Neutral Citation Number: [2005] IEHC 190

THE HIGH COURT

[Record No. 2004 19461P]

BETWEEN

INTRUM JUSTITIA BV

PLAINTIFF

AND

LEGAL AND TRADE FINANCIAL SERVICES LIMITED

DEFENDANT

Judgment of O'Sullivan J. delivered the 10th of June, 2005

Introduction

1. The plaintiff is a Dutch Company located at the Hague and carries on the business of credit management and debt collection.

2. The defendant is an English Company located in Lancashire and carries on a similar business.

3. By agreement dated 11th October, 2004, the plaintiff agreed to purchase the entire issued share capital of an Irish subsidiary of the defendant (Legal and Trade Collections (Ireland) Limited) for a purchase price of €2.15 million of which 90% was paid on closing. Prior to entering into the agreement the plaintiff had conducted a comprehensive due diligence process.

4. The agreement provided for delivery of Completion Accounts not later than four weeks following the completion date, that was not later than Monday 8th November, 2004. These accounts were to comprise the un-audited balance sheet and un-audited profit and loss account for the period from the last accounts date to 1st October, 2004. This exercise would have included a reconciliation of the defendant's client's accounts which was of significance to the plaintiff because these had come under particular scrutiny in the course of the due diligence process and some concern had been raised in relation to them.

Embezzlement comes to light

5. The financial director of the defendant was Mr. Colin Thorpe and he worked from the defendant's Ashtown Gate premises in Dublin. The chief accountant of the defendant was Mr. Ronald Whitehead and he was based in the United Kingdom. At the end of October and the beginning of November, 2004, he was in Dublin working on the Completion Accounts. In particular he was working on the provision of a reconciliation between the client account balance in the nominal ledger and the balance in the CUBS, which was a computerised system operated by the defendant to administer the debts on behalf of the companies' clients. In the early afternoon of Tuesday 2nd November, 2004, Ronald Whitehead had made a comparison between the nominal ledger and the control account and found a discrepancy in the order of €457,000. He had a subsequent discussion with Colin Thorpe who at that point confessed that he had been embezzling money from the defendant for a period of almost three years from the beginning of 2002 to feed a gambling habit.

6. Following his confession Colin Thorpe was emotionally upset and Ronald Whitehead took some time to quiet him down and to persuade him to contact Price Waterhouse Cooper, the company's auditors, in an attempt to clarify the method and extent of the embezzlement. Mr. Whitehead also contacted his superiors in the United Kingdom and it was agreed that Paul Anslow, the Chief Financial Officer would come from England to Dublin the following day, which he did. That following day, Wednesday 3rd November was spent checking references and the system with the result that a figure of €453,000 approximately appeared to be the extent of the embezzlement. That exercise took all of Wednesday 3rd November, 2004, and on the morning of Thursday 4th November, Mr. Anslow contacted Mr. Biggam of the plaintiff who had been made a Director of the Ashtown Gate Company after completion of the agreement. Mr. Biggam immediately informed Mr. John Easdon who was Regional Managing Director of the plaintiff for the UK and Ireland and who was just returning from Zurich Airport. He arranged to come over to Dublin the next morning, Friday 5th November. He did so and having contacted his solicitors, Mr. Biggam and Mr. Easdon interviewed Colin Thorpe on the morning of Friday 5th November.

7. At that time they were concerned at the delay which had elapsed between Colin Thorpe's confession in the early afternoon of the previous Tuesday and their being informed only on the morning of Thursday 4th. At the interview Colin Thorpe told Messrs. Easdon and Biggam what he had been doing since his confession and that he had wanted to go to the police. After meeting Mr. Thorpe, Mr. Easdon suspended him pending an investigation. He then contacted Mr. Anslow and Ronald Whitehead at around lunchtime on Friday 5th November. The big concern in Mr. Easdon's mind at that point was why there had been a delay between Colin Thorpe's confession and his being informed. He therefore asked Mr. Anslow and Mr. Whitehead to give their account of what had happened since Colin Thorpe's confession.

8. At this time the defendant's auditors, Price Waterhouse Coopers, were busy working on the finalisation of the Completion Accounts which were due to be delivered not later than the following Monday 8th November. Mr. Easdon asked that this activity cease for the duration of his conversation with Mr. Anslow and Mr. Whitehead and this was done. At the end of that conversation they had confirmed the account given by Colin Thorpe. Mr. Easdon said that he was "somewhat reassured" and that he was happy to let the auditors back in to complete their work and said so. In fact as transpired in evidence that Price Waterhouse Coopers were contacted on that Friday afternoon but had redeployed their personnel and did not have them available to continue work that Friday or indeed the following Monday.

The early correspondence

9. It will be recalled that Clause 4.5 of the agreement required furnishing by the defendant of Completion Accounts (as defined) on or before Monday 8th November, 2004. On that date a document was sent by Mr. Anslow, Chief Financial Officer of the defendant, which stated that "…we and our professional advisors need access to the premises at Ashtown Gate in order to access the records and have further discussions with senior management to carry out the investigation to the fullest extent possible. Until we are allowed to carry out fully our investigation, you will appreciate that the Completion Accounts can only be regarded as provisional."

10. The letter went on to say that the writer was not able to present at that time the full reconciliation between the client account balance in the nominal ledger and the balance in CUBS.

11. On the same day, Monday 8th November, the plaintiff wrote to Geoffrey Ognall, Chairman of the defendant, saying that the disclosures were serious and had a fundamental impact on the share purchase agreement and that the integrity of all financial information provided to date was now open to question and that the magnitude of the problem was at that time unclear. The letter went on the say that it was of the utmost importance that the defendant immediately provide a complete account of all information

known to the defendants them concerning deficiencies and financial irregularities in the accounts of the defendant. All rights were reserved.

12. On the next day, Tuesday 9th, Mr. Ognall wrote to the plaintiff stating that the plaintiff's approval of further access with professional advisors was required to the records of the company and to senior management. The letter asked as a matter of urgency to be told how the defendant would be allowed to conduct the further investigations in relation to embezzlement. On the next day, Wednesday 10th, the plaintiff wrote asserting that the documents provided did not constitute Completion Accounts as defined by the contract and that the information did not fully identify the extent of the embezzlement, and therefore the defendant had not complied with the share purchase agreement. The letter stated that the plaintiff was currently considering the implication of the defendant's failure and would respond to the points raised in early course. All rights were reserved.

13. On the following day, Thursday 11th November, the defendant wrote reiterating that the company and its advisors no longer had access to the records of the company and the company was therefore unable to produce the Completion Accounts. The defendant went on to suggest that the parties work together with an expert as defined in the agreement to assist in investigating the embezzlement and finalising the Completion Accounts. A letter of the same date from the plaintiff reasserts the question mark over all financial information and states that the plaintiff is unable to take any formal or contractual steps in relation to the target company but suggests without prejudice cooperation between the parties in relation to the governance thereof. It requested that the defendant countersign a letter in acknowledgement of their agreement. A further letter of the same day and in reply states the defendant was not in a position to countersign the correspondence but did undertake to cooperate fully in all investigations necessary to resolve the matter including to cooperate fully in assisting and preparing the completion accounts with the assistance of a duly designated independent expert.

14. On the following day, Friday 12th November, the plaintiff responded asserting that the defendant's position appeared designed to advance the defendant company's interest rather than resolving the matter in a way satisfactory to the plaintiff, complaining that the defendant's position appears not to take into account the interest of third parties, pointing out that the implementation of Clause 4.5 was only of historical interest since no Completion Accounts had been provided and asserting that the defendant's proposal would not be appropriate and further that the impact of the misappropriation of funds could not be considered to be limited to the question of the amount of money missing. It concluded with a statement that the plaintiff was prepared to consider any proposal the defendant might have to make but not one which was limited to the financial question of the misappropriated funds but, rather, one which would have to be accompanied by offers of indemnity to the appropriate extent.

15. On Tuesday 16th November, the defendant replied, refuting the allegations of self-interest and enclosing a report, admittedly incomplete because of the limited time available to investigate, and reasserting that they no longer had access to Colin Thorpe who had been suspended and that its accountants had been asked to no longer access the records. The report in turn was furnished under cover of a front page stating that it was incomplete by virtue of the fact that the defendant was not able to continue its investigation due to the suspension of Mr. Thorpe and the plaintiff company's permitting no further access by the defendant to the records of the company. The defendant did not accept any responsibility for the accuracy of the information contained therein.

16. The report is clearly largely based on information which had been supplied by Colin Thorpe and is therefore based on information supplied approximately two weeks before the date of the report itself. The report includes also the reconciliation between the CUBS reports showing the actual amount of cash due to clients and the client funds creditor balance in the nominal ledger. The total amount of embezzlement is shown at €453,415.55.

17. On the next day, Wednesday 17th November, the defendant wrote in response, apparently, to telephone conversations on the previous day stating that the defendant was in full agreement with the plaintiff's proposal to appoint KPMG as an independent expert within the terms of the Chairperson's agreement in order to agree the Completion Accounts and that their decision would be final and binding. If there was to be a reduction in the purchase price the defendant stated it would comply with the mechanism set out in the agreement. The defendant stated it could give an indemnification and undertaking to compensate outside the terms of the share purchase agreement "when we do not know the possible extent of such an undertaking". Surprise is expressed at the request for "a blanket indemnity, given that there has been an inconclusive and insufficient investigation into the matter" and the letter points out that the defendant cannot be responsible for transactions during the ownership of the plaintiff or for acts of third parties.

18. The response to this letter was a long letter on Friday 18th November, accusing the defendant of an opportunistic distortion of the proposal which was misrepresented in the defendant's letter. The letter went on to reiterate the defendant's misrepresentation of its financial position and to assert that the value of the transaction was entirely undermined and that the true financial position was unknown. Completion Accounts had not been furnished or other appropriate information which would enable the plaintiff to assess the full impact of the defendant's misrepresentation. KPMG's initial advice was that the defendant company would require a full forensic audit before any view could be taken on the true position of the accounts. The plaintiff did not know whether the defendant was solvent. The defendant is accused of not responding to the opportunity to cooperate in the interests of the company or to make a proposal. Accordingly the plaintiff rescinded the contract of 11th October, 2004, on the grounds that the defendant had very substantially misrepresented to the plaintiff the financial position of the company.

19. They say that had they known of the embezzlement beforehand they would under no circumstances have concluded the agreement and that the misrepresentation goes to the very heart of the deal. It is added "the ease with which you appear to have discovered this matter after completion is a cause for serious concern". The consequences of rescission are then spelled out in relation to an interim continuation of the plaintiff's directors pending replacement by the defendant and an assertion that the directors will report to the defendant as owner of the company and run it to the defendant's account. The defendant must pass a resolution changing the name of the company from the plaintiff's name to the defendant's name. The entire purchase price must be returned.

Comment on this correspondence

20. The impression given by this correspondence is that each of the parties was adopting somewhat confusing if not self-contradictory positions. For example, the defendant was offering to cooperate but when faced with an indemnity which was too wide simply refused rather than returning with an appropriately by narrow indemnity; again, the defendant is seeking to operate the contract provisions in relation to an independent expert at a time when those provisions had no application. More fundamentally the defendant asserted more than once that the plaintiff had withdrawn permission to the defendant's accountants to access the books of the defendant company when the true position was that such withdrawal had operated only for a short period of some hours on the afternoon of Friday 5th November. Thereafter on that day and on Monday 8th, the defendant's accountants were asked by the defendant to assist in the finalisation of the Completion Accounts but had not the personnel to do it.

21. On the plaintiff's side, as well however, the correspondence is initiated with a question raised over the integrity of all the financial

information but notwithstanding this their letter of 8th November, states that it is of the utmost importance that the defendant immediately provide a complete account of all information known to the defendant concerning the deficiencies and irregularities in question. Again, at no stage does the correspondence point out that the defendant's assertion that neither they nor their accountants have access to the books and records of the defendant company is incorrect. It is not clear what purpose the information requested as of the utmost importance in the plaintiff's letter of 8th November, (the date for furnishing the Completion Accounts) would serve given that the deadline would have passed when same was furnished and indeed given that there was a serious question mark over all information that could be given. There were telephone calls between the principals before the defendant's letter of 17th November, apparently in the context of some kind of agreed accountancy exercise but the defendant's letter of that date was met with complete rejection on the basis that the defendant had apparently deliberately misunderstood those conversations. This was accompanied by the decision to rescind.

22. There seems to have been no real meeting of minds in this early, pre-solicitor, correspondence and indeed a certain amount of protecting of self-interest on both sides. There may well have been a lack of communication between the individuals on the defendant's side in relation to access to the books and, quite possibly, the same on the side of the plaintiff.

23. The correspondence passed thereafter into the hands of the solicitor and the pleadings were initiated on 19th November, 2004.

The pleadings and submissions
24. In the pleadings the plaintiff claimed rescission of contract based on (a) fraudulent misrepresentation, (b) misrepresentation whether negligent or otherwise, (c) mistake and, (d) in addition damages for breach of contract. Before dealing with the latter three, I note that the allegation of fraudulent misrepresentation was withdrawn, but only when the plaintiff submitted its written legal submissions in mid April, 2005. This allegation was presumably first alluded to in the plaintiff's letter of 18th November, 2004, which said "the ease with which you appear to have discovered this matter after completion is a cause for serious concern".

25. Insofar as it is appropriate to refer to the remainder of the evidence, I propose to do so in the context of considering the submissions made in relation to the issues of misrepresentation, mistake and breach of contract and, finally, the question of damages.

26. The defendant counterclaims for specific performance of the agreement with an appropriate adjustment to the purchase price.

Misrepresentation
27. The plaintiff's claim in this regard is founded on an e-mail sent by Geoffrey Ognall, Chairman of the defendant, to Ken Hanson Financial Director of the plaintiff on 14th May, 2004, before the commencement of the due diligence process which referred to the fact that the defendant had "no skeletons in the cupboard" and a further e-mail sent on 22nd June, 2004, in the middle of the due diligence process which indicated that all the key financial factors had been showed by the defendant. In evidence Mr. Easdon said that there was a difference between the parties in relation to the need to have what he described as "quite a rigorous and thorough due diligence" and the defendant's anxiety to complete the transaction by the end of June. He said "the comment was that such an extensive due diligence is not necessary because there is nothing wrong with this company, you won't find anything wrong with this company etc."

28. In cross-examination it was put to Mr. Easdon that the representation about no skeletons in the cupboard and from Mr. Ognall in May of 2004, did not make any difference in how sparing or how thorough he was going to be in the due diligence process that ensued and he agreed. He said "No, that is right". The second e-mail, which was on 22nd June, was in the course of the due diligence process. It was put to him again that nothing changed in the way that the due diligence was being carried out as a result of those words in the e-mail, and again Mr. Easdon said, "That's right, yes."

29. The evidence from Mr. Ognall was that he made the representations and intended them to be acted upon but in light of the foregoing evidence in my opinion the probability is that the defendant did not rely on those representations at all. Mr. Ognall explained that he was somewhat impatient and wanted to get the contract signed soon and was impatient with the thorough going due diligence process and made the representations in that context. It had no effect clearly from the replies of Mr. Easdon. The plaintiff went ahead with the thorough due diligence process and in my opinion on the balance of probabilities relied upon the information provided from that process which continued on unchanged despite the making of these representations.

30. I accept that in this context the representations do not have to be the main or paramount consideration in the mind of the representee but it is also true that they must be part of the underlying basis upon which the representee proceeds. There is no real sense, in my opinion, in which those representations were relied on or formed part of the underlying basis on which the plaintiff proceeded given that the due diligence process continued on in exactly the same way after they were made as before. The plaintiff relied on *Gahan v. Boland* (Unreported, High Court, Murphy J., 21st January, 1983) which establishes that an innocent representation made in good faith and with no intention to mislead can nonetheless entitle the representee to a rescission of the contract. In that case, however, the representation to the effect that a proposed major road would not affect the representee's purchase of his home and paddock was not, as I understand the judgment, overtaken or replaced by any other specific representation or information on the same point. In the present case it is clear that the plaintiff relied on the financial information thrown up by its own thorough and rigorous due diligence process for the purpose of informing itself as to the financial situation of the defendant company. I would therefore hold that the plaintiff is not entitled to rescission or indeed to any relief in the context of the misrepresentations because it did not rely on them.

Mistake
31. On reflection I have to say that I have doubts as to whether this is a case of true mistake as known to the law of contract at all.

32. The parties entered into an agreement which contains warranties by the defendant as vendor as to the accuracy and reliability of the financial information known to the parties at the time. These warranties are numerous and comprehensive and it is clear that they are wide enough to cover the situation that has arisen in the present case. Both parties clearly thought at the time that the accounts and financial information presented a true picture, and in that sense, of course, were mistaken as to the actual situation, but they also included by agreement warranties from the defendant intended to deal with a situation where their view of the account might not turn out to be the case. They acknowledged, in other words, that their current state of knowledge might be incomplete or inaccurate and came to an agreement as to which of them should bear the consequences if such should prove to be the case. Mistake in contract law concerns a situation where the parties think they know the true facts and proceed upon the basis of their erroneous assumption without even suspecting that their assumptions might be wrong, quite a different thing from the situation of the parties in the present case who thought they knew the true financial circumstances of the company but contemplated at the same time that their information may be misleading and proceeded to agree what was to happen if that should prove to be the case. No body suggests a contract of insurance is based on a mistake just because the parties cannot identify the event which it is intended to deal with.

33. Furthermore if, contrary to the above, it is correct to subject the circumstances of the present case to an analysis driven by the traditional law of mistake in contract cases, and that this analysis could, therefore, result in a conclusion that the plaintiff company is entitled to rescission, by reason of the fact that the parties did not appreciate the true financial picture, then in my view such a result would be anomalous given the situation that the same parties have addressed the possibility that the accounts might not present a true picture and in arranging what is to happen in such an event have agreed that rescission would *not* be available to the plaintiff. This latter position arises because the contract provides at Schedule 6, Clause 7 that:-

> "No breach or breaches of any of the warranties, specific warranties or the deed of indemnity shall give rise to any right on the part of the purchaser to rescind this agreement after completion."

34. The case was argued, notwithstanding the above, by counsel for both parties upon the basis that there had been a mutual mistake, namely that both parties at the time of entering the agreement made the mistake of thinking that there had been no embezzlement, and in deference to the submissions of counsel I will deal with their arguments in what follows.

35. In doing so however, and particularly in the context of a submission that the purchaser did not get substantially what he bargained for, it is necessary that I reach some view as to the extent of the embezzlement.

The extent of the embezzlement

36. The evidence is that just before Colin Thorpe confessed to embezzlement, Ronald Whitehead had identified a "discrepancy" in the order of €457,000 when he was doing the reconciliation of the client accounts. This figure was shown subsequently to have been substantially correct when with Colin Thorpe's assistance the matter was gone into in detail and a discrepancy of €453,415.55 was identified, which was reassuringly close to Mr. Whitehead's own calculation.

37. It was further established in evidence that the method of fraud, which briefly involved Colin Thorpe forging the signature of John Cahill, the Financial Director of the defendant company, on cheques which required two signatures namely his own and that of John Cahill and presenting them as bona fide cheques payable to clients, cashing them, and subsequently manipulating the books and records of the company to disguise the fraudulent transaction.

38. In particular, Colin Thorpe was able to identify the cheques in the fraudulent category by reference to secret and otherwise meaningless annotations in the IT software recording these transactions and which are all referenced in the report furnished by the defendant to the plaintiff on 16th November, 2004.

39. A further point was made in the hearing before me that given that the life of a cheque in this country is six months, if there were any further fraudulent transactions they would have "come out in the wash" in the intervening six months and that it is unlikely now that further fraudulent transactions will emerge.

40. As a matter of probability and on the basis of the information proved in court in my view the extent of Colin Thorpe's fraud is likely to be in the order of €457,000. There are three aspects which seem to me relevant in reaching this conclusion: in the first place that was the estimate of the discrepancy reached independently by Ronald Whitehead; secondly, Colin Thorpe had his own secret way of identifying the fraudulent cheques and using this identification his estimate of the extent of the fraud is strikingly close to Ronald Whitehead's estimate and thirdly, for what it is worth, there has been no evidence of further discrepancies other than those disclosed by Colin Thorpe in the intervening six months.

41. In reaching the foregoing conclusion, I am of course conscious that no forensic audit had been done. The company has been under the control of the plaintiff since the fraud was discovered. By its letter of 11th November, the plaintiff wrote to Geoffrey Ognall "…until we have clarified the true financial position of the company, we are unable to take any formal or contractual steps in relation to it."

42. The un-contradicted evidence of all relevant witnesses has been that once there is evidence of embezzlement such as in the present case it is essential that the company must do an appropriate audit. There may be issues as to how far such an audit should go, and I will return to this aspect later in my judgment, but in my opinion this was a case where the good management of the company required some level of forensic audit and indeed it is clear that the plaintiff was advised by KPMG initially that the defendant would require "a full forensic audit" before any view could be taken on the impact of (the defendant company's failure to disclose) the true financial position of the company (See the company's letter of 18th November).

43. Such an audit was not undertaken nor was any exercise done so far as I am aware by the plaintiff company whether by way of a sampling audit as suggested by Mr. Derek Donohue or otherwise.

44. I think it is necessary to reach some view of the extent of the embezzlement in order to consider the submissions of the parties in the context of mistake, and in particular in the context of an issue as to whether the purchaser did or did not get substantially what he bargained for. I must, however, reach my conclusion as to the extent of the embezzlement in the absence of definitive information.

45. Having considered such evidence as is available in my opinion the effect of the fraud does not mean that the subject matter of the share purchase agreement is essentially different from the one contracted for. Accordingly the plaintiff would not be entitled on the basis of mistake to rescission under common law as identified in *Bell v. Lever Bros* [1932] A.C. 161. Nor is this a case where the misapprehension (to the effect that there had been no embezzlement) was fundamental to the agreement (which included the wide ranging warranties already discussed and an agreement that their breach would not give rise to rescission). Accordingly the plaintiff would not be entitled to rescission in equity as identified in *Solle v. Butcher* [1950] 1 K.B. 671 and as applied in this country by Costello J. (as he then was) in *O'Neill v. Ryan* [1992] 1 I.R. 166 672 at p. 185.

46. Of course I acknowledge that the plaintiff company's witnesses said that if they had known in advance of the embezzlement, they would not have entered the agreement. This does not prove, however, that therefore the effect of the embezzlement was fundamental, anymore than an insured driver's assertion that he would not have driven on the day of the accident had he known of it beforehand means that he did not need insurance. This was an agreement to buy shares in a company with specific objectives in mind and the plaintiff company's evidence referred to has to be seen in context.

47. The evidence is that the "drivers" for the purchase of these shares were the plaintiff company's desire to acquire the very good client base including some blue chip clients of the defendant, and its good employees and in particular, John Cahill the Managing Director, to improve the company's position in the Irish market and to receive the disclosed revenue stream, enhanced by the synergies that would become operative when the two companies were merged together.

48. It is also clear from the evidence that the merging process has been put on hold since the discovery of Colin Thorpe's embezzlement but that notwithstanding this the revenue stream has remained as predicted, and that John Cahill remains employed at the Ashtown Gate premises albeit not as Managing Director. One or two clients have transferred from the Ashtown Gate (erstwhile defendant) company's business to the plaintiff's own English subsidiary business at Park West and that the one or two clients who have ceased doing business have done so for reasons other than those related to the embezzlement. Of course it is true that the embezzlement has not become public knowledge and that when it does many clients may become concerned as has happened apparently in England to a subsidiary of the plaintiff company's where a non-fraudulent discrepancy was discovered and which caused considerable upset and loss to that company.

49. There was further evidence that the clients, particularly the blue chip clients such as banks, of a company engaged in debt collection on behalf of those clients will be particularly sensitive to the publication of financial impropriety within the debt collecting company. They can only be reassured, it is said, by a full forensic audit which establishes that none of their own monies were taken, that none of their clients had complained about being asked to discharge bills already paid and that there was a clear and reliable identification of the extent of the embezzlement. Nobody suggested that such an exercise is impossible but there has been widely divergent views as to the cost of such an audit and indeed the specific scope involved.

50. Once again in this context I am left in the situation where no such audit has taken place and accordingly I must deal with the evidence produced without speculating beyond it.

51. Given, therefore, that the likelihood is that the extent of the audit is limited to some four hundred and fifty seven thousand euro and that a forensic exercise can be done which will establish with reasonable certainty such extent and can satisfy clients including blue chip clients of the defendant company, and bearing in mind the "drivers" which motivated the plaintiff in acquiring the defendant's company shares, I do not think that what the plaintiff got in their share purchase agreement was so different from what they contracted for as to qualify for the descriptions in the authorities which justify an entitlement to rescission either at common law or in equity. In other words this is not one of those exceptional circumstances which are extremely limited where rescission as distinct from damages will be granted by a court as identified by Costello J. (as he then was) in *O'Neill v. Ryan*.

Breach of contract

52. The plaintiff in its written submission refers to twelve warranties all of which it claims were breached. I will refer to one or two only as follows:-

> 1. All written information given by or on behalf of the vendor or the company to the purchaser or any shareholder, accountant, lawyer or agent thereof in the course of the due diligence exercise carried out by the purchaser and his professional advisors was, when given and is at the date hereof, true, accurate and complete in all respects.
>
> 2. There is no fact or matter which has not been disclosed in writing to the purchaser which rendered the information referred to in paragraph 1 onto or misleading at the date of this agreement.
>
> 3. None of the representations or warranties made by the vendor in this agreement or in any document to be delivered by and pursuant hereto or in connection with the transactions contemplated hereby contains any untrue statement of a fact, or omits to state a fact necessary to make any statement or fact contained herein or therein not misleading.
>
> 4. All the accounts, books, ledgers, financial and other records of whatsoever kind of the company;
>
> (a) have been fully, properly and accurately kept,
>
> (b) do not contain any material, inaccuracies or discrepancies of any kind,
>
> (c) give a true and fair view of its trading transactions and its financial, contractual and trading position,
>
> (d) the principal accounts are true, complete and accurate in all respects…

53. It is beyond reasonable argument, as the plaintiff puts it, that there was a breach of these warranties. It is also agreed, however, that no breach or breaches of any of the warranties, shall give rise to any right on the part of the purchaser to rescind the agreement.

54. Accordingly, the relief to which the plaintiff is entitled, in the absence as I hold, to an order rescinding a contract or to an order declaring it void *ab initio*, is damages.

The measure of damages

55. There is a considerable divergence between the parties as to the measure of damages to which the plaintiff is entitled.

56. It is common case that the plaintiff is entitled to have the amount taken put back into the company.

57. The defendant in correspondence and argument contended that it was liable also to pay half the costs of whatever audit exercise is necessary to identify the extent of the embezzlement. This proposition seems to have originated from a misunderstanding of the effect of clause 4.5 of the agreement which deals with Completion Accounts. These were to be provided on or before the 8th November. Once Completion Accounts were furnished under the contract, the vendor and purchaser were required to agreement same on or before 15th December, or in default of agreement the purchaser was entitled to serve notice to dispute the Completion Accounts and refer the matter to an independent accountant known as "the expert" to determine the matter at issue and whose determination was agreed to be binding and final. The costs of the expert were to be borne 50% by the vendor and 50% by the purchaser.

58. None of the foregoing applied, however, because completion accounts were not furnished in accordance with the contract on or before Monday 8th November, or indeed on any date subsequently.

59. Insofar as the defendant company seeks to rely on the contention put forward in the early correspondence that it was effectively frustrated from doing this by the refusal of the plaintiff company to grant them and their accountants access to the books and records of the company, I hold on the evidence that this is not correct. They were refused access only for a matter of hours on Friday 5th November and thereafter (despite those contentions) had access albeit that that position was not clarified by the plaintiff

in its correspondence in response to those contentions.

60. Accordingly in my view the defendant company will have to pay damages to cover the cost of an appropriate forensic audit. I will return to the question of this at a later point.

The value of the shares
61. Evidence was given on behalf of the plaintiff by Desmond Peelo the well-known accountant to the effect that on the date of the transaction the value of the shares was nil. He based this on his view that no properly informed purchaser would have bought the shares on that date. This conclusion and opinion was agreed with by Mr. Derek Donohue who was called on behalf of the defendant.

62. Mr. Peelo went on to say that if the money taken was restored to the company and if a full forensic audit showed that no further monies other than those restored to the company were taken and assuming the cost of the accounting exercise were reimbursed, the entire shareholding in the defendant company might at this point in time have a value approaching the net asset value which was some €600,000.

63. Evidence was also given by Derek Donohue on behalf of the defendant. In the first place he agreed that at the date of the contract no properly advised purchaser would have bought the shares. He took issue with the conclusion from that fact, however, that the shares were on that date of nil value. He said that they had an unascertained value and went on to say that if an appropriate accounting rectification exercise were conducted and the company was reimbursed the costs thereof and whatever had been taken from the company were restored to it then the value of the company remained unaltered namely at 2.15 million euros. He clarified this by stating that this was the value to the plaintiff as objectively determined by reference to the drivers which motivated its acquisition of the defendant's shares. It seems to me that Mr. Donohue was talking about "value to the plaintiff" as distinct from "market value" which was what Mr. Peelo was referring to. Indeed in the latter context, Mr. Peelo went on to say further to his opinion referred to above, that his view that the company might have a value approaching it its asset value of €600,000, in the circumstances already identified, meant that there was no value for goodwill. However, he added, things get forgotten "but it takes time and I would certainly think the time is at least a year, if not two years, away", by which I understand him to mean that the value on the open market in a year or two would be restored to the price paid by the plaintiff.

64. The plaintiff relied on the Privy Council decision in *Lion Nathan Limited v. C-C Bottlers Limited* [1996] 1 W.L.R. 1438. That was a case about the sale of shares in a soft drinks company. The whole of the share capital was sold with a warranty that forecast profits for a number of months into the future had been calculated with all due care – as distinct from a warranty that those profits would be a specified figure. The latter had it been given would have been what Lord Hoffman described as a warranty of quality and if it had been a warranty of quality then "the damages would *prima facie* have been the difference between what the shares would have been worth if the earnings had been in accordance with the warranty and what they were actually worth". However in *Lion Nathan* the breach of warranty was only in relation to the forecast (to the effect that it had been done with all due care) and therefore the damages were the difference between the price agreed on the basis of the forecast as made and the price it would have been had the forecast been properly made.

65. In the present case the plaintiff submits that the warranties, for example, the warranty that "all written information given by or on behalf of the vendor… was, when given, and is at the date hereof, true, accurate and complete in all respects", were warranties of quality in Lord Hoffman's termination so that the measure of damages should be the difference between what the shares would have been worth if those warranties had been adhered to by the defendant and what they were actually worth which the plaintiff contends was nil on the day of the execution of the agreement. Lion Nathan is dealt with in McGregor, McGregor on Damages, 17th Ed. (London, 2003) at para. 24-007.

66. In my opinion the plaintiff's contention is correct in principle: the warranties given, and I have cited one example, were warranties of quality in that they warranted that the relevant figures were accurate and true as distinct from the other kind of warranty to the effect that the calculation had been made with all due care. In those circumstances following the Privy Council in Lion Nathan, the measure of damages is *prima facie* the difference between what the goods as warranted would have been worth and what they were actually worth.

67. Mr. Connolly S.C. for the defendant has reminded me in the course of hearing, however, that the plaintiff company in this case was under an obligation to mitigate its loss. The company came to court, six months later, claiming that on the day of the contract the shares were worth nil because no one properly advised and aware of the embezzlement would have purchased them on that day. There is evidence also, however, that if a forensic audit were conducted and if whatever sums taken were reimbursed to the company together with the costs of that audit then in time (Mr. Peelo says that this would certainly take at least a year if not two years) then the goodwill might be recovered so that the value as intended would be restored. Mr. Donohue says that the value to the purchaser (based on his objective criteria approach) would be restored on these assumptions without delay. Is it realistic or fair, therefore, to ignore the fact that the plaintiff has not conducted any forensic audit (and the jurisprudence on mitigation of loss establishes that a plaintiff is entitled to the costs of mitigating its loss even if those steps are unsuccessful provided they were reasonable) and simply accept that the plaintiff is entitled to sit idly by in reliance upon its claimed right to rescind the agreement and come to court six months later in unqualified reliance upon a nil valuation as of the date of the agreement itself and no other date regardless of how unfavourable such a stance might be to the defendant?

68. I do not think so.

69. Equally, it is difficult to assess damages given the state of the evidence as I have described it. There is a letter but no more than that from KPMG estimating that the cost of a full forensic audit would be of the order of €250,000 to €500,000 and may be more. That is not evidence at all. On the other end of the scale Mr. Donohue says that a sample audit might well establish with sufficient certainty to satisfy clients of the company that the extent of the embezzlement had been determined and that such an audit would cost in the order of €25,000. He expressed strong disagreement with the KPMG estimate referred to above. Furthermore, it seems from a reading of *Lion Nathan* although it is nowhere stated, that the purchase of the shares in that case was as an investment. If correct, that would distinguish *Lion Nathan* from the present case where the purpose of the purchase by the plaintiff was driven by the specific commercial considerations referred to above. Insofar as those were the drivers of the agreement there is no indication that any of them has not been delivered although clearly there is a risk that clients may be lost when the circumstances of Colin Thorpe's embezzlement become common knowledge. That is a risk and no more. There has been no audit and therefore that particular issue has not been tested. It is not even clear whether an audit could have been conducted in time for the hearing. This is therefore a case where it is uncertain whether a loss will be incurred. The plaintiff has not established in evidence whether any audit could have been done prior to the hearing or even whether such an audit as could have been done could have satisfied the appropriate criteria for reassuring clients. I am simply left in the dark on these matters.

70. The same edition of McGregor on Damages para. 8.015 says that this category (i.e. where it is uncertain whether a loss will be incurred) covers a wide field ranging from gains prevented by the defendant's wrong to expenses made necessary by that wrong. The uncertainty in the present case relates to the former category namely "gains prevented by the defendant's wrong", that is fees earned from clients of the defendant company in the future who by reason of the defendant company's breach of contract may (when the embezzlement comes to light) make a decision to cease employing the defendant. That is a potential wrong dependant on the activity of the third party, namely the client in question. How do I approach the risk? There is evidence that something similar has happened to a subsidiary company of the plaintiff in the United Kingdom in reasonably comparable circumstances. To some extent the more that is spent on the forensic audit, the more the risk will be reduced that clients will decide to leave.

71. I do not think the evidence on this aspect of the case, such as it is, establishes as a matter of probability that loss of clients is the natural and direct result of the defendant's wrong (as distinct from a risk that such might happen). That was the test established in *Ratcliffe v. Evans* [1892] 2 Q.B. 524, a Court of Appeal case dealing with slander. Rather the present is closer to another early case *Chaplin v. Hicks* [1911] 2 K.B. 786, also a Court of Appeal case where the plaintiff was one of fifty finalists among six thousand entrants in a competition where the defendant offered engagements as actresses to twelve out of those fifty finalists. The plaintiff was not offered a fair chance of being interviewed in accordance with the advertised rules and twelve prize winners were chosen from amongst the other forty nine. A jury awarded £100 for loss of the chance to the plaintiff. Vaughan Williams L.J. in upholding that award said at p. 792, (having discussed remoteness in a case where the contingencies are too numerous and difficult to deal with):- "I only wish to deny with emphasis that, because precision cannot be arrived at, the jury has no function in the assessment of damages."

72. The evidence as presented by the plaintiff in this case leaves me with nothing but the most rudimentary information as to the chance of the loss of customers when Colin Thorpe's embezzlement is finally published. It is obvious that the more conclusive the forensic audit, the smaller the risk of loss of custom. In those circumstances I would assess by way of general damages under this heading a figure of 5% of the net annual post tax profits of the defendant company as shown in the last fully audited accounts of the company (duly corrected for Colin Thorpe's embezzlement for that twelve month period) to compensate the plaintiff for the risk that when the embezzlement is made common knowledge some clients may quit the plaintiff. In doing so, I have borne in mind the character of the audit to be provided so far as I know it and also Mr. Peelo's estimate of the time needed for the recovery of the goodwill of the company.

73. In regard to the necessary expenditure on the audit I would measure the figure of €25,000 given in evidence by Mr. Donohue as being the only admissible evidence in relation to this cost.

74. Accordingly the plaintiff is entitled to:

(a) €457,000 to be put back into the company to make up for its direct loss due to the embezzlement of Colin Thorpe,

(b) €25,000 to pay for the necessary audit to identify the extent of that embezzlement,

(c) 5% of the post tax profits of the company for the last duly audited twelve-month period adjusted for the effect during that period of Colin Thorpe's embezzlement, and

(d) in the event that the forensic audit to be carried out discloses further losses directly due to Colin Thorpe's embezzlement in excess of €457,000 such further sum to be payable when ascertained.

75. The defendant is entitled to an order directing specific performance of the agreement with an appropriate adjustment to the purchase price.