THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

JUDGMENT

Not Reportable
CASE NO 348/2006

In the matter between

JOCHEN KOFAHL Appellant

and

S L KEILEY Respondent

Coram: Streicher, Heher and Jafta JJA
Heard: 7 MARCH 2007
Delivered: 29 MARCH 2007

Summary: Company shares – valuation – relevant factors – onus on the plaintiff.

Neutral citation: This judgment may be referred to as *Jochen Kofahl v S L Keiley* [2007] SCA 41 (RSA)

JAFTA JA

[1] This is an appeal against a judgment by Willis J in the Witwatersrand Local Division in an amount of US $ 100 000,00 against the appellant in favour of the respondent in an action in which the issues had been split. Blieden J had previously declared that the respondent, as a result of the appellant's repudiation of a contract with the respondent, was entitled to 10% of the value of Palmerfield Ltd calculated as at 6 January 1997. The valuation was to be done on the assumption that Palmerfield was vested with the exclusive licence to manufacture and sell Hydraform machines worldwide outside Africa. Willis J placed a value of US $ 1m on Palmerfield Ltd.

[2] The appellant, a mechanical engineer based in Boksburg, invented a brick making machine called 'Hydraform Machine' in 1988. This machine may be powered by an electrical or diesel motor. It is compact and easily transportable. It produces bricks by hydraulically compressing soil mixed with a small amount of cement. The bricks are shaped in such a way that they interlock with each other so as to make it unnecessary to use binding material at construction. They also provide more thermal insulation and are rendered impermeable by applying grout or a coat of paint. These bricks are ideally suitable for building low cost houses. The appellant sold the machine in South Africa and other African countries. Patents had been registered in the name of companies operated by the appellant.

[3] In 1995 Mr John Carter (Carter), a businessman from Malawi, introduced the respondent to the appellant. The respondent is an American businessman with a degree in economics from Yale University and a MBA degree from Havard University. At the time he was a partner in a business consultancy firm known as Robert A Weaver Junior and Associates which operated as such in the United States. The respondent was stationed at its branch in Washington DC.

[4] Before the parties' meeting the appellant was anxious to sell the machines outside Africa. He had contacted the Cement Institute in Argentina in the hope that it would facilitate the introduction of his business there. He had hoped also to explore the market in India and he held some discussions with a third party in that regard. After the meeting the appellant was optimistic that the respondent was a potential partner to successfully drive the sale of his machine worldwide. While the respondent saw the invention as presenting an opportunity for him to get involved in an exciting venture. However, the respondent could not immediately get involved in the venture with the appellant because he was still contractually bound to the consultancy firm. Instead and acting on behalf of the firm, he proposed an agreement between the appellant and the firm for the exploitation of the invention but the latter turned it

down.

[5] However, in November 1995 before the respondent left the consultancy firm, he concluded an oral agreement with the appellant to market and sell the machines in countries outside Africa. Due to the qualities of the machines, their target market was the developing countries. The parties decided to use a company as a vehicle through which the joint venture was to be carried out. For this purpose they agreed, together with Carter, to use Palmerfield Limited, the latter's dormant company registered in the British Virgin Islands. The appellant was allocated 80% of shares in that company while the respondent and Carter received 10% each. They agreed that the appellant would grant an exclusive licence to Palmerfield to market and sell the machines outside Africa. The appellant was hopeful that the respondent would raise capital for the company.

[6] At the time Argentina had a housing backlog amounting to millions of units. This caused enormous optimism. As a result the respondent gave his partners unrealistically high sales projections for the machines. At one point he estimated that in Argentina alone, they were going to sell 1000 machines in five years. In January 1996 the respondent expressed the view that they might realize profits in an amount of $8,5m to $20m.

[7] The appellant had appointed Oscar Termine, an architect in Buenos Aires, as his representative in Argentina. However, by March 1996 the appellant had run out of money whereupon the respondent undertook to take Termine over and to pay his salary. The respondent remained in Washington while Termine was doing the marketing of the machine in Argentina. As Termine could not speak English, the respondent engaged Ms Patricia Scott, an Argentinian who was then working in Washington DC, to interpret for him from Spanish to English whenever he had a telephonic conversation with Termine. At that time Ms Scott was working for Special Olympics International, an entity that was involved in the development and organisation of sports events for the physically challenged people. She was promised a fulltime employment at Palmerfield in the event of the business being successful. By virtue of her professional relationship to the respondent, she interacted almost daily with Termine, albeit by telephone. She visited her relatives in Argentina once a year and claimed to have been familiar with the housing market there as information relating thereto was easily available. She claimed to have been involved in the marketing of the machines but her involvement would not seem to have gone any further than acting as an interpreter and translator. She never saw a hydraform machine nor did she know how it was operated or what kind of soil was suitable for use in making bricks with the machine.

[8] The marketing of the machine in Argentina took the form of a presentation by the respondent to the Cement Institute, an entity representing cement companies in Argentina. They were exhibited at major trade fairs and demonstrated to municipal and provincial governments. An overwhelming interest was shown in the machine by all those who were introduced to it. Despite the extensive marketing and the exposure it received, no more than 8 machines had been sold by 6 January 1997.

[9] In May 1996 the relations between the appellant and the respondent were strained and the appellant offered the Argentinian franchise in respect of the machine to the respondent for US$100 000 but the respondent declined. The joint venture was struggling to carry on its operations because it had no capital. It attracted no investments. As relations between the partners continued to deteriorate, further attempts were made to reach an amicable dissolution of the joint venture without success. In June 1996 Carter made an offer for the business in Argentina to the respondent in exchange of his shares in Palmerfield on certain conditions. Again the respondent declined the offer.

[10] In September 1996 the appellant repudiated the joint venture

agreement. The respondent accepted the repudiation and cancelled the agreement on 6 January 1997. Meanwhile the appellant and Carter had approached some businessmen in Guernsey in the British Virgin Islands to invest in the venture as they still, at that time, had hope in its success in Argentina. A presentation was made to potential investors who were impressed by the machine but instead of investing in Palmerfield, they insisted that a new company, licensed to sell the machine outside Africa, be formed which would be fully controlled and managed by them. The sum of US$100 000 was raised and a company called International Equipment Distributors Ltd (IED) was formed to be substituted for Palmerfield in Argentina and other parts of the world. With a capital investment of US$100 000, there was again optimism that IED would succeed. But this was not to be. In November 1996 there were clear signs that IED was going to suffer the same fate. In order to accommodate the investors IED was granted additional rights to sell machines in Africa.

[11] Following the cancellation of the agreement in January 1997, the respondent sued the appellant in the Johannesburg High Court for damages in the sum of US$2 300 000 which, he claimed, represented 10% of the value of Palmerfield, had the agreement been properly performed. At the trial the issues of liability and quantum were separated. Blieden J was asked to determine liability only. The learned Judge found

that the appellant had indeed repudiated the agreement and issued an order in the following terms:

''1. It is declared that the plaintiff is entitled to 10% of the value of Palmerfield Ltd (Palmerfield), calculated as at 6 January 1997 on the assumption that Palmerfield was vested with exclusive licence to manufacture and sell the Hydraform machines worldwide outside Africa.

2. The matter is postponed sine die for the purpose of the parties calculating the aforesaid value. If the matter cannot be resolved by the parties, leave is granted to either of the parties to set the matter down in this court for resolution of this issue.'

[12] Resolution of the issue eluded the parties and as a result the matter came before Willis J for determination of the 10% value of the shares. The learned Judge found that such shares carried the value of US$100 000 and ordered the appellant to pay this amount to the respondent. The appellant unsuccessfully sought leave against the latter order only. The appeal serves before us with leave of this court.

[13] The only issue in this appeal is whether the respondent on whom the onus lay, has established the value of the shares in question. Palmersfield did not have assets other than the licence to sell the machines which it must be assumed it had, nor did it have capital for its operations.

[14] Willis J adopted, correctly in my view, the approach of determining what a willing reasonable buyer would have been prepared to pay for 10% of the shares. He referred to *Holt and Others v Inland Revenue Commissioners* [1953] 2 All ER 1499 E-H. In that case Danckwerts J said at 1501:

'The result is that I must enter into a dim world peopled by the indeterminate spirits of fictitious or unborn sales. It is necessary to assume the prophetic vision of a prospective purchaser at the moment of the death of the deceased, and firmly to reject the wisdom which might be provided by the knowledge of subsequent events. …
By the terms of the section I have to imagine the price which the property would fetch if sold in the open market. This does not mean that a sale by auction (which would be improbable in the case of shares in a company) is to be assumed, but simply that a market is to be assumed from which no buyer is excluded. … At the same time, the court must assume a prudent buyer who would make full enquiries and have access to accounts and other information which would be likely to be available to him…'

[15] Our courts have time and again determined the value of assets by reference to the price which a willing seller might reasonably expect to obtain from a willing buyer (*Illovo Sugar Estates Ltd v South African Railways & Harbours* 1947 (1) SA 58(W) at 73 and the authorities there cited). This method of determining the value of property was affirmed by

this court in *Scott and Another v Poupard and Another* 1971 (2) SA 373 (A). There Miller AJA said at 381E-G:

'What has to be determined is what the actual value of the shares would have been had the company been formed in accordance with the agreement and had the appellants acted as they were required to do. The ultimate criterion in regard to evaluation of the shares of the company on that hypothesis, and bearing in mind that the shares would not be quoted on the market, is what a willing purchaser would, at the given time, have been prepared to pay to a willing seller for such shares; and in considering that question it is necessary to attribute to such imaginary purchaser reasonably detailed knowledge of the company, its management, its assets and liabilities, its potential and other relevant factors which might have a bearing on the company's prospects of flourishing and of paying a dividend.'

[16] In the present case the fictitious purchaser would have, on the one hand, information relating to the attractive market in Argentina: the housing backlog there amounting to 5.5 million units and the government's budget of US$600 million for low cost housing; he would also take account of the fact that the machine had impressive qualities which attracted interest of all those to whom it was introduced. He would consider that Palmerfield had an exclusive licence to sell the machine. All these factors may tilt the scale in favour of buying the shares.

[17] But, on the other hand, our imaginary prudent purchaser would

have in his possession information which waters down those attractive factors. He would know that despite extensive advertising and marketing the machines did not sell; that in January 1997 no more than eight machines had been sold. He would be aware of the fact that no market research was conducted prior to introducing the machine and that the company's management failed to establish whether the soil in Argentina was suitable for use by the machine. He would also consider that the company had no assets other than the licence which it is deemed to have had and which was given to IED free of charge. He would establish that Palmerfield had no capital and that its management was not based in Argentina, factors which would severely hamper it in its operations.

[18] In placing a value of $100 000 on Palmerfield the court a quo relied on:

a) The sales projections testified to by Patricia Scott purporting to be an expert witness and the evidence of Prof Wainer who valued the shares on the basis of these projections. Although she was born in Argentina she last worked in Argentina in 1982. From 1991 to 1997 she worked for Special Olympic International. Being fluent in Spanish she acted as an interpreter and translator for the respondent during the period January 1996 to August/September 1996. She was obviously not qualified to

express an opinion as to what sales could be achieved. Her evidence should have been rejected as being of no value.

b) The appellant's offer during June 1996 to sell to the respondent the right to market the machine in Argentina for $100 000 which it wrongly interpreted to have been an offer in respect of 10% of such rights whereas it was an offer for 100% of such rights. The offer was not accepted by the respondent.

c) Johan Blersch's willingness to invest in the project in Argentina. Blersch advanced money in respect of the project in Argentina, he did not acquire any equity interest in the project.

d) The fact that Guernsey investors were in September 1996 prepared to invest $100 000 and later an additional $50 000 in the marketing of the machine outside Africa. However, the company International Equipment Distributors, a company managed and controlled by them, acquired the licence to do so, being Palmerfield's only (deemed) asset, free of charge.

e) The widespread enthusiasm generated by the machine. However, by 6 January 1997 that enthusiasm had not converted into meaningful sales and had proved to have been misplaced.

f) The fact that some sales had materialised by 6 January 1997. However, no more than eight sales had been concluded by that date.

[19] In my view the evidence does not establish that the right to market the machine outside Africa had any value as at 6 January 1997. In the event the enterprise to market the machine outside Africa, proved to be unsuccessful by reason of cheaper products being available, the unavailability of suitable soil, traditional building methods, vested interests, labour costs and in the case of Brazil the availability of a cheaper manually operated machine. The judge a quo mentioned the fact that the venture was unsuccessful in South America but was of the view that it was with the benefit of hindsight that the reasons are known and that hindsight may not be applied in the valuation. In this regard he relied on the judgment of Danckwerts J in *Holt and others v Inland Revenue Commisioners*. However, to the statement by Danckwerts J that wisdom which might be provided by the knowledge of subsequent events should be rejected Danckwerts J added that one must assume a prudent buyer who would make full enquiries. There is no reason to believe that such a purchaser would not have discovered many if not all the problems which caused the project to fail. In the result knowledge of the problems cannot be considered to be the wisdom of hindsight. In fact, by 6 January 1997 Blersch, a South African businessman, had become aware, after two visits to Argentina, of at least some of the problems. He thought that this was a high risk business and that no buyer would be prepared to pay anything

for a 10% interest in the project.

[20] This is not a case where evidence and witnesses were not available to the respondent. The respondent himself is a well qualified businessman who had tried to raise money for the project and who was intimately involved in attempts to market the machine. He should have been able to assist the court in determining a value. There should also have been Argentinian building contractors who had knowledge of the machine and of conditions in Argentina who could have assisted. Yet the respondent chose not to testify and not to call witnesses who could be of assistance to the court. Instead of doing so he elected to call a person who he had employed in the United States on a part time basis as an interpreter and translator and who did not know the machine and who had no knowledge of factors that could affect the marketability of the machine.

[21] In these circumstances the court below should have granted absolution from the instance. It follows that the appeal must succeed.

[22] The following order is made:

1. The appeal is upheld with costs.
2. The order of the court *a quo* is altered to read:

‘Absolution from the instance with costs.’

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C N JAFTA
JUDGE OF APPEAL

CONCUR:) STREICHER JA
) HEHER JA