

FORM A
FILING SHEET FOR EASTERN CAPE JUDGMENT

PARTIES:

TARPAULIN & CANVAS CC

PLAINTIFF

and

SUNSHINE COAST TOURS CC

DEFENDANT

- Case Number: **2578/06**
- High Court: **SOUTH EASTERN CAPE LOCAL DIVISION**

Date Heard: **12 June 2007**

Date Delivered: **11 September 2007**

JUDGE(S): **DAMBUZA J**

LEGAL REPRESENTATIVES-

Appearances:

- Applicant(s): **Adv Beyleveld**
- Respondent(s): **Adv Rorke**

Instructing attorneys:

- Applicant(s): **Burmeister De Langer Inc**
- Respondent(s): **Randell-Oswald Inc**

CASE INFORMATION –

- *Nature of proceedings* : **Trial**

**IN THE HIGH COURT OF SOUTH AFRICA
(SOUTH EASTERN CAPE LOCAL DIVISION)**

CASE NO: 2578/06

In the matter between:

TARPAULIN & CANVAS CC

PLAINTIFF

and

SUNSHINE COAST TOURS CC

DEFENDANT

JUDGMENT

DAMBUZA J:

1. In this case the plaintiff claims, from the defendant, an amount of R483 569.87 being the balance of the purchase price due to plaintiff on an agreement of sale between the parties. The defendant contends that the plaintiff is not entitled to this portion of the purchase price as the original purchase price falls to be reduced by the amount claimed.
2. The agreement of sale was concluded by the parties on 23 June 2005. In terms thereof the plaintiff sold to the defendant its business known as Tarpaulin & Canvass CC (the business), for an

amount of R1 250 000.00. The effective date of agreement was 30 June 2005. Defendant paid the purchase price save for the amount which is the subject of these proceedings. The purchase price was determined on the basis of the management accounts of the business for the period starting on 1 March 2004 and ending on 28 February 2005. According to the plaintiff the purchase price was calculated on an amount of R450 000.00, which was available to the members of the plaintiff at the end of February 2005. Calculation of the purchase price was as follows:

Profit as per February management	R155 957.00
Add back:	
Members' salary:	R144 000.00
Members' personal expenses:	
Telephone:	R30 000.00
Motor vehicle expenses:	R30 000.00
Short term insurance:	R15 000.00
Refreshments:	R6 000.00
Policies (Insurance):	<u>R69 000.00</u>
Add to the profit:	R449 957.00
Round off:	R450 000.00
Return on investment:	<u>30%</u>
Valuation:	R1 500 000.00

The management accounts from which the above figures were drawn formed part of the written agreement of sale. Pursuant to negotiations between the parties the purchase price was set at R1

250 000.00.

3. In response to the summons issued against it in these proceedings for payment of the balance of the purchase price, the defendant contended, in the main, that the plaintiff had failed to comply with its obligations under the agreement and that the management accounts from which the figures used in calculating the purchase price were obtained, were incorrect. According to the defendant the expenditure of the business was more and the actual income less than revealed in the management accounts. The defendant took issue with the manner in which the plaintiff calculated the purchase price.
4. It was common cause at the trial that the management accounts were incorrect and that the entries thereon differed from unaudited annual financial statements which were made available to the defendant after the conclusion of the agreement of sale. For example, the fact that the business had suffered a loss of R86 296.00 did not appear in the management accounts. Certain personal expenses of Peter James Mote, who was the sole member of the plaintiff at the time of sale, also did not appear in the management accounts. Expenses relating to a business owned by another Close Corporation in which Mote was the sole

member, the Red 7 Ski Manufacturing CC did not appear in the management accounts. All these items only appeared in the unaudited annual financial statements of the business.

5 Each party only led the evidence of a chartered account. Factual evidence relating to the conclusion of the agreement and the defects in the plaintiff's books of account was common cause. The witnesses only differed on whether the defendant was entitled to reduction of the purchase price as a result of the defective books of account.

6. According to the plaintiff's witness, Mark Allistair Bradley, during negotiations preceding the conclusion of the agreement the issue of Mote's personal expenses was brought to the attention of Allan Macphail, who represented the defendant at the negotiations. Such expenses, so it was argued, could therefore not constitute latent defects in the business.

7. Paragraph 5.1 of the written agreement of sale provides that:

"The SELLER warrants as at close of business on the EFFECTIVE DATE, that:

5.1.8 That audited Income and Expenditure Statement for the year ended 28th

February, 2005, will not materially differ from the Income and Expenditure Statement furnished to the PURCHASER on 24th March, 2005. A copy of the aforementioned Income and Expenditure Statement is annexed hereto marked "A".

8. No audit was done on the plaintiff's books of accounts and therefore no audited financial statements (or Income and Expenditure Statements) were prepared for the period ending 28 February 2005. Instead the plaintiff furnished the defendant with unaudited financial statements. Hence the defendant's contention the plaintiff has not complied with all its obligations under the agreement. The only explanation furnished on behalf of the plaintiff regarding its failure to furnish audited financial statements was that it was not a legal requirement that a Close Corporation provides audited financial statements.
9. Mr Rorke, who appeared on behalf of the defendant, correctly submitted that the failure by the plaintiff to furnish audited financial statements constituted breach of agreement. The explanation that the plaintiff was not legally bound to provide audited financial statements could not be correct when the plaintiff had warranted that the contents of audited Income and Expenditure accounts would not differ materially to the

management accounts which formed part of the written agreement. In this context I can only conclude that the plaintiff warranted that firstly, audited Income and Expenditure accounts would be prepared. Mr Beyleveld, who appeared on behalf of the plaintiff sought to argue that it was not clear from the agreement whose responsibility it was to furnish the audited financial statements. However, in view of the fact that such financial statements related to the plaintiff's business and that it is the plaintiff who issued the warranty, the obligation to furnish the audited statements could only be the plaintiff's. The other issue to which the warranty related was, of course, absence of material difference. I am satisfied that in the circumstances the plaintiff acted in breach of its obligation under the agreement.

10. Although the submission on behalf of the defendant was that there was "*no material difference*" between the management accounts and the unaudited financial statements, Bradley, was constrained to admit, under cross-examination, that the differences, in fact, constituted "*material differences*"; it being common cause that the differences in some of the figures in the management accounts and corresponding figures in the unaudited financial statements was more than 10%. The evidence was that according to accounting principles any difference

exceeding 10% in figures representing the same item constituted a material difference. Consequently I agree that the material differences in the respective books of account constituted latent defects in the business.

11. The defendant relied on *exceptio quanti minoris* in its defence to plaintiff's claim. It was submitted on behalf of both parties and I was in agreement that the onus was on the defendant to prove the actual value of the business (or that it was entitled to reduction of the purchase price). See: Davenport Corner Tea Room (Pty) Ltd v Joubert 1962 (2) SA 709 at 712A. Mr Beyleveld submitted that the defendant had failed to discharge this onus in that it had failed to furnish a proper evaluation of the business as at the relevant time. Mark Daverin, the chartered account who testified on behalf of the defendant set forth the following as a more accurate method of calculation of the purchase price:

Nett income:	-R86 296.00
Add: Amortization:	R76 000.00
Members' salary:	R144 000.00
Less: profit on disposal:	<u>R39 473.00</u>
	R93 601.00

Daverin's evidence was that he made the above calculations on

the basis that plaintiff's member(s) were not employed in the business. On this basis, the defendant's version was that a reasonably achievable profit for the business would be about R200 000.00 per annum and that the value of the business, calculated on a return of 25%, would then be R800 000.00. (In view of the fact that the member (Mote) was employed by the business, his salary had to be taken out of the equation and the purchase price would consequently be halved).

12. I agree that the figure of R450 000.00 on which the purchase price was initially based was not supported by the financial statements. Daverin's method of calculation was not challenged and I cannot find any fault with it. The fact that the plaintiff might not have agreed to the price as calculated on this method (Daverin's method) is, in my view, irrelevant. That cannot be valid justification for using incorrect figures or method of calculation to attain the purchase price sought by the plaintiff.

Even if I am wrong in finding that the defendant did prove the value of the business, I remain unpersuaded that the plaintiff did prove that it was entitled to the balance of the purchase price.

In its summons, the plaintiff pleaded that it had discharged its

obligations under the agreement. The warranty relating to the basis for determination and/or confirmation of the purchase price was, in my view, a major aspect of the agreement. As I have said, until the plaintiff had furnished the audited financial statements as it undertook to do so in terms of the agreement, it had not, in my view, discharged its obligations under the agreement. I am mindful of the fact that no time was stipulated in the agreement within which the audited financial statements had to be furnished. It is trite however, that in a contract where no time is expressly stated for performance of an obligation, such an obligation should be performed within a reasonable time. On the pleadings, the plaintiff's performance of its obligations under the agreement was placed in issue by the defendant. I can only conclude from the evidence that when the summons was issued, the plaintiff was aware of the differences between the management accounts and the annual financial statements. The summons was issued on 25 July 2006, a year after the agreement was concluded. It seems to me that it should have been obvious, to the plaintiff, that further to its obligation under the agreement to furnish audited books of account, such books were necessary, in the circumstances, for it to prove its claim. According to Daverin, the unaudited financial statements were still unreliable, as the figures therein had not been verified by auditors against source documents. He

suggested that expenses presented in the financial statements as having been incurred in respect of the Red 7 Ski business could, in fact, be expenses of the business under consideration. This, in my view, is not far fetched, given the defects proved in the books of accounts and the inexplicable reluctance on the part of the plaintiff to have the relevant books audited. By failing to furnish the audited Income and Expenditure accounts, the plaintiff acted in breach of its obligations under the agreement.

The fact that the defendant raised a plea to which an onus of proof attaches did not, in my view, absolve the plaintiff of its duty to prove that it had discharged its obligations under the agreement as it had pleaded.

Consequently the plaintiff's claim is dismissed with costs.

N DAMBUZA

JUDGE OF THE HIGH COURT

Plaintiff's Counsel:

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Plaintiff's Attorneys:

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PORT ELIZABETH

Defendant's Counsel:

Adv Rorke

Defendant's Attorneys:

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Heard on:

12 June 2007

Delivered on:

11 September 2007