



(Disputes Tribunal Act 1988)
ORDER OF DISPUTES TRIBUNAL

District Court

[2023] NZDT 480

APPLICANT O Ltd

RESPONDENT B Ltd

The Tribunal orders:

B Ltd is to pay O Ltd \$8,434.00 within 28 days.

Reasons

[1] O Ltd ("O LTD"), represented by director Mr OS, claims from B Ltd ("B Ltd"), represented by director Mr KH, the sum of \$30,000.00. O LTD claims that B Ltd breached an agreement that the parties had made, and that it has suffered financial loss to that extent as a result.

[2] O LTD manufactures custom made rugs, as did B Ltd until 2016. In 2016, B Ltd wished to wind down its manufacturing, and the parties agreed that O LTD would carry out manufacturing work for B Ltd, although B Ltd would continue to sell manufactured rugs. B Ltd purchased a substantial part of B Ltd's manufacturing equipment, and the arrangement proceeded whereby B Ltd would, upon receiving orders for rugs from customers, engage O LTD to carry out manufacturing work. This arrangement continued, apparently with no great difficulties, for some five years.

[3] On 27 May 2021, the parties signed a new agreement that was expressed to operate for three years. So far as relevant here, the agreement provided that:

- O Ltd would continue to tuft, back, edge and pack all B Ltd Rug orders from 27 May 2021 until 27 May 2024; and
- B Ltd would supply the yarn needed for each order; and
- the rugs would be made, finished and packed to the same quality standards as those of B Ltd; and
- NRR would prepare a regular (monthly) production schedule that did not disadvantage B Ltd's lead times of its orders; and
- O LTD would store an agreed quantity of B Ltd's stock at no cost; and
- "The parties may discuss – in year three (or earlier if both parties agree) - a possible purchase by NRR of B Ltd's marketing assets, sock and business goodwill."; and
- "B Ltd will ensure that O Ltd has first option to purchase these assets subject to a satisfactory agreement being reached."

[4] OS said that in February 2022 KH had offered to sell to O LTD the assets of B Ltd that related to its rug business. OS said that he had had other priorities at the time, and had not accepted the offer. Subsequently, said OS, he had found that KH had sold those assets to ("D LTD"), and had engaged D LTD to do manufacturing work of the kind that O LTD had been doing for B Ltd. B Ltd gave no more work to O LTD after April 2023, which was when O LTD did its last work for B Ltd.

[5] OS had received from B Ltd's solicitors, ED, a letter, dated 6 July 2023, in which it was stated that B Ltd was cancelling the contract it had had with O LTD. The reason given in the letter was that B Ltd was concerned that O LTD had breached the contract by:

- failing to provide a regular monthly schedule; and
- failing to create a computerised list of product manufacturing specifications; and
- failing to make and finish samples to the same quality standards that had applied to B Ltd's production; and
- seeking to reduce the amount of B Ltd's yarn stored on O Ltd's premises.

[6] OS said that there had been occasional minor issues that had arisen over the years but that, generally, the parties' trading relationship had continued satisfactorily between 2016 and 2022. He denied that any of the items described as breaches on O Ltd's part were established, or that any of them justified B Ltd's purported cancelling of the contract.

[7] OS provided evidence relating to O LTD's trading record over the period in question. In summary, he said that B Ltd's work constituted about one third of the manufacturing done by O LTD. He considered that, as the agreement was stated to remain in place until 27 May 2024, O LTD had lost income from B Ltd that would have accrued between April 2022 and 27 May 2024. Each year, O LTD's average area of tufting work for B Ltd was 491.42 sq m; the price was 4220.00 per sq m; so, taken proportionally, the lost income amounted to over \$99,103.00 + GST.

[8] For B Ltd, KH agreed that the parties had traded as described above. He said, however, that he had made it clear to OS, when the parties signed their most recent agreement on 27 May 2021, that for health and other reasons he, KH, might not be able to continue the business until 2024. He said that by early 2022 B Ltd was not very profitable, and that his own health was such that he wished to bring the rug business to an end. Accordingly, he had offered the sale of B Ltd's remaining assets relating to its rug business to O LTD and, when that offer was refused, he had sold some of B Ltd's assets to D LTD. He considered that he was entitled to do so because of the clause in the parties' agreement, cited above, that referred to O LTD being given the first option to buy the assets. In any event, KH considered, there was no obligation on B Ltd to remain in business in order to provide O LTD with income.

[9] KH said that B Ltd had engaged in five more rug manufactures after it stopped providing work to O Ltd, and B Ltd had engaged D LTD to the necessary manufacturing work. The first of these was before he had authorised ED to inform O LTD that B Ltd was cancelling the contract; and three were made after that. The fifth, a large and expensive rug, would not have been made by O LTD in any event, said KH, because OS had indicated that he had not wanted to do that work.

[10] KH considered that B Ltd had been justified in cancelling the contract as it had stated that it was doing on 6 July 2023. In addition to the grounds stated in ED's letter, KH said that O LTD had become difficult to work with during the latter part of the parties' arrangement. That was because, said KH, OS was commuting from [Country 1] and was often unavailable, and a key employee of O LTD had elected to work part time. KH provided copies of messages in order to establish that this had caused some difficulties with deliveries and pickups of products, because O LTD's factory was closed on occasions during the working week.

O LTD's alleged breaches of contract

[11] As the parties have each provided detailed written statements regarding these, I shall briefly summarise their arguments. I have, however, considered all their arguments and the material that they provided.

(i) First, KH said that O LTD had not provided a production schedule relating to yarn delivered to O LTD's factory. He had had yarn for 1 – 4 rugs at the factory from time to time, and had wanted a schedule for when rugs would be made and sent. O LTD's failure to provide such a schedule was a breach of the parties' agreement, and had made it difficult for KH to keep his customers informed of the progress of their orders.

OS's response to this was that there was, generally, only yarn for 2 or 3 rugs on O LTD's premises at any one time. It was understood by both parties that, when yarn arrived, any work of another client that was in progress would be completed, and then B Ltd's work would be done immediately after that. There had been no issues about this flexible arrangement over 6 years. On one occasion, when a staff member was on leave, there was a delay, but he had kept KH informed about this.

(ii) KH said that OS had not recorded specifications relating to the yarn, which had disadvantaged B Ltd. This was particularly so with samples named "N" and "SG". He had had trouble as a result in ordered, regarding yarn details. He said that he had repeatedly asked for specifications. The material he had received relating to this had been roughly handwritten, was provided late, and was difficult to decipher. A result of this was that two batches were produced too late for a planned trade show. He had considered O LTD's conduct regarding this as unacceptable, but had not taken the matter further because B Ltd's business was, in any event, coming to an end at that point.

OS said that O LTD had created the necessary information, but had not sent it on to KH because KH had not asked for it. KH had communicated when he needed to with O Ltd's head tufter, and the needs and issues were discussed as they arose.

(iii) KH considered that some of the work done by O LTD was not up to the standard required by the contract. He said that it was generally impossible to tell if there were imperfections in yarn wound on a cone, and it was up to the tufter, who worked on the back of the rug, to check constantly that the appearance on the other side of the rug was satisfactory. Repairs could, and should, then be carried out as work continued. KH said that in some cases, particularly an expensive order for a customer in [city 1], this was not done, and there were visible imperfections in the work. A repair was done on the completed work by using a seam, which was unsatisfactory. The customer's agent had raised that issue but, said KH, the customer had fortunately accepted the rug as it was. This had caused KH considerable stress. KH emphasised that all yarn could have imperfections, and only the tufter could see that as the work progressed. It was not possible to send perfect yarn for tufting.

OS accepted that imperfections in yarn could not be seen on the cone, and that a tufter had to check the appearance of the work as it continued. Variances could become visible while the rug was on the frame, but that was not always the case. Sometimes, the finished effect was not visible until the rug was removed from the frame, and sheared. He said that O LTD had to work with the yarn that was provided to it, and could not control its quality. He noted that O LTD had made, if measured in square metres, some 3,000 sq m of rugs and samples for B Ltd over a six year period; and that the samples of which KH complained were 1.8 sq m in size, and so a minuscule proportion of the total work done.

(iv) KH said that there had been plenty of space at O LTD's premises for storage of B Ltd's goods, but that OS had placed a limit of 3 pallets. Some material had been stored at the factory of OS's father, which was some distance away. This was a nuisance when it came to deliveries by suppliers, which were troublesome to organise.

OS's response was that he had stored a reasonable amount of B Ltd's yarn, but that space had been limited and other clients had also sent yarn. Some yarn had remained on O LTD's premises for some years. On many occasions, deliveries were arranged, without objection from KH, at OS's father's factory, which was a five-minute drive away from O LTD's premises.

(v) KH, in addition to the items mentioned as grounds for cancellation in ED's letter, said that problems had arisen because a key employee of O LTD had cut his hours and began to work part time. This, added to the fact that OS was commuting from [Country 1], meant that O LTD's factory was closed on occasions and problems with deliveries had resulted.

OS said that he had increased the time that he had spent in the factory when his employee had cut his hours. He said that there had been only a few days when the factory had been closed and he had notified KH about them when deliveries were to be made. He did not consider that delays or disruptions had been caused to B Ltd by this.

O LTD's claim for compensation

[12] OS, as described above, sought compensation for work that O LTD would have had if B Ltd had not gone out of business. He argued that the contract was expressed to run until 27 May 2024 and that, by withdrawing its business from O LTD, B Ltd had caused loss to O LTD amounting to \$99,103.00 + GST. He also argued that, the contract providing that B Ltd would give all its manufacturing work to O Ltd, B Ltd had not been entitled to give such work to D LTD when O LTD was prepared to do it.

[13] KH, having described the five items of work done by D LTD mentioned above, considered that O LTD would have lost only four of those items. He emphasised that only one of the four was done by D LTD before ED's letter was sent, and the other three were done after that. These four items, according to O LTD's averages, would have provided to O LTD, if it had done the work, \$5,434.00. Of this, said KH, only a portion, perhaps a third, would have been profit because O LTD would have had overheads associated with doing the work. With regard to the fifth item, which D LTD made in late June, KH said that he had told OS of the possible work, which was a large and more expensive undertaking, and OS had indicated that he had not wished to do it.

[14] OS did not accept that he had rejected the possibility of doing the fifth item of work. He had been aware that this larger job was coming up, which would have, he said, yielded about \$3,000.00 to O LTD. He had waited for the yarn to be supplied. He had expected until May 2023 that B Ltd would continue to comply with its agreement and would provide all its manufacturing work as described in the contract exclusively to O LTD.

The issues

[15] I must decide:

- whether B Ltd was in breach of its contract by ceasing to supply work to O LTD; or
- whether O LTD was itself in breach so as to justify B Ltd's cancellation of the contract; and
- if B Ltd was in the wrong, whether B Ltd should compensate O LTD; and
- if so, what sum should be payable.

Has O LTD proved a breach of contract on the part of B Ltd?

[16] Fundamental to this question are the terms of the parties' contract. The parties agreed that B Ltd would give all its manufacturing work, as described in the contract, to O LTD. However, the contract does not provide for any particular quantities, or even that any work had to be supplied at all. I read the contract as meaning that B Ltd must, if it has manufacturing work to be done, give that work to O LTD. The term during which it is required to do so is expressed to end on 27 May 2024.

[17] I consider that B Ltd, by giving manufacturing work to D LTD, was in breach of its contractual obligations to O LTD. It had agreed that "all" such work would be given to O LTD during the period in question, but failed to do so. Rather, before it ceased its business, it diverted its last items of work to D LTD.

[18] As the parties' contract did not provide for any particular quantities of work to be given to O LTD, I do not think that B Ltd was not entitled under the contract to cease its rug business. I do not think it can be implied into the contract that B Ltd would remain in business, despite declining profitability, so that O LTD could continue to receive earnings from it. Rather, I think that B Ltd's obligation was to give such manufacturing work as it might have, from time to time or as long as it remained in business, to O LTD. I accept that OS had been told by KH, a key and essential person in B Ltd's business, that KH had some health issues, and that it might not be possible for B Ltd to remain in business for the full term stated in the contract.

Did any breaches on the part of O LTD justify B Ltd in cancelling the contract?

[19] I do not consider any of the breaches described by KH were such that B Ltd was justified in purporting to cancel the contract, as it did by means of ED's letter.

[20] First, I accept that KH has established that a formal production schedule and detailed specifications were not provided, as he said. However, despite this, the parties' contract continued to operate without any apparent problems for some six years. There is no evidence that these matters were particularly significant, or that B Ltd suffered any financial loss relating to them. Rather, I consider that the parties continued to operate over the contract period in an informal way, and that any essential information that was needed was asked for and provided as required.

[21] I accept that KH has proved that there were some imperfections in, perhaps, two samples. These were a very small proportion of the total work that O LTD provided to B Ltd over the years that the contract continued and, in my view, did not justify a cancellation of the contract. KH did not act to bring the contract to an end at that point, but chose to leave matters as they stood. This was because, as he said, B Ltd's business was in any event coming to an end. Again, he has not established any financial loss in relation to any defective work done by O LTD.

[22] KH did not press the issue of storage, but described it as a more minor matter. I do not think that that matter would have justified the cancellation of the contract, or that it caused any particular loss to B Ltd, whether financial or otherwise.

[23] I consider that KH has proved that O LTD's factory was closed on some days because a key employee had cut his hours. I also accept that OS increased his work time in the factory to compensate for this. While this was an inconvenience on some occasions to KH, I do not think that he has shown that that inconvenience was more than minor, or that losses to B Ltd resulted.

[24] Thus, I consider that the above matters did no more than constitute annoyances on occasion to B Ltd, but did not result in any substantial disruption to business or financial loss. It is, of course, possible for a number of minor matters to constitute a breach of contract so serious that an innocent party is justified in cancelling the contract. I do not think that this is so in this case. Rather, I consider that the parties continued for some six years to trade with each other in a flexible and informal manner, and tolerated, or dealt with, minor annoyances or difficulties as they arose. It was only when B Ltd's business was coming to an end, and O LTD had refused B Ltd's offer to buy its assets that these issues were given prominence by KH.

[25] Thus, I consider that B Ltd was not entitled to purport to cancel the contract as it did by ED's letter of 6 July 2023.

What compensation is payable by B Ltd?

[26] As O LTD had committed no substantial breach of contract, B Ltd's purported cancellation was unjustified and ineffective. Thus, O LTD is entitled to be compensated for what it should have received under the contract, which was the manufacturing work described in it. I consider that B Ltd was in breach by giving this work to D LTD when it had an existing obligation to provide such work exclusively to O LTD.

[27] I accept that O LTD has proved that it would have received, had it been given the first four of the jobs that were given to D LTD, \$5,434.00. This is the sum that B Ltd would have paid to O LTD for this work. I do not think that any deduction should be made for overheads, or costs that might have been incurred by O LTD in doing the work. It was running its factory and paying its employees in any event, and there is no evidence that O LTD received substitute work to compensate for what it lost from B Ltd. B Ltd's contracts had constituted about one third of O LTD's business, and losses could not easily be mitigated.

[28] With regard to the final business act of B Ltd, which was the larger job given to D LTD, I consider that OS has proven that O LTD should also have had this work. I do not accept that it was offered to OS but that he declined it. I accept his evidence that he expected the work to be placed with O LTD and, at that point, had not realised that B Ltd wished to deal with D LTD, which had bought B Ltd's assets, instead. OS said that this item of work would have yielded some \$3,000.00 in profit to O LTD, and KH did not contradict that. Thus, I have allowed this sum also.

Result

[29] The result is that B Ltd must pay O LTD \$8,434.00 as compensation for the work that it provided to D LTD instead of to O LTD, as it should have done under its contract with O LTD. As B Ltd stopped trading after this, and required no more manufacturing work, O LTD is not entitled to any compensation for lost work beyond this.

Referee: C Hawes

Date: 21 September 2023



Information for Parties

Rehearings

You can apply for a rehearing if you believe that something prevented the proper decision from being made: for example, the relevant information was not available at the time.

If you wish to apply for a rehearing, you can apply online, download a form from the Disputes Tribunal website or obtain an application form from any Tribunal office. The application must be lodged within 20 working days of the decision having been made. If you are applying outside of the 20 working day timeframe, you must also fill out an Application for Rehearing Out of Time.

PLEASE NOTE: A rehearing will not be granted just because you disagree with the decision.

Grounds for Appeal

There are very limited grounds for appealing a decision of the Tribunal. Specifically, the Referee conducted the proceedings (or a Tribunal investigator carried out an enquiry) in a way that was unfair and prejudiced the result of the proceedings. This means you consider there was a breach of natural justice, as a result of procedural unfairness that affected the result of the proceedings.

PLEASE NOTE: Parties need to be aware they cannot appeal a Referee's finding of fact.

Where a Referee has made a decision on the issues raised as part of the Disputes Tribunal hearing there is no jurisdiction for the District Court to reach a finding different to that of the Referee.

A Notice of Appeal may be obtained from the Ministry of Justice, Disputes Tribunal website. The Notice must be filed at the District Court of which the Tribunal that made the decision is a division, within 20 working days of the decision having been made. There is a \$200 filing fee for an appeal.

You can only appeal outside of 20 working days if you have been granted an extension of time by a District Court Judge. To apply for an extension of time you must file an Interlocutory Application on Notice and a supporting affidavit, then serve it on the other parties. There is a fee for this application. District Court proceedings are more complex than Disputes Tribunal proceedings, and you may wish to seek legal advice.

The District Court may, on determination of the appeal, award such costs to either party as it sees fit.

Enforcement of Tribunal Decisions

If the Order or Agreed Settlement is not complied with, you can apply to the Collections Unit of the District Court to have the order enforced.

Application forms and information about the different civil enforcement options are available on the Ministry of Justice's civil debt page: <http://www.justice.govt.nz/fines/about-civil-debt/collect-civil-debt>

For Civil Enforcement enquiries, please phone 0800 233 222.

Help and Further Information

Further information and contact details are available on our website: <http://disputestribunal.govt.nz>.