintiff, for it runs counter

to the findings expressed in my earlier judgment. It is true that the purchase price was not fixed with particular relation to net earnings. The evidence was to the effect that Mr Harding nominated his price, and justified it by reference to a schedule showing the value of the juke boxes, estimated at $105,850, and to the actual and projected turnover. I held that the statements as to turnover were a material inducement to Mr Snell to purchase. Had they not been, he would have failed on the issue of liability. Mr Snell in evidence said little about profit as compared with turnover. But he was buying the business in order to make a profit from its operations. It was pointless to spend $100,000 on juke boxes unless an adequate profit were to be realised. Whatever the profit he thought he would make from the promised turnover, it was a business with fairly fixed costs, so that profitability would be very dependent on the volume of turnover. Much of the value of the machines lay in their ability to earn at a relatively low running cost.

These considerations reinforce my view, which I think necessarily follows from Walsh v Kerr, that the proper measure of damages in this case is the value of the shortfall in turnover. I consider that the value of the assets is irrelevant for this purpose. Mr Snell certainly received what he had bargained for in terms of assets. But he did not receive what he had bargained for in terms of turnover and, consequently, of profit. It is the value of

that that must be assessed. This view does not run counter to Mr Cox's preference for the assets value method for assessing the value of the shares at a particular date. For as I have said, Mr Cox was not asked to make a comparison.

In the Paltridge case, too, the Court's task was to assess damages for an overstatement of turnover. Doogue J, referring to the judgment of Henry J in Herbison v Papakura Video Ltd (No 2) [1987] 2 NZLR 720, made the point that in the normal course a representation as to turnover cannot be treated as a guarantee for the future. It is no more than a statement of what has been, or is being, achieved under the vendor's control. Acceptance that that is so, is implicit in the approach contended for by Mr Parker in this case. His approach was, however, rather different from that adopted in Paltridge, for there it was the gross profit that was capitalised, whilst Mr Parker's calculations were based on the tax paid profit, this being the same basis as that employed by Mr Cox in his valuation of the shares by the earnings method. There was no evidence as to what the result would be were the gross profit to be capitalised, and so I think it was appropriate for Mr Parker to use the tax paid profit basis which seems more to meet the realities of this case.

Mr Parker arrived at the figure of $7,400 as the additional net profit that would have been derived had the

turnover been $100,000 by assuming additional expenses of $4,500 and a tax rate of 45%. These assumptions were supported by Mr Cox and neither was challenged; and I accept them as fair and reasonable. However Mr Parker's starting point was a shortfall in turnover of $18,025, based on the 1985 figure of $81,975. It would I think be more appropriate to take the 1986 figure of $83,543 for it was to that year that the forecast of $100,000 applied. On that figure, the shortfall is $16,457, a net $11,957 before tax, and $6,576 after tax. Capitalised at 20%, this amounts to $32,880. This sum on Mr Parker's approach would represent the value of the promise that was not fulfilled and so would be the measure of Mr Snell's loss.

Although I think that Mr Parker is right in his submission that it is the shortfall in turnover that is to be valued, I consider that there is a fallacy in his method of assessing it. As with Mr Jones' reliance on realization prices, it overlooks the fact that unlike that in the Paltridge case, this transaction involved the purchase of shares in a company. Mr Snell was not simply buying turnover. Further, it focusses on one year only, whereas the evidence is that a prudent buyer of shares would base his price on an average of at least three years.

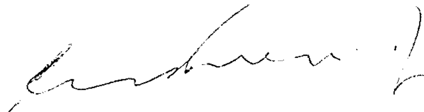
It was I think for these reasons that Mr Cox was unwilling to accept Mr Parker's approach when put to him in the course of his evidence. While being reluctant to value

hypothetically, he did however indicate what value his earnings method would produce on a higher turnover. As mentioned, he valued the shares, on the basis of the average net earnings for the 1983-85 years of $5,000, at $25,000. If the earnings for the 1985 year are increased to allow for sales of $100,000, the average becomes $7,440. He rounded that off to $7,400, and applied the 20% capitalisation rate thereby increasing the value of the shares to $37,000. Thus he said the business with the promised turnover brought into the 1985 year would be worth $12,000 more than without it. This exercise does not of course completely reflect the representations Mr Harding made. He did not promise sales of $100,000 in the 1985 year, but in the 1986 year. In the 1985 year his promise was sales approaching $100,000. There is no evidence before me as to the earnings based value of the shares assuming such a representation to have been correct. I must therefore do the best I can with the material I have. I am content to accept Mr Cox's figure of $12,000. It needs to be discounted because of the nature of the representation for the 1985 year; but regard must also be had to the fact that the representation extended to the 1986 year. I consider that this sum of $12,000 will appropriately compensate Mr Snell for the shortfall in the value of the shares consequent upon the overstatement of the turnover.

Finally, I note that in the Herbison case Henry J adopted a similar comparison between earnings based values

in order to arrive at the difference between the value of the business as warranted and its true value.

The result is that on the counterclaim there will be judgment for the defendant in the sum of $12,000. As each party has been successful on his particular claim, and the amount involved in Mr Harding's is unknown, I leave each party to pay his own costs. But on the counterclaim, I order that Mr Harding pay Mr Cox's fee for his report of $3,308.42.



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