REPUBLIC OF SOUTH AFRICA

THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Case number 252/05

Reportable

In the matter between:

MASTERSPICE (PTY) LTD **APPELLANT**

and

BROSZEIT INVESTMENTS CC **RESPONDENT**

CORAM: HOWIE P, FARLAM, BRAND, JAFTA JJA et MAYA AJA

HEARD: 13 MARCH 2006

DELIVERED: 31 MARCH 2006

SUMMARY: Contract – breach of warranty – restrictive cancellation clause.

Neutral citation: This judgment may be referred to as Masterspice (Pty) Ltd v Broszeit Investments CC [2006] SCA 52 (RSA).

JUDGMENT

FARLAM JA

INTRODUCTION

[1] The appellant instituted proceedings in the Cape High Court for the provisional winding up of the respondent. On 21 August 2002 Griesel J referred the matter for the hearing of oral evidence on the issues as to (1) whether the applicant, now the appellant, was a creditor of the respondent; and if so (2) whether the respondent was unable to pay its debts. On 25 June 2003, after hearing oral evidence, the same learned judge granted a final winding up order. An appeal brought by the respondent against that order was upheld by the Full Bench of the Cape High Court on 26 January 2005. The appellant now appeals with special leave to this Court contending that the original final winding up order was correctly made and that the Full Bench erred in setting it aside on appeal.

FACTS

[2] The winding up application was a sequel to an agreement of sale concluded on 31 August 2000 in terms of which the respondent sold a spice blending business known as Masterspice as a going concern to the appellant for an amount of R2 198 574.00 plus the value of the stock. Expressly included among the business assets which formed the subject matter of the sale were what were described as '(t)he recipes and product formulations of the Business [which were listed in an annexure to the agreement by reference number as stored electronically on the business's computer] including the computer software and back-up copies thereof'. In clause 9 of the agreement were set out in twelve subclauses what were called the 'Seller's Warranties.'

[3] Two of these subclauses are of particular importance in this case, viz clauses 9.3 and 9.10.

They read as follows:

'9.3 The Seller warrants that all assets hereby sold are the Seller's property, are or will on the Date of Possession be fully paid for, and that they are not subject to any lien or

right of retention of whatsoever nature.'

'9.10.1 The Seller warrants that apart from as set out in paragraph 9.11 below, at date of signature hereof it is not aware of any factors in respect of its business, products, customer satisfaction or other dealings with its customers and suppliers that could negatively impact on the smooth and profitable operation of the Business after the Date of Possession. Further, the Seller warrants that he will advise within 24 hours of him becoming aware of any such factors, which arise between the dates of signature hereof, and the Date of Possession.'

[4] Another clause of importance in this case is Clause 13, which deals with breach of the agreement and which reads as follows:

'In the event of either of the parties committing a breach of any of their respective obligations in terms of this Agreement of Sale and further failing to remedy such breach within 14 (FOURTEEN) days from the date of a written notice addressed by or on behalf of the non-defaulting party to the defaulting party calling upon it so to do, the non-defaulting party shall be entitled, without prejudice to any other right which it might have against the defaulting party, whether at common law or otherwise to:-

13.1 Enforce the provisions of the Agreement,

Or

13.2 cancel the sale, in which event the parties shall give each other *restitutio in integrum,* without prejudice to the non-defaulting party's aforesaid right to claim damages or otherwise in consequence of such breach.

Provided that no party shall be entitled to cancel this Agreement of Sale as a consequence of any breach of any provision hereof unless the breach is a material breach going to the root of this Agreement and is incapable of being remedied by payment in money or, if capable of being so remedied, the defaulting party fails to make such payment within 14 (FOURTEEN) days after amount thereof has been finally determined.'

[5] In a relatively short period after the appellant took possession of the business its turnover fell to a significant degree and the majority of its clients were lost. In particular, it lost the custom of its largest customer, Today Frozen Foods, a division of Pioneer Foods (Pty) Ltd, which in the last financial year before the appellant took over the business accounted for approximately 46% of the turnover.

[6] Subsequent to the loss of the customers to which I have referred the two directors of the appellant, Messrs Taylor and Read, set about finding a

basis for cancelling the agreement and recovering the purchase price against a tender of the by now substantially reduced business. They ascertained that some of the recipes and product formulations sold to the appellant were not the property of the respondent and that the respondent had accordingly breached the warranty contained in clause 9.3. They also contended that the respondent had disseminated some of the formulations listed in the annexure to which I have referred to Today Frozen Foods, a fact which was not but should have been disclosed to the appellant in terms of clause 9.10 of the agreement.

[7] On 14 March 2002 the appellant sent a written notice to the respondent calling upon it to remedy the alleged breaches of clause 9.3 and clause 9.10 within fourteen days and stating that if the breaches were not remedied within that period it intended cancelling the agreement and reclaiming the purchase price. After the respondent had replied denying the alleged breaches the appellant sent it a notice of cancellation on 2 April 2002. Three weeks later on 23 April 2002 it launched an application for the winding up of the respondent.

[8] The respondent opposed the application and filed, *inter alia,* an affidavit by Mr Michael Broszeit, one of its members. One of the defences raised by the respondent was that it was inappropriate for the appellant to have instituted proceedings for the winding up of the respondent where the claim on which it based its *locus standi* as a creditor was *bona fide* disputed by the respondent. In this regard reliance was placed on what Corbett JA, in giving the judgment of this Court in *Kalil v Decotex (Pty) Ltd* 1988 (1) SA 943 (A) at 980B-G, called ‘the Badenhorst rule’ (after the decision of the Transvaal Provincial Division in *Badenhorst v Northern Construction Enterprises (Pty) Ltd* 1956 (2) SA 346 (T)).

[9] In the answering affidavit filed on behalf of the respondent Mr Broszeit also denied that the recipes and formulations in question were not the property of the respondent and that some of them had been disseminated to Today Frozen Foods.

[10] Mr Broszeit pointed out in para 62 of the answering affidavit that the appellant was only entitled to cancel the agreement if it could satisfy the proviso to clause 13 of the agreement and show not only that the breaches relied on were material and went to the root of the agreement but also that they were incapable of being remedied by payment in money. He contended that the appellant had disregarded the proviso and submitted that the breaches, if established, fell within it. It is correct that in the founding affidavit no attempt was made to show, by factual averment or otherwise, that the case fell within the proviso.

[11] In the replying affidavit filed on behalf of the appellant, the deponent, Mr Taylor, dealt with this last point as follows:

‘Having regard to the nature of the breaches by Respondent, it is denied that the payment in money could remedy same, in particular in light of the claim of Todays as appears from annexure “TPT12” to Applicant’s Founding Affidavit and the destruction of the exclusivity of such formulations.’

[12] Griesel J, as I have said, referred the matter for the hearing of oral evidence on the two issues set out above.

[13] Prior to the hearing of oral evidence the parties agreed at a pre-trial conference to confine the hearing to the first issue on the basis that if that issue were decided in favour of the appellant and it were found that the appellant was entitled to repayment of the purchase price, then and in that event a winding-up order would be justified. In the result the financial position of the respondent was not gone into in detail at the hearing.

JUDGMENT BY GRIESEL J

[14] In his judgment at the end of the oral hearing Griesel J held that the appellant had succeeded in proving the two breaches alleged by it, that the breaches were material and that they were incapable of being remedied by payment in money. He accordingly held that the appellant had validly

cancelled the agreement.

[15] He proceeded to hold that the appellant was entitled to a winding-up order. Being of the view that it was unlikely that any further relevant facts would be forthcoming if a rule *nisi* were issued he granted a final order.

[16] His conclusion that the breach was incapable of being remedied by payment in money was based on his finding that after the loss of the custom of Today Frozen Foods 'the business ceased to be viable.' He continued:

'It would be an extremely difficult task . . . to place a monetary value on the effect of the breaches in this instance, short of repayment of the full purchase price.'

He went on to hold in effect, that even if the appellant were not entitled to claim restitution it was still entitled to a winding-up order. This was because it would, in his view, enjoy a substantial claim for damages against the respondent, which claim would give it the necessary *locus standi* as a contingent or prospective creditor of the respondent.

[17] 'Where the respondent,' he continued, 'has ceased trading, maintains no cash resources and has insignificant assets, it is in any event clear that the respondent is unable to pay its debts. If follows, in the light of the foregoing, that the [appellant] is, in my view, entitled to an order for the winding-up of the respondent.'

JUDGMENT OF FULL BENCH

[18] The Full Bench judgment was delivered by Louw J, with the concurrence of Desai J and Bozalek J. He held that Griesel J had correctly applied the *Badenhorst* rule in his judgment referring the matter for oral evidence, that the appellant had proved that certain of the formulations which formed part of the subject matter of the sale were not the property of the respondent and that a breach of the warranty in clause 9.3 had accordingly been established but left open the question as to whether a breach of clause 9.10 had been proved. He also held that Griesel J had correctly held that the breach of clause 9.3 was a material breach.

[19] He held, however, that the appellant had not succeeded in showing that the breach was incapable of being remedied by the payment of money

and that the appellant had accordingly failed to bring the case within the second part of the proviso to clause 13, with the result that it did not establish that it had the right to cancel the agreement. He pointed out that the appellant, on which the onus rested to prove that the breach could not be remedied by payment in money, had not addressed the issue in any of the affidavits it placed before the court and or in the course of the oral evidence advanced by it during the hearing.

[20] He dealt with the finding of Griesel J that what he called the 'second requirement' had been satisfied because the evidence showed that after the loss of Today Frozen Foods as a customer 'the business ceased to be viable' and that '(i)t would be an extremely difficult task . . . to place a monetary value on the effect of the breaches in this case short of repayment of the full purchase price' as follows:

'On appeal the [appellant] seeks to rely on the evidence of Read and Taylor. The submission on behalf of the [appellant] is that their evidence was that upon *Today* ceasing to be a customer of the respondent, the business of the respondent ceased to be viable. In this regard, Taylor said
"Substantially it basically made it from the original structuring and purchase price no longer viable".
Read said that the sales to *Today* represented about 50-55% of the total turnover and that the loss of *Today* had a very significant impact and made the business "really basically unviable." In cross examination, Read explained further that
"viable has to be defined in a relative term . . . relative to what you paid or what it was"

and that he had

"not done an exercise to extricate purely *Today* out of the equation and then done a comparison of turnover margin expenses. It is normally clear that when you have a customer that's 55% of the business and it's lost that it has a material impact on that business, in that context it was not viable relative to the investment"
The evidence shows that, during the last financial year prior to the [appellant] taking over the business (the period 1 July 1999 to 30 June 2000), the sales to *Today* amounted to 45,9% of the total turnover of the business. The figures representing the extent to which the sales to *Today* contributed to the turnover of the business were available and the loss of profits or loss of value of the business brought about by the loss of *Today* as a customer could be examined and be determined. This exercise was not done by the [appellant] as part of its case to show that the payment of money would be incapable of remedying the breach. Save for the general statements regarding viability of the business in relation to the price paid, which I refer to above, the [appellant] did not attempt to place evidence of such a nature before the court. No attempt was made, for instance, to demonstrate that it was not possible or feasible to replace *Today* with other customer/s or, that it was not possible to separate the effect of the loss of the other customers, from the effect of the loss of *Today.'*

[21] Louw J also rejected a submission made on behalf of the appellant that it was not open to the respondent to rely on non-compliance with the second

requirement of the proviso in clause 13 because, as it was put, the respondent did not, apart from a mere bald denial, raise this issue as a defence on the papers. After referring to the way in which the matter was raised by Mr Michael Broszeit in the opposing affidavit filed on behalf of the respondent and Mr Taylor's response thereto in the appellant's replying papers, the learned judge said:

'It was for the [appellant], as the party seeking cancellation, to allege and prove both the breach and further, compliance with the cancellation clause. This, the [appellant] failed to do, both in its letter of 14 March 2002 and in its launching papers. In the circumstances, it was not for the respondent to put up evidence of an accounting nature or, any other nature, to suggest that the breach was capable of being remedied by the payment of money, as was submitted on the [appellant's] behalf. The [appellant's] reliance on the judgment of Murray AJP in **Room Hire Co (Pty) Ltd v Jeppe Street Mansions (Pty) Ltd** 1949 (3) SA 1155 (T) at 1165 for the proposition that it is not sufficient for a respondent to merely raise bald denials of the factual averments upon which the [appellant] relies, is misplaced. This passage, and also those in other cases, upon which the [appellant] relies and which deal with the question when a party in application proceedings is entitled to rely on legal contentions not raised in the papers, are not applicable to this case, since not only did the [appellant] not make any factual allegations in regard to this issue in its launching papers, but the respondent, in the answering affidavit deposed to by Broszeit junior, in terms raised the [appellant's] failure to deal with the requirements of the proviso to clause 13.'

SUBMISSIONS ON BEHALF OF APPELLANT

[22] When the matter was argued before us counsel for the appellant submitted, as he had done before the Full Bench, that it was not open to the respondent to raise what one may call the second requirement defence as this defence had not been put forward by it as a ground on which it disputed its indebtedness in resisting the winding-up application.

[23] They also argued that a warranty relating to an essential attribute of the *merx* is by its very nature incapable of being remedied or substituted by the payment of money. They relied in this regard on a *dictum* by Claassen J in *Small v Smith* 1954 (3) SA 434 (SWA) at 437A-E, which is in the following terms:

'A warranty may be either express or implied. South African law has taken over the term warranty from English Law, in which system it seems to have the effect that although such a statement is part of the contract it is nevertheless only a collateral term and as such its breach gives rise only to a claim for damages and not for rescission. (See *Terrene Ltd v Nelson,* 1937 (3) All E.R 739; *Petit v Abrahamson II,* 1946 N.P.D 673.) In this last case it seems that a warranty was held to be equivalent to a condition precedent.
The use of the terms "warranty" has not been consistent, but has also been used as equivalent to condition precedent. (See *Bouwer v Ferguson* (1884) 4 E.D.C. 90, at pp 94 and 96.) It seems, therefore, that where the warranty is a vital term or a term going to the root of the contract it is in reality a condition of the contract and not a warranty (*Wessels,* para 3045). *Anson* says:
"if the parties regarded the term as essential it is a condition; its failure discharges the contract. If they did not regard it as essential it is a warranty; its failure can only give rise to an

action for such damages as have been sustained by the failure of that particular term".
An example of a warranty in this sense is to be found in *Townsend v Campbell* (1905), 26 N.L.R 356, where the seller warranted that the cow sold had sound teats. The purchaser was only entitled to damages on breach. *Wheeler v Woodhouse* (1900), 21 N.L.R 162, illustrates a true condition. The purchaser wanted to buy a milch cow. The seller warranted the cow to be a milch cow. She was not. This was a breach of a condition. The purchaser did not get what he had bought. Hence he was entitled to repudiate the contract.'

[24] They also referred to passages in Wessels, *The Law of Contract in South Africa,* 2 ed, vol 2, paras 3044 and 3049, which read as follows:

'The term warranty is, however, frequently met with in a wider sense, and then it is synonymous with condition precedent (see Pust v Dowie, 32 L.UJ.Q.B. 177 at p. 181: 1865, 34 L.J.Q.B 127: 5 B. & S. 33: 122 E.R. 745, Ex. Ch.).

. . .

Whether a term which is called a warranty is one in fact, or constitutes a condition precedent, depends upon the nature of the contract and the intention of the parties, and is a question of construction.
Anson expresses it thus: "If the parties regarded the term as essential, it is a condition: its failure discharges the contract. If they did not regard it as essential, it is a warranty; its failure can only give rise to an action for such damages as have been sustained by the failure of that particular term."'

[25] They submitted that clause 9.3 constitutes a warranty of the kind referred to by Wessels, namely a condition, the non-fulfilment whereof leads to the discharge of the contract. It follows, so it was argued, that 'a breach of such an obligation is, by its very nature, incapable of being remedied or substituted by the payment of money. It can only be remedied by the seller making good that which was warranted.'

[26] They also contended that the phrase 'incapable of being remedied by the payment of money' should be carefully and sensibly interpreted. Developing this submission, they pointed to the fact that the agreement between the parties was a commercial one, for the sale of a business, and every obligation imposed on the parties thereunder, including a total failure to render any performance whatsoever, could notionally be made good by the payment of money. They contended that this would lead to an absurd situation in a case where the merx was not delivered at all. It makes no sense, they

said, to suggest that before the purchaser is able to claim restitution in the form of repayment of the purchase price it must first demand exactly the same thing, namely repayment of the very same purchase price, not in the exercise of a right of a cancellation but because such payment would remedy, by the payment of money, the breach in question.

[27] Counsel for the appellant argued further that the evidence showed that the breach was incapable of being remedied by a monetary payment. In this regard they relied on the evidence of Messrs Taylor and Read that without the formulations which were not owned by Masterspice the business was not commercially viable.

[28] It was also argued on behalf of the appellant that by denying that the warranty in clause 9.3 had been breached the respondent had repudiated the agreement and that the appellant was entitled to accept this repudiation and cancel the agreement on that basis.

[29] Finally, it was argued that even if the appellant's remedy was for payment of a sum of money to remedy the breach, that nevertheless constituted a claim sufficient to entitle the appellant to a winding-up order.

SUBMISSIONS ON BEHALF OF RESPONDENT

[30] Counsel for the respondent submitted that the Full Bench had correctly held that the winding-up order made by Griesel J had to be set aside. Because of the limited basis on which special leave was granted, they did not challenge in argument before us the Full Bench's findings that clause 9.3 of the agreement had been breached and that this breach was material. In their submissions they pointed out that cancellation on breach is an extraordinary remedy: the normal remedy for breach is a claim for performance, either in forma specifica or by way of a monetary surrogate therefor. In the present case, for understandable reasons, there was an unusually rigorous cancellation clause in the agreement, which raised the bar for cancellation very high. They contended that the respondent was entitled to raise as a defence that the second requirement of the proviso to clause 13 had not been

complied with and that such defence had been established. Finally it was contended that it was not open to the appellant to contend that even if it was not entitled to cancellation, the winding-up order made by Griesel J could be upheld because the appellant had a damages claim and on the evidence led in the court of first instance the respondent could not pay its debts.

DISCUSSION

[31] It is appropriate to begin with the appellant's contention that it is not open to the respondent to raise the defence that the second requirement in the proviso to clause 13 had not been complied with. On this point I am completely in agreement with what was said by Louw J in the passage from his judgment which I have quoted in para 21 above on which I cannot hope to improve.

[32] I turn now to the question as to whether the appellant succeeded in bringing its case within the second part of the proviso to clause 13. I do not think that there is anything in the point that what was breached was a warranty. I am also of the view that the passage from *Small v Smith, supra,* relied on by the appellant takes the case no further.

[33] The expression 'warranty' comes from English law. In England it has been described as 'one of the most ill-used expressions in the legal dictionary' (*Finnegan v Allen* [1943] 1 K.B. 425 at 430). A 'warranty' is usually distinguished from a 'condition', the point of distinction being that a condition is a term whose breach entitles the injured party to treat a contract as discharged while a 'warranty' is a term whose breach entitles the injured party only to damages: see Cheshire, Fifoot and Furmston *Law of Contract,* 14 ed, p 166 and ss 11(1)(b) and 62 of the Sale of Goods Act 1893 and ss 11(3) and 61 of the Sale of Goods Act 1979 of the United Kingdom.

[34] As appears, however, from the extract from *Small v Smith, supra,* the expression 'warranty' is sometimes used to describe a term the breach of

which entitles the injured party to cancel the contract, what is, as has been seen, more properly described in English law as a 'condition'. I agree with the view expressed by Professor RH Christie in *The Law of Contract,* 4 ed, p 598, that the use of the words 'condition' and 'warranty' to describe contractual terms is best avoided, not only because of the danger of confusion between conditions in the sense of contractual terms whose breach entitles the injured party to cancel and what Professor Christie calls 'true' conditions, ie, suspensive or resolutive conditions, which are not contractual terms at all, but also because we have adopted the English terminology of describing as 'warranties' terms in insurance policies and some other contracts which are really terms the material breach of which justifies cancellation.

[35] In view of the fact that the word 'warranty' can mean a term whose breach only gives rise to a claim for damages but can also mean a term whose material breach gives rise to a right to cancel, it is necessary in every case where the expression is used to examine the terms of the contract in question closely in order to endeavour to ascertain in what sense the parties have used it. I do not think that the parties in the present case attached any special significance to the word or that there is any basis for holding that they intended it to mean a term whose breach gives rise to a claim for cancellation even if notionally a monetary payment could remedy the problem. That this is so appears from clause 9.1, the first of the 'Seller's Warranties' in the agreement which reads as follows:

'The Seller shall be liable for all the debts and liabilities of the Business until the Date of Possession including, but not limited to, sums due to staff for Leave pay, P.A.Y.E deductions, Workmen's Compensation Insurance, and the like. The Seller accordingly indemnifies the Purchaser against any claim or liability incurred by the Business, or in respect thereof, prior to the Date of Possession.'

It is clear that this is a term whose breach can be remedied by a monetary payment.

[36] In truth what happened was that some (but by no means all) of the formulations were not the property of the respondent and could not be transferred to the appellant. Clearly to the extent to which portions of the *merx*

were not delivered the appellant had a claim for payment of an amount equal to the value of what was not delivered and presumably to a further claim if the business was worth less because these formulations were not delivered. There is no reason to believe that this claim was incapable of quantification in money.

[37] I do not think that the evidence of Messrs Taylor and Read that because of the breach the business was not commercially viable alters the position. It is clear from the passages from the evidence of Mr Taylor and Mr Read quoted by Louw J in the extract from his judgment reproduced in para 20 above that they regarded it as unviable in relation to their initial outlay. Payment of an amount as damages for the breach would presumably, as the respondent's counsel submitted, have served to restore the viability of the appellant's investment.

[38] I also do not agree with the appellant's contention that the respondent, by denying that it had breached clause 9.3, had repudiated the contract and that it was open to the appellant to accept the repudiation and thus bring the agreement to an end. Apart from the fact that the evidence did not show any acceptance as alleged, it will be remembered that clause 13 makes it clear that the proviso applies to 'any breach', which would include a repudiation.

[39] I am also of the opinion that the Full Bench was correct in holding that it is not open to the appellant to fall back on its damages claim as a basis for obtaining a winding-up order. Because of the agreement at the pre-trial conference the hearing before Griesel J was concerned solely with the question as to whether the appellant had the right to cancel the contract. The respondent conceded that *if it had to repay the full purchase price* it would be unable to do so. To that extent it would be unable to pay its debts. *Non constat* that would have been unable to pay to the appellant any damages awarded against it. Although it was clear on the evidence that the appellant had a damages claim against the respondent, the quantum of such claim has not been established. It was also not shown that the loss of Today Frozen

Foods as a customer was causally linked to the breach proved.

[40] For these reasons I am satisfied that the Full Bench's decision in this matter was correct. It follows that the appeal must be dismissed.

ORDER

[41] The following order is made:

The appeal is dismissed with costs, such costs to include the costs of two counsel.

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IG FARLAM

JUDGE OF APPEAL

CONCURRING

HOWIE P
BRAND JA
JAFTA JA
MAYA AJA