

**IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY**

CIV-2008-485-1701

BETWEEN	OCEANIA FURNITURE LIMITED Plaintiff
AND	DEBONAIRE PRODUCTS LIMITED Defendant

Hearing: 4 - 8, 21 May 2009

Appearances: J J Delany for the plaintiff
R C Laurenson for the defendant

Judgment: 27 August 2009

JUDGMENT OF CLIFFORD J

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Introduction

[1] On 3 December 2008 Associate Judge Gendall awarded the plaintiff, Oceania Furniture Limited, summary judgment against the defendant, Debonaire Products Limited, for \$328,572.73. That judgment represented unpaid purchase moneys owed to Oceania by Debonaire for ten container loads of furniture componentry supplied by Oceania to Debonaire under a supply agreement between Oceania and Debonaire entered into on 13 October 2005 (the Supply Agreement).

[2] In the same decision, the Judge:

- a) stayed Oceania's enforcement of that summary judgment pending the hearing and determination of counterclaims by Debonaire; and
- b) declined to enter judgment for Oceania as regards default interest and legal costs claimed by Oceania under the Supply Agreement.

[3] Before me, Debonaire pursued its counterclaims against Oceania, and Oceania its claims for interest and legal costs.

The parties and their claims

[4] Debonaire is a wholesale supplier of furniture. First established in 1966 at Waimate, Debonaire originally manufactured a range of furniture products, including those made from medium density fibreboard (MDF). Debonaire no longer manufactures furniture, but continues to assemble furniture at plants in Waimate and Petone, and through the Department of Corrections at prison sites in Christchurch and the Waikato. At the relevant time Debonaire supplied a number of significant New Zealand retailers, including Big Save Furniture Limited (Big Save) in the North Island and Smiths City (Southern) Limited (Smiths City) in the South Island. Products made from MDF traditionally constitute about fifty percent of Debonaire's sales.

[5] Oceania, formerly called Shengli Oceania Limited, was incorporated in New Zealand in December 2003 as a vehicle whereby Mr Ronald Atkin, a New Zealander, would work together with various Chinese interests to supply MDF furniture componentry to Debonaire for assembly in New Zealand. That componentry was, until the events which gave rise to this litigation, manufactured at a factory which formed part of the Shengli Oil Fields complex in Shendong province in China. That factory was known to the parties as the Shengli Dahao factory. The Shengli Oil Fields complex would appear at relevant times, based on the evidence I heard, to have been majority owned by the Chinese Government with minority “private” ownership. The Shengli Dahao factory was owned by an emanation of that complex, or persons associated with that complex, referred to generally as the Shengli Goods and Supply Department. The precise position was never made clear.

[6] From December 2003 onwards Oceania supplied Debonaire with furniture, including MDF componentry. The legal arrangements between Oceania and Debonaire were, at that time, recorded in a Memorandum of Understanding dated 19 December 2003 (the Memorandum of Understanding). Arrangements between Debonaire and Oceania under the Memorandum of Understanding worked satisfactorily. By October 2005 Debonaire had made the decision to close down its New Zealand MDF manufacturing plant in Waimate. The Supply Agreement, clearly based on the Memorandum of Understanding but subject to a number of modifications, would appear to have been developed in that context.

[7] Arrangements between Debonaire and Oceania under the Supply Agreement also initially worked well. From late January 2007, however, supply from the Shengli Dahao factory was increasingly disrupted.

[8] Orders placed up to 29 January were, in general terms, shipped and delivered in acceptable timeframes. By that time Debonaire was ordering between four and six containers a month. The position would appear to have changed in terms of orders placed on or after 30 January 2007. It is not disputed by Oceania that there were significant disruptions in 2007 to the supply of MDF furniture componentry ordered by Debonaire. There was no delivery of product from 10 March until the end of April. After that, delivery remained intermittent. It transpired that the problems at

the Shengli Dahao factory were (primarily) caused by a Chinese Government decision requiring the Shengli Oil Field complex to divest itself of what might, in our terms, be called “non-core activities”. This eventually led to the closure of that factory in April 2007. Thereafter, and albeit subject to further disruption, Oceania sourced product from a new factory at Ouyahuaxu (the Ouyahuaxu factory).

[9] By reference to those supply problems, Debonaire in its pleading counterclaims in breach of contract for \$580,000.00 loss of profits. As the hearing transpired Debonaire revised its claim for loss of profits to \$435,000.00 (see [21] below). It argues that Oceania was in breach of a term of the Supply Agreement to supply goods ordered by Debonaire “in a timely fashion and in good order”. It also says that Oceania supplied some furniture to Big Save in breach of exclusivity provisions in the Supply Agreement. Debonaire claims that those breaches caused it to lose business it already had, and business that it would have acquired but for those breaches. It says, in particular, that those breaches:

- a) caused the breakdown of its relationship with its principal North Island customer, Big Save;
- b) resulted in lost sales to its existing customers Big Save, Smiths City and Target New Zealand Limited (Target); and
- c) meant that it was unable to capitalise on the opportunity provided to supply North South Furnishings Group Limited (North South) when its major competitor, D A Funnell Limited (Funnell), went out of business.

[10] Oceania responds to Debonaire’s loss of profits claim by arguing that:

- a) the events affecting the Shengli Dahao factory were outside its control and therefore Oceania has no legal liability under the Supply Agreement in connection with disruptions to supply caused thereby;
- b) the damages claimed, loss of profits, are consequential damages for which liability is excluded by the terms of the Supply Agreement; and

- c) in any event, Oceania's actions did not cause Debonaire to lose Big Save's business, and Debonaire's claim as regards the business opportunity provided by Funnell going out of business is speculative and exaggerated.

[11] In addition to its claim for loss of profits, Debonaire counterclaims further amounts ("the subset claims") in respect of:

- a) a series of agreements it says Oceania made with it as difficulties with the Supply Agreement developed (\$49,767.30);
- b) MDF componentry paid for by it which was not supplied or which, as supplied, was defective (\$17,330.96); and
- c) "dead or deficient" stock left in its possession after the termination of the Supply Agreement (\$56,825.97) and the costs of storing such stock (\$13,889.00 as at 30 April 2009).

[12] Oceania disclaims liability with respect to the subset claims. It either does so on the basis that it reached no (binding) agreements with Debonaire as alleged, or by reference to the terms of the Supply Agreement.

[13] Oceania's claim to interest and legal costs is based on specific terms of the Supply Agreement. Debonaire says that the interest claimed would constitute the imposition of a penalty and so the relevant provision of the Supply Agreement is unenforceable. As to the claim for legal costs, Debonaire would appear to acknowledge legal costs as claimed up to and including the entry of summary judgment, but not thereafter.

[14] As will become apparent, many of the issues Debonaire faced can in my judgment be seen as having their origin in the unsatisfactory nature of the contract Debonaire entered into with Oceania. Debonaire closed its New Zealand MDF manufacturing operation in reliance on its arrangements with Oceania. At the end of the day, however, Oceania's commitment to Debonaire, which was for two years only, was limited to supplying goods as ordered, and then when it was within its

ability to do so. The limitations of such a commitment, from Debonaire's point of view and albeit perhaps now in hindsight, are clear.

An overview of the evidence

[15] For Debonaire, Mr Robert Smith, its General Manager, was the principal witness. Mr Smith had dealt directly with Oceania, and in particular Oceania's Managing Director, Mr Ronald Atkin, throughout 2007 when the events which gave rise to this litigation unfolded. He was not, however, involved in the signing of the Supply Agreement. His evidence was directed at all aspects of Debonaire's claims, and will be referred to as appropriate in my consideration of them.

[16] In addition, Ms Karen Billington, Debonaire's Office Administrator, gave evidence as to her dealings with Debonaire's customers during 2007. Her evidence was that it was a very difficult and stressful year, with salespersons from Debonaire's three principal customers (Big Save, Target and Smiths City) constantly ringing with complaints about lack of delivery.

[17] Debonaire did not call evidence from three other principal players, but it is perhaps useful to note their roles in the company at this stage. Mr Stuart Davenport was Debonaire's General Manager at the time that the Supply Agreement was entered. He remained with Debonaire until approximately September-October 2006. By 1 July 2007 he had contracted with Big Save, apparently having left Debonaire on less than amicable terms with Mr Smith. Ms Shirley Fan was employed by Debonaire in a "comprehensive role" including managing accounts and payments. My understanding is that Ms Fan had returned to China by the time of the trial. Lastly, Mr Stuart Nattrass is, and was at all relevant times, a director of Debonaire. He took over responsibility for dealing directly with Oceania on aspects of this dispute in the second half of 2007. Based in particular on the written materials supplied to me, it would appear that Mr Nattrass may at certain times have had a different attitude to Debonaire's dispute with Oceania than did Mr Smith. Given that he was not called to give evidence, the Court was without – from Debonaire's point of view – an important witness of fact (as Mr Smith acknowledged). In these circumstances, where Mr Nattrass's evidence may have been relevant to the

resolution of disputed factual issues, I have been unable to place as much reliance on Mr Smith's account.

[18] Evidence was also provided for Debonaire by witnesses associated with North South, Smiths City and Target.

[19] Mr Errol McCall, North South's General Manager, gave evidence that North South saw Debonaire as a replacement source for MDF product when Funnell closed down in May 2007. He confirmed that in April 2007 North South had placed an order with Debonaire for MDF product (and samples of product) that they never received. Mr Michael Ellis, a Divisional Manager for Smith City, gave evidence that the 2007 supply difficulties disrupted an existing business between Debonaire and Smith City which affected not only the 2007 year, but also the 2008 year. Mr Vaughan Bielby, Target's Managing Director, also gave evidence of the disruption that the 2007 supply difficulties caused for Target's relationship with Debonaire. The general tenor of the evidence of each of Messrs McCall, Ellis and Bielby was to confirm that they experienced considerable difficulty in obtaining supply of MDF furniture from Debonaire during calendar year 2007 and subsequently, and that this adversely affected the level of business they did with Debonaire. A feature of this evidence, however, was the relative vagueness as to exactly when in 2007 they began to experience those supply difficulties.

[20] The final witness for Debonaire was Mr Murray Lazelle, an independent Chartered Accountant. Mr Lazelle gave expert evidence in support of Debonaire's loss of profits claim. He did so on two bases:

- a) First, on the assumption that the Supply Agreement would have remained in force, on the basis of which assumption he assessed damages as being at least the \$580,000 claimed by Debonaire.
- b) Alternatively, and on the basis of the assumption that the Supply Agreement, as it transpired, came to an end on 13 October 2007, he assessed damages for loss of profits at \$435,000.

[21] In the course of argument, Mr Laurenson (for Debonaire) accepted that the second approach was the appropriate one.

[22] For Oceania, the principal witness was Mr Atkin, Oceania's Managing Director in New Zealand. As with Mr Smith, Mr Atkin's evidence addressed all aspects of the dispute between the parties and will be referred to in detail as appropriate.

[23] Mr Lijun Qin (also known as Karl Qin), Oceania's Chief Executive Offshore, gave evidence in particular as to events in China, and also as to dealings he had with Mr Natrass when Mr Natrass took over Debonaire's dealings with Oceania from approximately the beginning of August 2007 onwards.

[24] Evidence was also given for Oceania by witnesses associated with Big Save and TDC Limited, a competitor of Debonaire.

[25] Mr Ray McKimm, the Managing Director and owner of Big Save, gave evidence as to the reasons why Big Save terminated its relationship with Debonaire. That evidence, to which I will return, was less than satisfactory. In evidence-in-chief Mr McKimm said that supply difficulties played no role in Big Save's termination of its relationship with Debonaire. He expressed quite a different view in cross-examination, and qualified his evidence again in re-examination. In those circumstances I am unable to place much, if any, reliance on Mr McKimm's evidence as regards the reasons Big Save terminated its relationship with Debonaire.

[26] Mr Graham Neutze, the General Manager of TDC, described how TDC moved back into manufacturing MDF bedroom furniture in May 2007 through purchasing Funnell's machinery, materials, marketing information, sales history, customer contact details and rights to specific designs, as well as TDC's activities in the market since then. He also provided general information as to the competitiveness of the MDF furniture trade in early 2007, and in particular denied the contention that Debonaire and Funnell had a "stranglehold on the MDF furniture business in any part of New Zealand".

[27] Another Chartered Accountant, Mr Charles Purcell, gave expert evidence for Oceania, commenting on Mr Lazelle's evidence. Mr Purcell's evidence was to the effect that, in general terms, and provided Debonaire established causation and liability, he accepted the methodology adopted by Mr Lazelle to calculate profits lost by Debonaire but disagreed with the gross margin Mr Lazelle had adopted. In essence, if Mr Purcell's criticism's of Mr Lazelle's approach to that calculation were accepted, the resulting figure for the loss of profits claim would be \$319,000 (on the second approach at [20] above).

Central factual narrative

[28] As noted, Debonaire and Oceania first did business with each other in terms of the Memorandum of Understanding. The Memorandum of Understanding referred to "an ongoing supply arrangement whereby Oceania would supply from China furniture components to Debonaire, who will then assemble such components into furniture". Oceania agreed to extend to Debonaire 128 days' credit from the time of order. Payment was to be made either upon Debonaire's receipt of payment for the resale of the goods or 120 days from the placement or order, whichever first occurred. That period of 120 days, which became 100 days from the date of shipment in the Supply Agreement, reflected the following understanding, as expressed by Mr Atkin:

We decided upon 100 days on the basis of 30 days for shipping on the water, 20 days for Debonaire to assemble and sell the product, and up to a further 50 days within which Debonaire could get paid and Debonaire pay us. We also agreed that if Debonaire got paid prior to the 100 days from shipping, it had to pay us immediately it was paid.

[29] The parties entered into the Supply Agreement on 13 October 2005, with Mr Atkin and Mr Davenport signing for Oceania and Debonaire respectively. The agreement was for a term of two years from the date of signing unless there was prior agreement by the parties to extend the term of the relationship. It did not set a price for the goods to be supplied, but stated that Oceania's price for the goods would be "fixed for particular orders once they are placed and accepted by [Oceania]".

[30] Oceania was obliged to supply goods ordered by Debonaire “in a timely fashion and in good order, in so far as it is within [Oceania’s] control to do so”. The Supply Agreement did not specify what “timely” delivery was. However, it is common ground that the parties’ general expectation, at least in terms of an objective, was that “timely delivery” under the Supply Agreement required that goods be dispatched from the factory in China around 21 days after the placing of the order by Debonaire.

[31] The Supply Agreement provided for default interest and the payment of legal costs and expenses in the event of non or late payment. Oceania was also entitled to cancel orders in these circumstances. In addition, the Supply Agreement provided for exclusivity of supply to Debonaire in relation to two of three categories of goods. Provisions under the heading “Liability” purported to exclude or limit Oceania’s liability.

[32] For the first year or so, the Supply Agreement appears to have worked satisfactorily on the whole.

[33] It is now apparent, however, that in April 2006 the Chinese government had issued a high level directive to the Shengli Oil Fields conglomerate to divest itself of non-core businesses. It is not clear from the directive whether the divestiture was intended to apply to foreign investments and business interests. It appears, however, to have launched a major restructure within the Shengli Oil Fields conglomerate in which, on Mr Qin’s evidence, some 25,000 workers were made redundant. Although the target time to effect the divestiture was within two years, there is no indication that the directive affected the Shengli Dahao factory’s operation – directly or indirectly – until the end of 2006.

[34] Leading into 2007, Debonaire had an oral agreement with Big Save that it would supply MDF furniture as ordered by Big Save. Its other principal customers were Target and Smiths City. To supply these customers (and miscellaneous others) Debonaire was ordering, on average, between four and six containers of componentry from Oceania each month.

[35] From the end of December 2006 problems started to arise at the Shengli Dahao factory. Based on Mr Qin's evidence, it seems that the workers had heard rumours that the factory might close, causing fear of job loss, low worker morale and union type meetings. This apparently caused a slow down in production at the Shengli Dahao factory in January and February 2007. Moreover, this was followed by the traditional factory shut down over the Chinese New Year holidays (18 February to 2 March), followed by the traditional period of time after the holiday period in which workers were still returning to work (given that many workers go to their homes in the outlying provinces of China during this break).

[36] On (or around) 29 January 2007 Mr Atkin informed Mr Smith of the Chinese New Year break in the following terms:

... I am pleased to advise that we can still get orders completed before the holidays if we get them soon. Overall the factory will close from Feb 10th and not resume until March. If you place orders that might be a bit of a struggle, the holidays will be either delayed or shortened.

We will do our very best to keep you supplied. Some lines will be easier than others.

[37] In what Debonaire said was in reliance on that email, Debonaire ordered four containers of componentry between 29 and 31 January 2007 and then another eight containers on 21-22 February 2007. Given the previous pattern of orders, I accept Debonaire's position on that matter. I note, however, that Mr Atkin had requested that such "special" orders be placed prior to the closure of the factory on 10 February. As is obvious, the order for the eight containers was not made in that timeframe.

[38] Staff morale remained low when the staff returned to the Shengli Dahao factory after the Chinese New Year break, and labour disputes persisted. Production in March 2007 therefore continued to be slower than normal.

[39] Notwithstanding these disruptions, it seems that orders placed by Debonaire continued to be delivered in a reasonably timely fashion until the second week of March 2007 – i.e. orders placed with Oceania until 30 January 2007 (up to, and including, order 492). From the second week of March there were no further orders

delivered to Debonaire until 30 April 2007. Based on three weeks between orders and shipment, four weeks on the water, and three weeks for assembly, the untimely delivery of the orders placed from 30 January 2007 onwards (order 493 and following) would not have been expected to affect Debonaire's customers until 10 April 2007 at the earliest.

[40] At the same time, there was evidence of problems with Debonaire's supply to its customers throughout the whole – or most – of 2007. On this point Mr McKimm's evidence was of some assistance. In general terms he referred to ongoing supply difficulties from an early stage. This evidence was consistent with Mr Smith's acknowledgement of delays in an email of 23 May 2007 (see below). Mr Ellis of Smiths City stated that supply from Debonaire was fine prior to the early-to-mid part of 2007. Supply then became very erratic "[d]uring the course of 2007", such that Smiths City stopped advertising Debonaire products. He said quality also deteriorated, which had a marked effect on sales and the long term effect of the product losing credibility with sales staff. Mr Bielby of Target said that "leading into 2007" or "in 2007" supply started to become erratic, with the result that Target cancelled orders with Debonaire. In evidence was a list of approximately 230 voided purchase orders from Target to Debonaire between 8 January 2007 and 10 December 2008. Mr Bielby stated that supply from Debonaire in 2007 "virtually came to a standstill with the result that Target then looked for alternative suppliers". Ms Billington's evidence was that there were constant complaints about lack of delivery from Debonaire's principal customers "during 2007".

[41] In March/April 2007 Funnell announced its intention to close.

[42] In April 2007 the Shengli Dahao factory suddenly closed. The exact date of the closure was never made entirely clear, although the weight of the evidence indicates 3 April.

[43] Oceania was permitted to resume manufacturing at the Shengli Dahao factory for a short period after the closure. In this way Oceania was able to source a number of containers from the Shengli Dahao factory after April 2007 (until at least 25

May). However, there were problems with the Chinese Bureau of Foreign Currency Exchange in exporting some of these containers from China.

[44] On 12 April 2007 North South placed an order with Debonaire to supply MDF product to the value of \$59,065, and also requested samples that could be displayed at the biannual Auckland furniture show in May 2007. Debonaire consequently placed two orders with Oceania on that date (orders 506 and 507). Neither the ordered stock nor the samples were ever supplied to North South.

[45] Up until early-to-mid April 2007 there were a number of emails from Debonaire to Oceania inquiring as to the delivery time for certain orders – or, more usually, replacement components where product had been damaged or was defective or missing – but there are no communications in evidence indicating an overall concern as to the timeliness of deliveries. On 13 April, however, Mr Atkin emailed “Stony” (Mr Shi Yan, who was associated with the Shengli Dahao factory), referring to Oceania being “desperately short of stock” and “getting hammered from all directions”. He noted that Oceania was “not getting anything like the 20 day delivery times” and sought advice as to when they could expect delivery.

[46] Although surely aware of delays in deliveries from Oceania, Debonaire was not advised of the nature of the difficulties in China until mid April 2007. Oceania’s advice to Debonaire at this time is evident in two emails from Mr Atkin to Mr Smith. In the first, on 14 April, Mr Atkin stated:

... I think it is about time that I filled you in with what has been going on in China. I appreciate all too well how you have been through a war zone over the last year or so and that we have caused our fair share of it. I certainly want you to have a more tranquil and prosperous time ahead and you can be assured of my personal best efforts to make this happen.

Like you we have had to deal with and are still amidst dealing with some major issues back in China, which have been detrimental to staff morale (causing slow production) and most concerning to our directorship. Aside from all the shipping hassles and lack of profit we have had to deal with, there are major reforms going on within Shengli Oil Field which like in any large corporate, cause havoc and have lead to bitch fighting between Executives and Directors. We have guys looking for faults in others [sic] performance, so they can leapfrog in promotion which is most damaging. This is why I have been so persistent with payment terms. ...

Back in China we are working very hard to make sure we come out of these turbulent times continuing to provide our product as required and in fact improve on how we do things when we were at best. But this requires change and some fancy footwork. We are setting up back-up resources, changing (streamlining) interested parties, tying in another factory, endeavouring to take total control (probably ownership) of the factory and many other actions. ...

[47] On 20 April Ms Fan emailed Mr Atkin asking for the estimated date of delivery of eight orders (500-507) which they needed urgently.

[48] On around 26 April Mr Atkin informed Mr Smith:

Our meeting in Australia was more than a tad nerve wracking. I will fill in all details when we meet, but in short the Shengli Oil field restructure in China I have alluded to before, has resulted in major internal change for us, which are effective now.

- Shengli Material Goods Supply Div., has from today passed their interest in Shengli Dahao to “Wuhua” but without staff. The last containers leave the Dahao workshops today.
- Wuhua are totally unacceptable to us as replacement manufacturers – they simply have no furniture capability or expertise. (This is under extreme objection from us).
- We are right now setting up a totally separate factory using existing staff, plans, methods, suppliers etc.

It is obviously essential that for us to produce you furniture as you want, we must continue with current staff, expertise, equipment etc, otherwise it is essentially starting from scratch. So totally outside of the internal arguments we are amidst our new factory is being set up with all existing capabilities including all the new designs. ... It will all be ready and producing within 6 weeks. Regretfully I can do nothing about this (maximum) downtime.

To reduce further downtime, we are trying to knobble [sic] all the existing equipment (not that this is essential, but it will be the fastest solution). ...

[49] Also in that email, Mr Atkin asked Mr Smith to write a letter to Oceania:

...that goes ballistic at us, for the atrocious delays you have been suffering from and the diabolical quality of late and how it is destroying your business and that of Big Save, Smiths City etc. Threaten Legal action – anything you like. It cannot be too savage, (*You were probably about to write this anyway*). This will help us with our tactics (designed to scare the beegeebers out of our problem people) and get things back in tranquil waters ASAP.

[50] Mr Smith complied with that request, stating amongst other things:

We have been requesting information from your company over the last three months regarding the non delivery of product and the poor quality of the product that has been received, all to no avail. We have been given so many promises and misinformation it has become a joke.

We are fast losing credibility in the market place with these non deliveries and are under constant pressure from both Big Save Limited and Smiths City over these non deliveries. We have also just taken over all North South's MDF business and orders placed in February for delivery in May still have no left the factory. What do we say to our retailers?

[51] From this date onwards there was fairly regular communication between Debonaire and Oceania in relation to non- or late delivery.

[52] Notwithstanding Debonaire's knowledge of the problems in China, Debonaire placed another nine orders (in total) on 30 April and 2 May. Another two orders were placed in early July and three orders in the first week of August 2007. There was evidence that Debonaire and Oceania reprioritised orders once Debonaire became aware of the problems.

[53] As a consequence of the closure of the Shengli Dahao factory, Oceania arranged to set up a new factory at Ouyahuaxu to continue supply to Debonaire. Oceania advised Debonaire that the factory was up and running from at least 13 June 2007, but it would appear that the first orders did not leave the factory until early July. An email of 20 July indicates that the Ouyahuaxu factory would be "delivering to full capacity" by August.

[54] Funnell closed in May 2007. As at this time, Funnell was said to be obtaining business from North South worth \$2.8 million per annum, of which more than half was MDF furniture. TDC purchased Funnell's equipment and designs, employed a key ex Funnell sales representative, and began to talk with retailers.

[55] On 23 May 2007 Debonaire first advised Big Save of the difficulties it was having in terms of its supply from China. It apologised for the delays and lack of information that had affected orders up until that time.

[56] Debonaire stopped paying Oceania with any regularity for deliveries at the end of May 2007. On 29 May one order, overdue for payment at that time, was paid

for in full. There were two other orders (which were also overdue for payment) that were not paid for. It has to be acknowledged, however, that by then it would appear Oceania was allowing Debonaire considerable latitude in terms of complying with the contractual payment terms, given the difficulty being encountered on the production side.

[57] Mr Laurenson endeavoured to link the refusal to pay to the late delivery of certain containers. As the Supply Agreement required payment within the specified time (100 days) of shipment, and was effectively on “pay now, argue later” terms, I do not think Debonaire can rely on late delivery of containers it received to justify withholding payment for those containers. That is, in effect, the conclusion Associate Judge Gendall also reached.

[58] In early June 2007 Big Save advised Mr Smith that if it was not 100 percent confident as to Debonaire’s abilities as a supplier by 1 September, it would be closing its account. It would appear that Big Save was concerned not only with supply issues from China, but also about other aspects of its relationship with Debonaire, including Debonaire product that was supplied not only to Big Save but also to others. Through June, Debonaire endeavoured to keep Big Save informed of the difficulties in China, and of revised delivery schedules.

[59] From 1 July 2007, Big Save contracted with Mr Stuart Davenport to arrange for Big Save to purchase its MDF componentry directly from offshore suppliers. It appears that Big Save wanted to source product directly from China to cut out the costs associated with dealing with a middleman. It seems that Mr Smith became aware of this sometime during July.

[60] Things in China did not improve. On 5 July Mr Smith provided an update to Big Save’s group buyer (Mr Salter), including that Debonaire would not be able to deliver an outstanding order for 360 scotch chests until early August. He offered to supply more expensive stock, in place of cheaper stock, at the cheaper price.

[61] On 29 July 2007 – and perhaps in light of his knowledge as to Big Save’s plans – Mr Smith emailed Mr Atkin asking for “something in writing” that he could

forward to Debonaire's directors to "reassure them of our exclusivity arrangement", and confirming that Oceania "will not be supplying any other party in NZ with MDF from either your new factory or any other factory that you may have contact with". Mr Atkin's reply confirmed Oceania's commitment to its contract with Debonaire, but noted that the contract allowed Debonaire to supply MDF product to others, provided it did not fall within Category 1 or Category 2. He also said that if Big Save stopped dealing with Debonaire, and tendered for the manufacture of products of their design and specification, Oceania might elect to tender for such business.

[62] Mr Smith responded expressing the view that Oceania supplying any product to Big Save would negatively impact on Debonaire's business, and asking Mr Atkin to "give some thought as to whether you wish to tender for Big Save's business or not". Ron Atkin replied, reiterating the views he had earlier set out.

[63] In evidence, Mr Smith acknowledged the strict contractual position that Oceania was only limited in its ability to supply Big Save, and indeed others, for the two year term of the Supply Agreement. Mr Smith also acknowledged, however, that at that time (from July 2007) he was concerned with the position not only during the term of the contract, but afterwards. In asking for a commitment that Oceania not supply any other party "with MDF" he was asking for more than the Supply Agreement provided. Moreover, and as regards the special "Hunter Hills" paper used in some of the product supplied to Debonaire, whilst Mr Smith acknowledged the strict legal position, he said that in his view Oceania ought not to be able to deal in product using that paper with others in New Zealand at all. Quite understandably in my view, Mr Smith at the time was looking for a commitment from Oceania that it would not deal with Big Save – that is, that it would go on dealing exclusively with Debonaire up to and beyond the expiry of the then two year term of the Supply Agreement.

[64] In an email to Mr Qin on 31 July 2007 Mr Atkin referred to a meeting that day with Mr Davenport on behalf of Big Save and that:

[Big Save] definitely want our product and it will be changed so that it is clearly not Debonaire's. But our unique product features are very much wanted. (I have given Stony [Shi Yan] full specifications already).

They want two substantially reduced ranges, which they will order in good quantities and they want production underway ASAP.

[65] At a meeting on 30 July – and as confirmed in a letter dated 31 July – Mr Smith was advised that Big Save would be closing its account with Debonaire, removing the ranges of product supplied by Debonaire from its stores with effect from 1 November. The reason given by Big Save at that time for closing its account was Debonaire’s inability to supply in a timely manner. On 31 July Mr Atkin informed Mr Qin that Big Save had decided to source its own supply of MDF furniture and to assemble it itself from its new premises in Napier.

[66] In early August Oceania began to make it clear to Debonaire that it would not be interested in extending the Supply Agreement – or the relationship with Debonaire more generally – unless Debonaire addressed the outstanding payments. Mr Smith conceded in cross-examination that from around August 2007 it looked “very likely” that Oceania would not supply Debonaire after the contract ended.

[67] It was around this time that the issue of Oceania cancelling orders because of non-payment arose. The Supply Agreement provided for Oceania to cancel orders in the event of non- or late payment in the following terms:

In the event that: ... Any amount payable by Debonaire to [Oceania] is overdue, or in [Oceania’s] opinion Debonaire is likely to be unable to meet its payment on the due date ... [Oceania] shall be entitled to cancel all or any part of any order or orders with the Debonaire [sic] which remains unperformed, in addition to and without prejudice to its other remedies. ...

[68] It seems that up until mid-August 2007 Oceania had not sought to exercise this power. Indeed, on 13 August Mr Atkin reassured Mr Smith that, as at that date, there had been no deliberation at Oceania as to whether Oceania would continue supply to Debonaire. However, Oceania’s position then changed. In an email of 17 August 2007 Mr Atkin advised Mr Smith that Oceania required an acceptable schedule for outstanding payments and that until the current payment situation was remedied all future orders would have to be paid for before stock was shipped from China.

[69] Around 21 August 2007, Big Save was expressing interest in acquiring stock from Oceania that Debonaire was not paying for.

[70] Sometime in August 2007, Mr Atkin and Mr Smith stepped back to allow Mr Qin and Mr Nattrass to be the point of contact to resolve the issues between the companies. Mr Qin and Mr Nattrass had an extensive phone conversation on 28 August setting out the companies' respective positions and agreeing how to go forward. Amongst other things, Mr Nattrass agreed to confirm payment of some of the overdue amounts by 31 August. Mr Qin sought payment of all of the outstanding payments or Oceania would "stop all deliveries to Debonaire immediately".

[71] It seems that on at least five occasions Oceania diverted to Big Save containers of product that had been intended for supply to Debonaire (under orders 503, 507, 509, 510 and 513). There is something of a dispute as to exactly when Oceania diverted these orders – a matter to which I will return – but in any event it would appear to have occurred sometime between the beginning of September 2007 and the end of November 2007. Thus, in an email to Mr Nattrass dated 30 August 2007 Mr Qin referred to Debonaire's non-payment and stated:

...not supplying Debonaire is not our preference. To reduce further loss of Oceania, we will be forced to find new customers for such stock, which will be in store in NZ.

...

To be honest, all the stock at sea has been redirected to other destinations now. I would like to work through this crisis with you, and resend the stock back to Debonaire as planed [sic] at our own cost. But we are running out of time and we have to get the following [payment issues] resolved today.

[72] Debonaire made a bulk payment for five orders (488, 490-492, 494) on 31 August 2007, and a further outstanding payment (for order 498) on 6 September 2007. Other than that, it made a further five payments (on 3 and 9 September) in order to obtain delivery of the individual orders.

[73] In early September Mr Smith sought confirmation from Mr Atkin that the designs and colours of Debonaire's products would remain exclusive to Debonaire "as per our sales agreement". Mr Atkin stated that they would abide by the contract but that the "colours and papers are not unique to [Oceania]".

[74] Also around this time, Debonaire raised with Oceania a claim for bulk freight costs for transfers within New Zealand, the costs of selling more expensive product at cheaper product prices, losses associated with short supplied parts and the costs of a guarantee label (the subset claims), lost profits from lost sales and the loss of the Big Save relationship. Mr Nattrass informed Mr Qin:

If we can come to an understanding on this matter of exclusivity of product we would have absolutely no claim on the loss of Big Save business. For the record, I am absolutely relaxed about you supplying Big Save, BUT, not with our ranges, as we have a ready market for them if we can guarantee exclusivity to our customers.

It is over this matter that Robert [Smith] has withheld payment. ...

[75] As is apparent, Mr Nattrass was considerably more relaxed about this matter than Mr Smith had been.

[76] On 19 September 2007 Mr Nattrass and Mr Qin met in a further attempt to resolve the issues existing between the parties. Minutes prepared by Mr Qin address Debonaire's subset claims, and indicate that Oceania agreed to cover some of these costs if supported by evidence. The parties also agreed to new payment terms – 30 percent payable when orders were placed and the balance to be paid three working days after receipt of a faxed copy of the bill of lading. After some delay, Mr Nattrass replied to these minutes on 13 October, setting out his view of what had transpired at the meeting. Amongst other things, he expressed the view that all of Debonaire's subset claims were valid and supportable, and stated that Debonaire would fully document those claims.

[77] It seems that the new payment terms were never effected. On 29 September Mr Qin informed Debonaire that production of its orders had been temporarily suspended due to non-payment. Then, on 7 October, he informed Debonaire that Oceania would not release containers until they were completely paid for.

[78] The Supply Agreement lapsed through the effluxion of time on 13 October 2007.

[79] Invoices dated 16 October 2007 from Oceania to Big Save indicate that Oceania re-consigned Debonaire's orders 507, 513 and 509 to Big Save. The shipment dates were 11 September (order 507) and 25 September. They were payable on delivery. Oceania also shipped another order (order 3233) directly to Big Save on 25 October 2007 (as illustrated by an invoice dated 30 October). Another invoice dated 30 October 2007 shows that Oceania re-consigned order 503 to Big Save "payable on shipment". It seems that order 510 was also redirected to Big Save at some date.

[80] After the breakdown of the relationship with Oceania, Debonaire secured a replacement manufacturer in Beijing, and received its first goods from this factory in November 2007. It soon became apparent to Debonaire that the Beijing factory did not have the capacity to meet Debonaire's orders (being able to produce only two to three containers per month). Indeed, Mr Ellis of Smiths City stated that the "rot set in with the sales staff" during the last two or three months in 2007 and in 2008 when Debonaire simply failed to supply. Supply difficulties continued into 2008.

[81] On 10 April 2008 Debonaire's solicitors wrote to Oceania purporting to cancel the Supply Agreement.

[82] In mid 2008, Debonaire located another manufacturer which it used (in addition to the Beijing manufacturer) to source MDF product for Target from 2 September 2008. Debonaire was also approached by the Ouyahuaxu factory directly in April 2008. Debonaire has since sourced a small amount of MDF from that factory.

[83] Based on those findings of fact, I think the following overall factual conclusions can be drawn:

- a) The events in China which affected production from the Shengli Dahao factory, and which ultimately resulted in that factory's closure, were beyond Oceania's control.

- b) The difficulties the Shengli Dahao factory had in meeting its obligation of “timely supply” undoubtedly contributed to problems between Debonaire and its customers. It would appear, however, that those problems had other causes as well, as the evidence is that customers were experiencing supply difficulty from at least the beginning of 2007 and that, moreover, the supply difficulties continued after the contract had expired and, before that, when Oceania cancelled orders (as it was entitled to do) because Debonaire suspended payment.
- c) Debonaire suspended payment (or at least continued to withhold payment) because of its concerns as to Oceania’s compliance with what it saw as the exclusivity provisions of the Supply Agreement. It would appear that, absent that problem, Mr Smith – at least – was confident that the parties could sort out the difficulties they had encountered. Oceania’s willingness to go on supplying product to Debonaire until mid August 2007 and to give Debonaire considerable leeway in complying with the payment terms of the arrangements would appear to indicate that Oceania was of a similar mind.

[84] On 3 December 2008 Oceania was successful in obtaining summary judgment for the purchase price of ten containers it had supplied to Debonaire but for which Debonaire had not paid (order numbers 493, 495-497, 499-501, 505, 506 and 512). Execution of this order was stayed pending further order of the Court once Debonaire’s counter-claim against Oceania is properly resolved in the current proceedings.

The Supply Agreement

[85] The parties disagree as to the proper construction of the Supply Agreement – and/or various provisions in the Supply Agreement – and it is necessary to determine these matters before assessing Debonaire’s various claims.

Separate contracts?

[86] Before me Mr Delany (for Oceania) sought to characterise the relationship between the parties as being comprised of individual and separate contracts for the sale of goods, each being entered into at the time at which Oceania accepted orders placed by Debonaire. Although these contracts were governed by the terms in the Supply Agreement, each was a discrete contract.

[87] This was a new argument. It was not pleaded. In obtaining summary judgment Oceania proceeded on the basis of an entire contract. In these circumstances, it is not open for Oceania now to argue that each order constituted a separate contract. In any event, I have difficulty in understanding the implications of that argument. As a matter of law, I would not have thought that it was necessary to find that there was a series of individual and discrete contracts for relevant provisions of the Sale of Goods Act to apply (as I understood was the impetus for the argument).

Obligation to manufacture?

[88] Debonaire argued that under the Supply Agreement Oceania had accepted an obligation to manufacture MDF furniture components and that, accordingly, it could not rely on events at the Shengli Dahao factory which I have found were outside its control.

[89] In support of this, Debonaire relied on a provision in the Supply Agreement as follows:

SOL will make MDF furniture components in China as defined by Debonaire and supply them to Debonaire in New Zealand, who will then assemble such components into MDF furniture at sites in New Zealand and sell the resultant fully assembled furniture throughout New Zealand. (my emphasis)

[90] For its part, Oceania argued that it was well understood that Oceania did not itself manufacture product, but obtained it from manufacturers in China. It also pointed to other provisions in the Supply Agreement which supported an

interpretation consistent with that understanding. In particular, under the heading “Liability” the Supply Agreement provides:

[Oceania] will endeavour to pass on to Debonaire, the benefit of the manufacturer’s warranty if any, relating to Goods supplied by [Oceania].

[91] In the general section of the Supply Agreement, where the “will make” covenant appears, there is a further description of Oceania’s obligations (what I will refer to as the “operative clause”) in the following terms:

[Oceania] will be responsible for having all goods as ordered by Debonaire, manufactured compliant with the specifications supplied by Debonaire and delivered to them in a timely fashion and in good order, insofar as it is within [Oceania’s] control to do so.

[92] Part of the factual matrix known to the parties at the time the Supply Agreement was entered into was the terms of the Memorandum of Understanding whereby Oceania had, up until that point, supplied MDF componentry to Debonaire. That Memorandum of Understanding is very clear and provides that Debonaire will supply furniture components from China to Debonaire. Moreover, in my judgment, although Debonaire was not aware of all aspects of Oceania’s arrangements within China, I conclude that it would have been aware that Oceania did not itself manufacture the componentry that was being sold to Debonaire. Indeed, Mr Smith at one point in his evidence acknowledged that whether or not Oceania manufactured the product itself was of little concern to Debonaire. As the Supply Agreement shows, what Debonaire was concerned with was Oceania agreeing to procure the manufacture of product, and its subsequent delivery to Debonaire.

[93] I therefore find that the Supply Agreement is properly to be construed as a contract whereby, subject to its terms, Oceania agreed to obtain MDF componentry from China and sell it to Debonaire. Even if that were not the case and Oceania had in some way accepted an obligation to “manufacture” – and indeed owned or in some way controlled the factory at Shengli – then, given events as they transpired, it is difficult to see how that would have made any difference in fact or law.

The operative clause

[94] A further issue is as to the nature of the supply obligation Oceania owed to Debonaire under the Supply Agreement.

[95] Most fundamentally, the Supply Agreement is an agreement for the sale and purchase of goods. That is clear from its terms. In addition to the operative clause noted above, the following two clauses, which in the Supply Agreement follow on from that clause, support that conclusion:

[Oceania] will act the as importer [sic] of the goods into New Zealand thereby taking responsibility for paying initial costs of customs clearance, GST and all other costs necessary to deliver the goods to Debonaire's defined sites unencumbered with cost other than [Oceania's] price.

Any goods supplied by [Oceania] to Debonaire will be supplied on the terms and conditions of this agreement. The only circumstance where any variation to these terms and conditions will apply is where the manager of [Oceania] has expressly agreed in writing to that variation.

[96] In my judgment, the principal obligation of Oceania is as set out in the operative clause. That clause means that Oceania was not responsible for accepting an order for goods from Debonaire unless, at the time the order was placed, Oceania was in a position to obtain the goods so ordered. In other words, Oceania did not accept an open-ended supply obligation under the Supply Agreement. In that context, I think that is the correct interpretation of the phrase "insofar as it is within Oceania's control to do so". Therefore, if Oceania had declined to accept orders from Debonaire when it was within its control to meet those orders, Oceania would have breached its contractual obligation to Debonaire. If Debonaire had sued it for that breach, the obligation would have been on Debonaire to establish that it was within Oceania's control to comply with the order.

[97] More relevantly for Debonaire's claims – given that Oceania accepted orders for goods under the Supply Agreement, but subsequently either did not deliver them in a timely fashion or at all – is the meaning of the phrase "insofar as it is within Oceania's control to do so" in that context. That is, Oceania having accepted an order, the question is whether it can subsequently rely on events being outside its control which prevent it from meeting its obligations.

[98] It seems reasonably clear that if those supervening events, as I will call them, arise after Oceania has accepted an order, then Oceania would not be in breach of its obligation. It is less clear that Oceania could argue that its obligation was substantively limited by the clause where, at the time it accepted an order, and therefore on the face of the Supply Agreement an obligation to deliver in a timely fashion, it already knew it would be unable to meet that obligation.

[99] Debonaire submitted that the operative clause should be construed strictly against Oceania. It submitted that the operative clause is an exemption clause, and that Oceania was its author. Debonaire relied on the following passages in *Chitty on Contracts* (30ed 2008) at paras 14-009 and 14-018:

Construction contra proferentum. This principle of construction embraces two differing, but closely related, principles. First, since the party seeking to rely upon an exemption clause bears the burden of proving that the case falls within its provisions, any doubt or ambiguity will be resolved against him and in favour of the other party. Secondly, as in the case of any other written document, in situations of ambiguity the words of the document are to be construed more strongly against the party who made the document and who now seeks to rely on them.

...

Burden of proof. It is for the party seeking to rely on the exemption clause to show that the clause, on its true construction, covers the obligation or liability which it purports to restrict or exclude. It would also seem that, in general, it is for that party to prove that the claimant's case is within the clause. (footnotes excluded)

[100] I am not persuaded by Debonaire's submission. First, the evidence indicates that Oceania is not accurately considered the author of the Supply Agreement. Mr Atkin's evidence was that Mr Davenport (Debonaire's then General Manager) was the author of the document – admittedly using documents prepared by Oceania as source documents. Mr Smith conceded that the drafting of the Supply Agreement was something he “was not privy to at the start so [he] cannot dispute it”. More generally, he accepted in cross-examination that he was “not privy to everything that Stuart Davenport did” and could not comment on the drafting of the Supply Agreement. Given these circumstances, in my judgment both parties are properly considered to be the author of the operative clause insofar as it is included within the Supply Agreement.

[101] Nor am I persuaded that the operative clause is correctly construed as an exemption clause. In my view, the operative clause is properly construed as a clause which specifies and delineates the scope of the contractual obligations, rather than an attempt to limit Oceania's liability for the non-performance of contractual obligations it would otherwise have. As such, in my judgment the operative clause is more akin to a force majeure clause.

[102] In Treitel *Frustration and Force Majeure* (2ed 2004) at para 12–018, the author compares force majeure clauses and exemption clauses as follows:

Where events occur which are covered by a clause of the kind here under consideration [provisions for supervening events], the party whose performance is prevented or delayed by the supervening events is not in breach at all. In this respect, such clauses differ from exemption clauses, which assume that there has been a breach and exclude or limit liability in respect of it.

[103] The party seeking to rely upon a force majeure clause is required to prove the facts bringing the case within the clause (*Chitty on Contracts* at para 14-140; Treitel at para 12-032). However there is no general principle of strict construction against that party (Treitel at para 12-023).

[104] It seems that a party generally will not be permitted to rely on a force majeure clause if he or she knew, or reasonably ought to have known, of the supervening events that he or she seeks to rely on: *Chitty on Contracts* at para 14-140. On this construction, to rely on the operative clause to substantively limit its obligation to supply orders to Debonaire, Oceania will need to establish that it was not within its control to supply Debonaire by reason of events of which it did not have knowledge at the time of accepting the order.

The liability clause

[105] As noted above, Debonaire claims lost profits as a result of the termination of its relationship with Big Save, lost sales to its principal customers, and Debonaire's inability to capitalise on the opportunity to pick up the ex Funnell business when Funnell closed in May 2007.

[106] The Supply Agreement purports to limit Oceania's liability to Debonaire in terms of the following provisions under the heading "Liability" (the paragraph references are mine):

- a) [Oceania] will endeavour to pass onto Debonaire, the benefit of the manufacturer's warranty, if any, relating to Goods supplied by [Oceania].
- b) The total liability of [Oceania] whether in contract, tort or otherwise for any loss, damage or injury arising directly or indirectly from any defect in or non-compliance of the Goods or any other breach of [Oceania's] obligations to Debonaire will not in any event exceed the purchase price of the Goods complained of.
- c) [Oceania] is not liable for any consequential, indirect or special damage or loss of any kind nor is [Oceania] liable for any damage or loss caused by Debonaire's servants, agents, buyers or by any other person appointed or connected with Debonaire's activities.
- d) Debonaire shall indemnify [Oceania] against any claims by Debonaire's servants, agents or other persons (whether similar to the foregoing or not) in respect of any loss, damage or injury arising from any defect in or non-compliance of the Goods or in respect of any other matter whatsoever.

[107] The provision in (c) above that Oceania "is not liable for any consequential, indirect or special damage or loss of any kind" is clear on its face. It precludes Oceania having a liability for losses of this nature.

[108] Debonaire argued, however, that those apparently plain words were fundamentally flawed by an ambiguity. The ambiguity Debonaire pointed to arose because the provisions of the previous paragraph (b) that refer to the total liability of Oceania "whether in contract ... damage or injury arising directly *or indirectly*" (my emphasis) constituted a recognition that indirect, and therefore consequential, losses could in fact be claimed (to the extent of the purchase price of the goods complained of). This ambiguity was, Debonaire further argued, to be construed against Oceania.

[109] I do not consider this to be an ambiguity as contended for by Debonaire. Paragraph (b) under "Liability" provides a monetary cap on damages. It does so by reference to "the purchase price of the Goods complained of". Where the essential claim is based on an alleged late delivery, and the consequences thereof, the clause – although not particularly elegantly worded – can be understood as placing a

limitation on the liability for that late delivery by reference to the purchase price of the goods that are affected by that occurrence.

[110] The exclusion of liability for consequential loss is, in my judgment, clear and capable of operating independently from the cap on liability contained in paragraph (b). Any overlap between the two paragraphs by reference to the use of the word “indirect” in both paragraphs, does not affect the clear import of the exclusion of liability for consequential loss found in paragraph (c). More specifically, it can be noted that paragraph (c) expressly excludes consequential losses, which are not mentioned in the clause which provides the cap on liability.

[111] Debonaire argued further that paragraph (c) only limits (i.e. excludes) liability for losses under the second limb of *Hadley v Baxendale* (1854) 9 Exch 341 by reason of the line of cases in the English Court of Appeal starting with *Millar’s Machinery Company Limited v David Way and Son* (1935) 40 Com Cas 204 and ending with *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] 1 All ER (Comm) 696.

[112] The *Hadley v Baxendale* test is as to the remoteness of damages, and categorises damages as falling within two limbs. As summarised in *Clarkson v Whangamata Metal Supplies Ltd* [2008] 3 NZLR 31 (CA):

[25] ... The two “limbs” of *Hadley v Baxendale* can be traced to the following statement by Alderson B in that case at p 354:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.”

[26] Thus Alderson B articulated two possible grounds (or “limbs”) upon which plaintiffs could stake their claim: (1) loss reasonably considered to arise naturally from the breach of contract; and (2) loss that could reasonably be supposed to have been in the specific contemplation of the parties when they contracted. In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 (CA) at p 539, Asquith LJ distinguished the two limbs as follows. The first limb is dependent on foreseeability of loss arising from knowledge that is imputed to the parties (because they are assumed to have

knowledge of the ordinary course of things). The second limb is dependent upon knowledge that, it can reasonably be supposed, the parties actually possessed of matters outside the ordinary course of things.

[113] The English Court of Appeal's approach is that, in the absence of any contrary indication in the contract, the dividing line between "direct losses" and "indirect and consequential losses" will be drawn along the boundary between the first and second limbs of *Hadley v Baxendale* – i.e. it defined indirect and consequential losses as being those losses which fall within the second limb only.

[114] It appears that the last reported authority touching on this issue in New Zealand is *Rolls-Royce NZ Ltd v Carter Holt Harvey Ltd* [2005] 1 NZLR 324. In that case the Court of Appeal referred to this line of authority from the English Court of Appeal and counsel's arguments for and against following that line in New Zealand (see [140] to [154]). Amongst other things, the Court noted the submission of Mr Williams QC that "the English approach is inconsistent with the ordinary meaning of the words as understood by the public and contracting parties and, in any event, the boundary between the first and second limbs of *Hadley v Baxendale* may be difficult to draw", and, on the other hand, that the Australian Courts had adopted the English approach: *Frank Davies Pty Ltd v Container Haulage Group Pty Ltd (No 1)* (1989) 98 FLR 289 and *GEC Alsthom Australia Ltd v City of Sunshine* (Federal Court of Australia, 60/96, BC 9600288, 20 February 1996) (cf. [119] below). However, the Court held that it was inappropriate to determine this issue in the context of an application for strike out, as was before the Court.

[115] Since then, the Court in *Finance Now Ltd v Finzsoft Solutions (New Zealand) Ltd* HC AK CIV 2006-404-4398 17 September 2007 also declined to determine the issue in another strike out proceeding.

[116] *McGregor on Damages* (17ed 2003) takes issue with the line of English Court of Appeal cases (at paras 1-037 to 1-039). The author of that text prefers a wider definition of consequential losses as follows:

The normal loss is that loss which every claimant in a like situation will suffer; the consequential loss is that loss which is special to the circumstances of the particular claimant. In contract the normal loss can generally be stated as the market value of the property, money or services

that the claimant should have received under the contract, less either the market value of what he does receive or the market value of what he would have transferred but for the breach. Consequential losses are anything beyond this normal measure, such as profits lost or expenses incurred through the breach, and are recoverable if not too remote. The distinction is not the same as that between the first and the second rules in *Hadley v Baxendale*: a consequential loss may well be within the first rule. (at para 1-036, footnote excluded)

[117] The author opines that it is “illogical and fails to make practical sense to confine consequential loss in contract to loss falling within the second rule in *Hadley v Baxendale*, being contradictory for one contracting party to communicate special circumstances to the other so as to fix him with a liability for loss to which he would not otherwise be subject and at the same time to accept an exclusion of liability in respect of the selfsame loss” (at para 1-038, footnote excluded). However the author notes the weight of authority against this view and concludes:

What is proposed is that the term consequential loss should be construed narrowly where exclusion clauses are concerned by resort to the *contra proferentum* rule and widely in all other cases.

[118] In *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] BLR 235 at [10] the English Court of Appeal expressly rejected the above criticism (as propounded in an earlier edition of *McGregor on Damages*).

[119] In Australia, however, the Victorian Court of Appeal has since taken a different view in *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* (2008) 19 VR 358; [2008] VSCA 26. In that case the trial Judge had interpreted “consequential losses” in an exclusion clause to mean loss within the second limb of *Hadley v Baxendale* (based on the English line of authority). The Court of Appeal disagreed. Nettle JA, with whom the other members of the Court concurred, held that “the true distinction is between ‘normal loss’, which is loss that every plaintiff in a like situation will suffer, and ‘consequential losses’, which are anything beyond the normal measure, such as profits lost or expenses incurred through breach” (at [87]). He agreed with *McGregor on Damages* that the conception of consequential loss should be restored to “the natural meaning of which commercial and legal usage in exclusion clauses has long since robbed it” (at [90] and [91], citing *McGregor on Damages* at 1-038 and 1-039). He concluded (at [93]):

In my view, ordinary reasonable business persons would naturally conceive of 'consequential loss' in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach. ... It follows as I see it that, although the judge's approach in this case was in accordance with the English cases, it was not correct to construe 'consequential loss' as limited to the second rule in *Hadley v Baxendale*.

[120] There is no binding authority on the meaning of “consequential losses” in this context in New Zealand. As noted, Courts in New Zealand have declined on two occasions to consider the point (albeit in the context of strike out applications). Moreover I note that the highest Courts in England and Australia have not yet considered the issue. In *Caledonia North Sea Ltd v British Telecommunications plc* [2002] 1 Lloyd’s Rep 553 (HL) Lord Hoffmann expressed a “wish to reserve the question of whether...the construction adopted by the Court of Appeal was correct” (at [100]).

[121] In my view it is preferable, as found by the Victorian Court of Appeal, to consider the ordinary commercial meaning of the term “consequential losses” in the context of the particular contract. That is, I do not consider it particularly helpful to adopt the conceptual distinction used in *Hadley v Baxendale* to explain the type of damages that may be recoverable for breach of contract. Rather, I think this is a matter that should be determined in a particular contract on the basis of the now well-established interpretational principle acknowledged by our Courts, most particularly in *Boat Park Ltd v Hutchinson* [1999] 2 NZLR 74 (CA). I acknowledge that there would appear to be some difference of view as to when recourse can be had to the matrix of facts to interpret a contractual term that would appear clear on its face. Given the difficulty, over time, of interpreting the concepts of “direct”, “indirect” and “consequential losses”, I do not think that debate is relevant where those difficult terms fall to be interpreted. Moreover, here, the meaning of the terms “indirect” and “consequential loss” is in my view clear from looking at those terms within the context of the particular contract entered into by Oceania and Debonaire.

[122] Oceania had no obligation to supply any particular quantity under the Supply Agreement. Instead, the obligation was to supply those orders placed by Debonaire and which Oceania accepted. Oceania was not obliged to accept orders when it was not within its control to supply them in a timely fashion. Even if it did accept an

order, it was not obliged to supply if supervening events – outside its knowledge at the time it accepted the order – meant that timely supply was not within its control. Even if Oceania did have an obligation to supply, and breached that obligation, its liability is limited to the purchase price of the goods complained of. For its part, Debonaire made no contractual commitment to Oceania as to the frequency with which, and the amounts in which, it would order goods from Oceania.

[123] Moreover, and although Mr Smith expressed the view that the Supply Agreement gave Oceania the exclusive right to supply Debonaire, such a right was not included on the face of the Supply Agreement. In other words, it would appear that Debonaire could have chosen to procure MDF product from other sources at its discretion.

[124] In this context, I am satisfied that the ordinary and natural meaning of the exclusion of liability for “indirect and consequential losses” in paragraph (c) covers all losses other than those arising directly from, or immediately associated with, the obligations that Oceania has taken on – namely, and as relevant, to supply the goods in the orders it has accepted, and not to sell goods to other distributors within New Zealand in breach of the exclusivity provisions.

Breach of contract – timely supply

[125] Oceania accepted that it failed to deliver orders in a timely manner from and including when the factory closed and after Chinese New Year. On Debonaire’s part, Mr Smith essentially accepted that position (i.e. that orders were timely until this time).

[126] Given this basic agreement, the issue becomes when Oceania became aware of the problems such that it cannot rely on the operative clause to limit its obligation to supply the orders it accepted from Debonaire after that time. As noted above, it is on Oceania to bring itself within the terms of the limitation contained in the operative clause.

Oceania's knowledge of supervening events

[127] It is not entirely clear when Oceania, as a contracting entity separate from the Shengli Oil Fields conglomerate, is properly regarded as having been aware of the difficulties faced by the Shengli Dahao factory.

[128] To assess Oceania's knowledge, it is useful at this stage to say something more of the persons involved in the operation of Oceania. The current directors of Oceania are Mr Atkin and Ms Weihua Kang. Ms Kang is Mr Qin's mother, and replaced him as a director in June 2006 for unspecified "family reasons". She lives in Dongying in the Shandong Republic of China. In addition, a Mr Wu, Mr Bu and Mr Ran were appointed directors of Oceania in May 2004 and a Mr Liu in September 2006 (the Chinese directors). The four Chinese directors were still recorded as directors of Oceania on a Companies Office record dated 16 July 2007. They appear to have resigned at some point after this date. As noted above, Mr Qin (although resident in New Zealand and Australia) was Oceania's "Chief Executive Offshore". As such, he travelled to China relatively frequently (for example, around five to seven times in 2007).

[129] Mr Qin stated in cross-examination that he had no interest in either the Shengli Dahao factory or Ouyahuaxu factory (and this was confirmed by Mr Atkin). He gave evidence, however, that Mr Bu – who he said was the chairman of Oceania's board – was a director (and "the head") of the Shengli Goods and Supply Department (the department associated with the Shengli Dahao factory) and that Mr Ran was the deputy director. Neither Mr Atkin nor Mr Qin could say whether the other Chinese directors of Oceania were associated with the Shengli Dahao factory.

[130] Mr Atkin's evidence was that he did not know that the Shengli Dahao factory was going to close until it had done so, and there does not seem to be any evidence to contradict this. It is clear, however, that he knew of the closure by 26 April at the latest.

[131] I do not think, given the general lack of evidence on this point, that it is useful or necessary to speculate when any of Mr Bu, Mr Wu, Mr Ran or Mr Liu may

have received knowledge of the April 2006 directive in such a way that that knowledge could properly be attributed to Oceania.

[132] I have reached the view, however, that Mr Qin – and very probably at least some of the Chinese directors – must have known of the problems, and particularly the labour problems, that the restructuring of the Shengli Oil Fields complex was causing for the Shengli Dahao factory prior to the closure. As noted, these effects were being felt by December 2006 and it is not credible that the Chinese directors and/or Mr Qin were not aware of these problems (and the disruption they were causing) from a relatively early stage.

[133] I am therefore persuaded that Oceania had knowledge of the difficulties in the Shengli Dahao factory which meant it was unlikely to be able to supply goods in a timely fashion, by, at latest, the time that it accepted the first orders which were not so supplied – i.e. by 30 January 2007 (see [39] above). Consequently Oceania has not brought itself within the limitation contained in the operative clause in respect of those orders.

Debonaire's knowledge

[134] I have further considered whether Debonaire's knowledge of the problems in China is of relevance to the issues to be decided in this case. That is whether, in placing orders with knowledge of the supervening events, Debonaire could be said to have acquiesced or accepted the likely variation to supply terms, and in particular Oceania's timely supply obligations.

[135] The basis for such an argument is clear enough. The basic role of force majeure clauses in commercial contracts is to preclude liability where unexpected or uncontrollable events affect the performance of contractual obligations. Where such an event occurs, and the parties continue to deal with each other notwithstanding, there will often be a reasonable inference that they have explicitly or implicitly agreed to vary their contract terms.

[136] As will be seen, however, my ultimate conclusion in these circumstances, is that it is not delay per se for which Oceania is to be held liable, but rather its failure to ever deliver certain orders placed by Debonaire.

[137] On that basis, it is not necessary for me to determine whether or not the parties agreed to varied terms of delivery. I am quite satisfied that they did not agree that Oceania would not be liable if it failed to deliver at all, notwithstanding the difficulties in China.

Debonaire's non-payment

[138] The extent to which Oceania was in breach of its obligation of timely supply is, however, limited as a result of Debonaire's non-payment.

[139] As noted above, the Supply Agreement clearly permitted Oceania to cancel orders in the event of late or non-payment by Debonaire. Therefore, from the time that Debonaire withheld payment in breach of the contract, Oceania was entitled to decline to accept, or to cancel, orders under the Supply Agreement. As already noted, however, it seems that Oceania did not insist on strict compliance with the 100 day payment date in light of its own inability to deliver within the expected time. Although Oceania would have been entitled to cancel orders from 29 May, the evidence establishes that Oceania did not in fact do so until mid August 2007.

[140] On 17 August Mr Atkin advised Mr Smith that, due to Debonaire's non-payment, Oceania would not supply any further orders to Debonaire until the payment position was resolved. In effect, it cancelled the pending orders. Thus, for orders due to be shipped after this date, i.e. those placed within 21 days of 17 August (orders 519 and following), namely on or after 28 July, Oceania was never in breach of its obligation to deliver in a timely fashion.

[141] Oceania also cancelled those orders it had accepted before 28 July, but which had not yet been delivered. All of these orders were due to be shipped between mid March and the end of May. Therefore, by 17 August – and indeed by the time Debonaire stopped paying – Oceania was already in breach of its obligations in

respect of those orders, as discussed above. Its subsequent cancelling of those orders does not negate its existing breach.

Conclusion

[142] I am satisfied that, for orders accepted by Oceania between (at latest) 30 January 2007 and 28 July 2007 (orders 493 to 518), Oceania had sufficient knowledge of the problems in China that it cannot bring itself within the limitation contained in the operative clause to substantively limit its obligation of timely supply. Insofar as those orders were not delivered, or not delivered in a timely manner, Oceania was in breach of the terms of the Supply Agreement.

Breach of contract – exclusivity

[143] Debonaire also alleges that Oceania breached its obligation of exclusivity as contained in the Supply Agreement in the following terms:

[Oceania] will not to sell [sic] to any distributor in New Zealand, other than Debonaire, any Category 1 Goods without the express written agreement of Debonaire.

[Oceania] will not sell to any distributor in New Zealand, other than Debonaire, any Category 2 Goods unless:

1. Debonaire choose to cease offering and promoting these goods to the marketplace or
2. Debonaire fails to achieve distribution of the products.

[Oceania] is not restricted as to where Category 3 Goods may be sold.

[144] The categories of goods are explained further under the heading “General” as follows:

[MDF furniture] components whether they be separate components or assembled into furniture are hereinafter referred to as “Goods” and fall into “3 Categories” being:

1. MDF furniture components for product ranges first manufactured by Debonaire.
2. MDF furniture components for product ranges that Debonaire introduces to the marketplace that [Oceania] assists with the development and supply of.

3. Other MDF furniture components where Debonaire has not been involved in the development and supply of.

[145] Considerable time was given in evidence as to whether or not a range of MDF furniture known as the *Kingston* range produced by Oceania for Debonaire was the exclusive product of Debonaire. At the centre of this dispute was whether the so-called “Hunter Hills” paper used in that range was Debonaire’s proprietary product. In cross-examination, Mr Atkin conceded that the *Kingston* range was a category 1 good. At the same time, Mr Smith acknowledged that Oceania had helped procure a supply of the relevant paper from China, to replace the foil-based product previously used by Debonaire in New Zealand. In fact, Mr Smith acknowledged that Oceania paid \$18,000 for the development of that product. On that basis I do not think it is possible for Debonaire to argue that, as between itself and Oceania, the paper was its intellectual property as it were. Nevertheless, and as acknowledged by Mr Atkin, the *Kingston* range in terms of the Supply Agreement would appear to have been a category 1 good, and I proceed on that basis. In any event, I note that had the *Kingston* range been a category 2 good – by virtue of Oceania’s assistance in the obtaining of the paper – there was no suggestion that Debonaire chose to cease offering that product or failed to achieve distribution, such that Oceania would have been entitled under the above clause to sell to other distributors in New Zealand.

[146] In assessing whether there was a breach in this respect it is useful to note a particular characteristic of the MDF furniture market. That is – as was accepted by the parties – the market is characterised by largely similar products (and indeed reverse engineering) because of the limited ways in which the furniture can be reconfigured. Therefore product similarity is to be considered in that context.

[147] Debonaire sought to show a breach by Oceania of the exclusivity provision in two respects. First, Debonaire submitted that Oceania supplied category 1 goods directly to Big Save during the term of the Supply Agreement. Secondly, Debonaire alleged that Oceania promoted category 1 and 2 goods to other New Zealand distributors at the Shanghai furniture show in September 2007.

[148] In my view the evidence indicates that the stand at the Shanghai furniture fair was not being run by or on behalf of Oceania. Moreover, there is no indication that

the furniture show led to any sales to “any distributor in New Zealand” such as to be in breach of the exclusivity provision. Indeed, Mr Smith accepted in cross-examination that there was no evidence of Oceania selling product to anyone other than Big Save in breach of the Supply Agreement.

[149] The second alleged breach of the exclusivity clause was in selling Debonaire product directly to Big Save during the term of the agreement. Although it was suggested by Mr Delany in closing submissions that Big Save was not a distributor – such that selling to Big Save was not breach of this provision – I am persuaded that the proper interpretation of the exclusivity clause, in context, was that the clause covers supply from Oceania directly to Big Save. That Oceania itself construed the clause in this way is evident in the emails between Oceania and Debonaire at the end of July 2007.

[150] Debonaire relied on the emails between Mr Atkin and Mr Smith, and between Mr Atkin and Mr Qin, at the end of July 2007. It also placed reliance on “order 3233” shipped by Oceania to Big Save on 25 October 2007. It was Mr Smith’s contention that, with the necessary lead time, Oceania had to have accepted that order before the end of the Supply Agreement.

[151] Mr Atkin stated that Oceania “did not enter into any deals with Big Save until the Supply Agreement and relationship with Debonaire had ended”, but conceded that Oceania *had* diverted and sold to Big Save a number of containers after Debonaire had continually refused to pay for them, and in mitigation of its losses..

[152] Mr Qin confirmed that Oceania supplied product to Big Save that Debonaire had refused to pay for. His evidence was to the effect that this occurred in relation to five containers on the water when the Supply Agreement came to an end. In contrast to this, however, is the email he sent to Mr Nattrass on 30 August 2007, in which he stated that “all the stock at sea has been redirected to other destinations now” (see [71] above).

[153] It is also clear that by 21 August Oceania had been in contact with Mr Davenport at Big Save as to the possibility of Big Save taking containers which

Debonaire would not pay for. I am not persuaded that that contact was “unsolicited” as alleged by Mr Atkin.

[154] In my view the evidence does not establish that Oceania supplied Big Save generally before the end of the Supply Agreement, let alone that it did so in breach of the exclusivity provisions. The correspondence referred to establishes, at most, a willingness on Oceania’s part to supply Big Save to the extent that the Supply Agreement permitted.

[155] As to the diverted containers and order “3233”, the Supply Agreement precluded Oceania from “selling” to other distributors in New Zealand. A “sale” occurs where, under a contract of sale, the property in the goods is transferred from the seller to the buyer, or, under an agreement to sell – where the transfer of the property in the goods is to take place at a future time, or subject to some condition – the time elapses or the conditions are fulfilled (see s 3 of the Sale of Goods Act 1908). Property passes when the parties intend it to pass, as ascertained by the terms of the contract, the conduct of the parties, and the circumstances of the case (s 19). Oceania invoiced Big Save for containers diverted to it by reference to Debonaire’s original order numbers. By reference to those orders and the shipping terms (variously FIS and FOB recorded thereon), and/or the dates on which the orders were shipped, I am satisfied that the product in two orders (507 and 510) was sold to Big Save in breach of the exclusivity clause. I reach that conclusion because, by reference to the sales terms (where available), and the date of shipment, I consider that property would have passed to Big Save prior to the expiry of the Supply Agreement. I am not satisfied that property in the other three orders diverted to Big Save (503, 509, and 513), or in order “3233”, would have passed before that date.

[156] I have considered whether the basis upon which I reach that conclusion involves an unnecessarily narrow interpretation of the word “selling”. For example, would it be more commercially realistic to construe the restriction on Oceania as precluding it from agreeing to sell? On reflection, I consider that it is not. The exclusivity clause was clear and operates to protect Debonaire during the term of the contract. Here, prior to the expiration of the contract, significant payment difficulties had arisen. Principally because of those difficulties, Oceania had

concluded that it would not extend the contract. It may also have been attracted by the possibility of supplying Big Save direct, but in my view if the relationship with Debonaire had remained on satisfactory terms, that would have been unlikely. Therefore, that Oceania took steps that meant it was in a position to sell goods to Big Save shortly after the Supply Agreement expired, does not, in my view, indicate a breach of that contract.

[157] Oceania argued that, in any event, the exclusivity provisions in the contract cannot apply to prevent Oceania mitigating its loss by disposing of stock on hand. It says that it had a duty to mitigate the losses arising from Debonaire's failure to pay.

[158] I was not referred to any authority for the proposition that a party may act in breach of its contract to mitigate its losses caused by the breach of the other party, in a situation where, as here, the contract is ongoing. Nor, through my own research, could I find any authority on point. On general contractual principles, following repudiation of a contract, the innocent party is entitled to elect whether to affirm or cancel the contract. The concept of mitigation is only legally relevant after cancellation of a contract: *Wood Factory Pty Ltd v Kiritos Pty Ltd* (1985) 2 NSWLR 105 at 114. If the contract is affirmed, it remains in force and each party is bound to perform its obligations as performance falls due: *Holmes v Booth* CA258/92 12 May 1993 at 14-16. In the present case, therefore, actions inconsistent with the exclusivity clause will amount to a breach of the contract unless the contract was (implicitly or expressly) cancelled, at which point the actions could be regarded as acts in mitigation of the other party's breach entitling the cancellation. There is no evidence – or, indeed, suggestion – that Oceania cancelled the Supply Agreement at any time.

The losses claimed

Loss of Big Save contract

[159] The reason Big Save gave on 30 July 2007 for terminating the relationship with Debonaire (with effect from 1 November) was Debonaire's inability to supply

in a timely manner. As noted, Mr McKimm's evidence at trial was unsatisfactory. In my view it was Mr Smith who threw most light on this matter.

[160] It would appear that, as of 1 July, Big Save had decided to purchase MDF componentry directly from offshore suppliers and had contracted with Mr Davenport – who had clearly left Debonaire on less than amicable terms with Mr Smith – to do so. In answer to questions from the Court, Mr Smith acknowledged that the likelihood of Mr Davenport sourcing MDF for Big Save from Debonaire was low:

Q. Was your sense that the relationship between Stuart [Davenport] and [Debonaire] and associates at that time, would that have meant it was likely or unlikely that [Mr Davenport for Big Save] would source [MDF] from you?

A. Well, he wouldn't have been able to source it from us because our margin and I guess what they were wanted to do was eliminate our margin out of the cost of that product, so he certainly wouldn't have been able to source from us.

Q. Irrespective of that, would he have chosen to deal with you, or was your relationship with him such that it would be unlikely he would choose to deal with you?

A. It was highly unlikely.

Q. Highly unlikely?

A. Yes.

[161] On that basis, I find that Debonaire has not established that the admitted supply difficulty caused Big Save to terminate its relationship with Debonaire, as it appears that it would have been brought to an end in any event – regardless of Oceania's supply to Debonaire or, indeed, any breach of the exclusivity provisions. Moreover, as to the latter, I note that Big Save gave notice that it was going to end its relationship with Debonaire at a time prior to the breaches of the exclusivity provisions I have found to be established. Therefore, no question of liability can arise in this respect.

Opportunity to obtain Funnell business

[162] Debonaire also claims loss of profits by reference to what it said was its inability to capitalise, and pick up new business – particularly the North South

business, and to a lesser extent Harvey Norman and Farmers Trading Company – when its competitor Funnell closed doors in May 2007. It argued that the missed opportunity to make profits on those sales was a loss that Oceania was liable for.

[163] Considerable evidence was adduced as to the competitiveness of the MDF furniture market in the first half of 2007, and as to the likelihood of Debonaire obtaining a significant share of the ex Funnell business. As best as I can tell, it seems likely that, had Debonaire been able to obtain reliable supply from Oceania from May 2007, Debonaire would have obtained at least some of the ex Funnell business, and in particular, some of the business from North South.

[164] However, I am not persuaded that this loss was within the reasonable contemplation of the parties at the time of entering into the contract in October 2005 – i.e. that the loss was within either limb of the rule in *Hadley v Baxendale*.

[165] Mr Atkin’s evidence was that “[t]he extra supply of product that would have been necessary to do the business Debonaire now claims it lost future profits for was not contemplated when we entered the Supply Agreement”, and that Oceania may not have been able to supply that product at a viable price. Mr Smith accepted in cross-examination that there was no discussion at the time of entering the contract with Oceania as to the number of containers that were to be supplied by Oceania to Debonaire. It is therefore clear that, at the time the contract was entered into, the loss of this opportunity was not within the parties’ specific contemplation. Nor is it a loss reasonably seen as naturally arising. The loss of the opportunity is therefore too remote in terms of the *Hadley v Baxendale* test.

[166] In any event, had the lost opportunity not been too remote, I am satisfied that it would have been excluded as “consequential losses” under paragraph (c) of the liability clause, regardless of which meaning is ascribed to that term.

[167] Lastly, I am also of the view that there would have been problems of causation in establishing this claim. The fundamental allegation is that the delay in supply was the operating breach of contract that precluded Debonaire from obtaining supplies that it was otherwise entitled to from Oceania. With one exception, there is

no evidence that Debonaire ordered any additional product from Oceania from which it might have grown new relationships with the ex Funnell customers. Moreover, at the relevant time – that is, from around May 2007 onwards when Funnell ceased supplying – it was clear to both Debonaire and Oceania that Oceania’s ability to supply from China was severely constrained, with the result that Oceania would not have had any obligation to accept further orders.

[168] In general, therefore, I do not think any loss of opportunity to supply the North South group, Harvey Norman and/or Farmers Trading Company is a matter for which Oceania can be liable.

[169] It is clear that Oceania did accept two orders from Debonaire for componentry intended to meet an order placed with Debonaire by North South on 12 April 2007 (orders 506 and 507). Order 507 was never supplied (I deal with Oceania’s liability for that supply below at [171] to [178]). (Order 506 was supplied but it appears that it was used by Debonaire to meet other demands.) Even if order 507 had been supplied, Debonaire was not in a position to obtain any further orders placed by North South from Oceania (or indeed from anywhere else). In these circumstances, the failure of Oceania to supply that one order was not in itself causative of Debonaire missing out on an opportunity to build a supply relationship with North South.

[170] I therefore find that Debonaire is not able to recover for the loss of the opportunity to supply the ex Funnell customers.

Lost sales

[171] As I understand it, Debonaire claims both for direct loss of profit and lost profit caused by damage to its reputation with its principal customers because of Oceania’s breaches of the Supply Agreement. The latter is expressed as arising not only from Oceania’s actions during the term of the Supply Agreement, but also from the difficulties Debonaire faced in obtaining sufficient supply after the contract ended.

[172] It seems reasonably clear that where Oceania had an obligation to deliver product in a timely fashion and has failed to deliver the product at all, it should be liable for the direct profit Debonaire lost as a result of that failure (orders 502, 503, 507, 509-511 and 513). There is no indication that Debonaire's direct profit on orders that were supplied belatedly was diminished as a result of those delays.

[173] Loss of direct profit suffered by Debonaire as a result of lost sales caused by failure to supply the componentry for those sales is clearly a loss which arises naturally from a breach of Oceania's obligation of timely supply. In terms of the liability provisions, therefore, Oceania's liability in relation to such losses is not excluded (but is limited to the purchase price of the goods complained of).

[174] Secondly, as noted above, there is evidence that supply from Debonaire to its customers was erratic and untimely, and that it became worse during the early to mid part of 2007. Although there may have been other factors at play, I am persuaded that Oceania's breach of its obligation to supply in a timely fashion was *a* cause of this progressive deterioration. As a result, it seems that, for example, Target cancelled orders with Debonaire, and Smiths City stopped advertising Debonaire products, such that Debonaire would have missed out on sales. In essence, Oceania's breach caused damage to Debonaire's reputation with its principal customers such that it received fewer orders from them, so missing out on the profits it could have otherwise obtained.

[175] It would appear, however, that for some time after 30 January 2007 – and even after the breach was likely to first start affecting Debonaire's customers on 10 April 2007 (see [39] above) – Debonaire did not order fewer containers from Oceania. Leading into 2007, it ordered on average 4-6 containers per month. Taking account of the large number of orders placed in January and February, by the end of May 2007 Debonaire had ordered on average 6.4 containers per month, and by the end of July 2007, 4.9 containers per month. These orders were either supplied, and the profits obtained, or the lost profits have already been taken into account.

[176] Beyond this, I accept that damage to Debonaire's reputation with its principal customers resulted in those customers placing fewer orders with Debonaire for the remainder of the 2007 calendar year and into the 2008 calendar year. However, during this time Oceania was under no obligation to supply product to Debonaire – both because it was not within its control to do so and because it had elected to cancel orders from Debonaire as it was entitled to do under the Supply Agreement. Moreover, the Supply Agreement then came to an end. There was no real evidence that Debonaire would have been able to obtain an alternative source of supply before November 2007. Therefore, insofar as Oceania's slow delivery during the period of breach – i.e. before 28 July 2007 – damaged Debonaire's reputation with its principal customers, with flow on effects into the future, the damage to its reputation would have arisen from 28 July in any event due to Debonaire's inability to supply from that point. At that stage, Oceania was not in breach in not supplying Debonaire. Therefore, it cannot be said that but for Oceania's breach, Debonaire would not have lost its reputation for reliable supply and consequently business with its principal customers. For these reasons, I find that Oceania's breach did not cause this loss to Debonaire.

[177] Moreover, and in any event, I am of the view that this loss would have been excluded as "consequential losses". Taking the ordinary commercial meaning of the term "consequential losses", it is my judgment that lost profit on the loss of sales flowing from damage to Debonaire's reputation caused by a breach of the Supply Agreement, is covered by the limitation of liability. It is not a loss which arises directly from, or is immediately associated with, Oceania's breach, but is, in essence, a flow on, or indirect and consequential, effect.

[178] Lastly, insofar as it was argued, Oceania cannot be liable (on the terms of the Supply Agreement) for problems Debonaire had in obtaining reliable supply after 13 October 2007.

Conclusion on breach of contract

[179] I have found that Oceania's liability for breaching its supply and exclusivity obligations under the Supply Agreement is limited to the direct profit Debonaire

would have received on the orders that Oceania was obliged to supply in a timely fashion but did not supply at all.

[180] I am not in a position to quantify the damages payable by Oceania to Debonaire with respect to that finding. Although there was some evidence of the price to Debonaire for those container loads, there was no evidence of the sale price to Debonaire's customers nor any evidence of sale costs that would have to be taken account of in calculating the loss of profit on those missed sales. It may, however, be that the parties are able to reach agreement between them, in terms of the comments I now make.

[181] Mr Lazelle calculated Debonaire's lost profits by reference to overall sales or revenue figures and the application of a "gross margin". My understanding is that a similar approach should be applied to the revenue Debonaire would have realised in selling goods not delivered to it in order to calculate its lost profits, and therefore the damages payable to it by Oceania.

[182] Mr Lazelle's methodology for calculating Debonaire's lost profits was broadly accepted by Mr Purcell, save in two particular regards. Taken overall, and as recorded in exchanges with counsel and the Court, Mr Lazelle and Mr Purcell acknowledged that the difference between them can be summarised in that, whereas Mr Lazelle considered that for the purposes of his loss of profits calculation a margin of 22.5 percent was appropriate, Mr Purcell's view was that the appropriate margin was 16.5 percent.

[183] The difference in outcome was the result of different approaches taken by each of Mr Lazelle and Mr Purcell to the freight and commission elements of their calculations. Given the relatively small differences involved, I would propose that damages be calculated by reference to the mid-point of those two margin calculations, namely 19.5 percent.

[184] If my understanding of the relevance of the margin calculations provided by Mr Purcell and Mr Lazelle to the damages I have awarded is incorrect, or the parties

are otherwise unable to agree on my proposal, then inevitably further submissions will be required.

Subset claims

[185] As stated above, Debonaire also claims discrete amounts in respect of a series of agreements it says were made with Oceania in respect of difficulties arising under the Supply Agreement (\$49,767.30), short-supplied MDF componentry which it says it paid for (\$17,330.96), and “dead or deficient” stock left in its possession after the termination of the Supply Agreement (\$56,825.97) and storage costs in respect of that stock (\$13,889.00 as at 30 April 2009).

Agreed amounts

[186] Debonaire claims that Oceania agreed to meet the costs of freight to move unassembled stock from one assembly point of Debonaire to another to meet customer requirements (\$1,560.00); the loss on more expensive stock supplied by Debonaire to meet customer requirements for a cheaper product range during the period of supply disruption (\$43,654.00); one half of the design and printing of a guarantee label (\$1,024.80); and loss it alleges it suffered as a result of the supply of defective stock (\$3,528.50). Oceania admits the quantum of the amounts claimed under this head but denies that Debonaire is entitled to the credits claimed, either because it did not agree as alleged or because Debonaire failed to provide evidence of the expenditure.

[187] Mr Smith’s evidence was that Mr Atkin agreed that Oceania would meet each of these losses. As to the freight costs, he said that he received an assurance from Mr Atkin prior to them shipping the product around New Zealand. He said that he and Mr Atkin discussed the lost profit on the expensive stock supplied as cheaper stock at a meeting in Petone. He said that he and Mr Atkin also agreed that Oceania would bear the cost of the defective stock sold as seconds and half the costs of the guarantee label and that Oceania was notified at the time of the initial cost of the guarantee label and he forwarded Mr Atkin the estimated quotes.

[188] Mr Atkin stated that he did not agree to pay the difference where Debonaire supplied more expensive stock for cheaper stock. He admits that he did agree to meet the costs of relocating product within New Zealand provided the need to do so was caused by Oceania and the claim was supported for evidence, which he says it was not. He also accepts that he agreed to pay half of the costs of the guarantee label “as a possible future enhancement for one of Debonaire’s new customers” but that Debonaire failed to provide Oceania with any advice or evidence of this having been commenced or priced. As to the alleged defective stock he says that no details of this alleged loss have been provided and Oceania made it known that it would take back and credit Debonaire for any faulty pieces.

[189] Mr Qin’s minutes in relation to the 19 September meeting correspond with Mr Atkin’s evidence. As noted above, however, Mr Nattrass replied to those minutes contending that Debonaire’s claims were valid and supportable. Mr Smith said that Mr Qin and Mr Nattrass were not privy to the communications between Mr Atkin and himself at which the agreements were reached.

[190] There is some independent evidence which is consistent with Mr Smith’s claims. Documentary evidence indicates that Debonaire did in fact supply more expensive stock to Big Save in place of a cheaper range (see, for example, [60] above and also an email of 25 June). As to the guarantee, in an email exchange between Mr Smith and Mr Atkin on or around 10-12 May 2007, Mr Atkin gave prima facie approval to Mr Smith engaging with “Lime Design” with respect to “a 5 year warranty for the MDF which [Mr Atkin] agreed to” and for which Mr Smith was “hoping [Mr Atkin] would look at contributing 50% of the cost of getting these swing tags done”. In a subsequent email exchange around 17-19 July Mr Atkin approved a proof for the guarantee label. There is also a “final invoice” from “Lime:design”. The bundle of documents includes significant correspondence from Debonaire to Oceania flagging defects in product supplied (e.g. 27 faulty tops were apparently delivered on 20 March 2007 and Debonaire notified Oceania on 5 April) and, in my view, it is reasonable for Debonaire to have used these components to try to satisfy its customers (rather than returning them to Oceania) in the circumstances of the disrupted supply from Oceania.

[191] Looking at these matters overall, I am persuaded by Mr Smith's evidence that Debonaire did bear the costs that are claimed and that Oceania agreed to meet them. There is considerable evidence supporting the guarantee label claimed. Whilst there is less (independent) evidence supporting the other claims, it is in my view reasonable that Oceania would have agreed to bearing these costs in the circumstances of its disrupted supply to Debonaire during this period. Moreover, and although not pleaded in this way, it is my view that these costs were essentially those arising directly out of Oceania's breach of its obligation of timely supply such that they are properly claimable.

[192] I therefore find in Debonaire's favour on these claims.

Short-supplied componentry

[193] Under this head Debonaire contends that Oceania short supplied MDF components to it in specified containers (under order numbers "492, 494/488, 493, 495, 498, 500, 504, 506, 507, 508, 512, 514 and 516") to a value of \$17,330.96. Debonaire contends that it has paid some of this amount to Oceania and the balance is included in the summary judgment sum, and that it is entitled to a credit for this amount. Oceania says that Debonaire had a reasonable time to inspect the goods and did not raise any claim in this respect within the permitted time.

[194] Where goods are short supplied in a contract for the sale of goods the purchaser may reject them. If, however, the goods are accepted by the purchaser, they must be paid for at the contract rate: s 32 of the Sale of Goods Act 1908. Acceptance occurs when the goods have been delivered to the purchaser and he or she does any act in relation to them which is inconsistent with the ownership of the seller, provided a reasonable opportunity to inspect has occurred, or when after the lapse of a reasonable time the purchaser retains the goods without intimating to the seller that he or she has rejected them: s 37.

[195] However, s 32(4) specifies that this is subject to any agreement between the parties. The Supply Agreement provides for claims for short delivery until the

expiry of 100 days of delivery, with delivery defined as occurring when the goods are received at the place defined in Debonaire's order.

[196] On the evidence before me, the alleged losses were first raised with Oceania in an email from Mr Nattrass to Mr Qin (incorporating an email from Ms Fan) and then again at the meeting of 19 September. It is not clear from either the email or the minutes of that meeting when the orders complained of were delivered, but in any event the minutes of the meeting show that Oceania agreed to credit Debonaire for the short supply of components if supported by detailed documents. Therefore, in my judgment Oceania cannot now contend that Debonaire is required to pay the contract price for those goods (particularly without evidence as to when the goods were delivered or when Debonaire acted in relation to them in a way inconsistent with Oceania's ownership).

[197] I therefore find that Debonaire has established this claim for \$17,330.96.

Dead stock

[198] Finally, Debonaire claims for dead or deficient stock supplied to it by Oceania which it was left with at the end of the Supply Agreement. It claims both the value of that stock (\$56,825.97) and the cost of storing that stock (at one third of the rental (\$25,000 per annum (plus GST)) of its storage premises – as being occupied by that stock – from 1 September 2007). Debonaire contends that “the dead stock is a rump left with Debonaire because Oceania precipitated an end to an otherwise enduring arrangement because of its breach of supply”.

[199] The Supply Agreement was not a “sale or return” contract such that Debonaire is entitled to credit for product it has been unable to sell. Accordingly, Oceania is not liable to Debonaire for the purchase price of the dead stock or the storage costs claimed in respect of it.

Oceania's interest and legal costs claims

[200] The Supply Agreement provides that the purchase price (plus GST) of product supplied by Oceania to Debonaire is to be “paid in full immediately upon

which ever [sic] occurs first between Debonaire's receipt of payment for the Goods or within 100 days from [Oceania's] shipment of the order". There is then provision for default interest and the payment of legal costs, as follows:

If full payment is not made to Debonaire [sic] by the due date for payment, then Debonaire shall be in default and Debonaire shall at [Oceania's] discretion (and without affecting any other right [Oceania] may have) pay default interest to [Oceania] in accordance with the following:

- a) The default interest rate shall be up to 2.5% per month.
- b) Default interest shall accrue on a daily basis from the date when the payment is due until the date when payment is actually made.
- c) Debonaire shall be liable to pay all expenses and costs (including legal costs as between solicitor and client) in relation to [Oceania] obtaining or attempting to obtain a remedy for the failure to pay.

[201] In reliance on this provision, Oceania first seeks default interest on the sum of \$382,572.73, being the sum ordered against Debonaire in the summary judgment proceeding for the ten containers of furniture components delivered to Debonaire but for which Debonaire did not pay. The Associate Judge declined to deal with this issue in that proceeding on the ground that full argument and the testing of evidence on the question of interest was required. Oceania says that the quantum of the interest rate was suggested and specified by Debonaire and is a reasonable commercial rate commensurate with the circumstances of the contract and other terms of the Supply Agreement.

[202] Debonaire opposes the interest claim on the basis that the contract interest rate (2.5% per month, or 30% per annum) is excessive, is a penalty and is unenforceable. It also seeks relief under s 9 of the Contractual Remedies Act 1979 against what it says is an oppressive claim for interest.

[203] The default interest clause essentially follows the clause in the earlier Conditions of Sale document drafted by Mr Atkin. Mr Atkin stated that he took the provisions from a consignment note of someone else. Consequently, Debonaire argues that there is no relation of the 30 percent figure to reality.

[204] There was no evidence as to interest rates provided. Nor was there any evidence as to whether a 30 percent interest rate was a fair pre-estimate of Oceania's

probable damages on Debonaire's non-payment. In my judgment, in the absence of evidence to support it being a genuine covenanted pre-estimate of damage, and as assessed at the time the Supply Agreement was entered into, the default interest rate of 30 percent per annum is in fact a penalty and in terrorem.

[205] On that basis it is unnecessary to consider Debonaire's claim for relief under s 9 of the Contractual Remedies Act 1979.

[206] In the circumstances, it is appropriate that I make an order under s 87 of the Judicature Act 1908 that Debonaire pay interest on the sum as established in the summary judgment proceeding from the date the cause of action arose until the date of the summary judgment. I consider that the appropriate rate here is the prescribed rate (8.4 percent per annum) and I so order.

[207] As to the period from the date of the summary judgment, with reference to *Nottingham v Registered Securities Ltd (in liq)* (1998) 12 PRNZ 625 (CA), I am of the view that interest does not run at the contract rate but at the rate prescribed in s 87 of the Judicature Act in accordance with r 11.27 of the High Court Rules. Again I so order.

[208] Pursuant to the same clause in the contract, Oceania also claims for "all expenses and costs (including legal costs as between solicitor and client) in connection with these proceedings, including its summary judgment application". I did not understand Debonaire to contend that the costs claimed in connection with the summary judgment application of \$27,358.00 were not payable under the Supply Agreement. In my view, given the terms of the Supply Agreement, that was an appropriate concession. I therefore find that Oceania is entitled under the Supply Agreement to these legal costs and expenses.

[209] Beyond this, it is clear that the provision in the Supply Agreement does not apply to costs incurred after Oceania obtained summary judgment. The proceedings since then have not been to obtain or attempt to obtain a remedy for Debonaire's failure to pay. Instead they have been directed at Debonaire's counter claims for breach of contract and the subset claims.

Result

[210] For the reasons given, I find that Debonaire is entitled to contractual damages for the direct profit it lost as a result of Oceania's non-delivery of those orders which were accepted by Oceania between 30 January 2007 and 28 July 2007 and which were not in fact delivered (orders 502, 503, 507, 509-511 and 513). I refer the parties to my comments in this judgment as to what I perceive to be the appropriate way of calculating those damages.

[211] In terms of its subset claims, Debonaire has also established its claim for the so-called "agreed amounts" and for short-supplied MDF componentry. As a result, Debonaire is entitled to damages of \$67,098.26.

[212] Debonaire is to pay interest to Oceania on the judgment sum ordered in the summary judgment proceeding (\$382,572.73) from the date the cause of action arose until the date of the summary judgment, and running from the date of the summary judgment in accordance with r 11.27, at the rate prescribed in s 87 of the Judicature Act 1908 (8.4 percent per annum).

[213] Debonaire is also to pay legal costs and expenses of \$27,358.00 to Oceania in accordance with the Supply Agreement and as incurred until the summary judgment was obtained.

[214] At the end of his submissions, Mr Laurenson suggested that I not reach a final conclusion on the significance of any judgment I render in this proceeding, by reference to the difficulties that he saw as being associated with the very difficult provisions of counterclaim judgments in the High Court Rules. I therefore do not reach a final conclusion as to the position at the end of the day as between Oceania, with the benefit of its summary judgment and interest and costs claims, and Debonaire, with the benefit of my rulings in its favour in this proceeding.

[215] Finally, the question of costs in this proceeding are reserved, as the parties requested.

[216] I invite the parties to submit a memorandum to me within 21 days indicating the basis upon which they propose to address the questions of the quantification of the damages payable to Oceania by Debonaire, the overall effect of the counterclaim rules, and the question of costs.

“Clifford J”