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Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd [2010] FCA 1028 (28 September 2010)

Last Updated: 8 October 2010

FEDERAL COURT OF AUSTRALIA

Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd [\[2010\] FCA 1028](#)

Citation:	Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd [2010] FCA 1028
Parties:	CASTEL ELECTRONICS PTY LTD (ACN 074 561 087) v TOSHIBA SINGAPORE PTE LTD (REG NO 197 401 688Z)
File number:	VID 141 of 2008
Judge:	RYAN J
Date of judgment:	28 September 2010
Dates of hearing:	3, 4, 5, 9, 10, 11, 12, 15-19 June 2009 inc; 17, 18, 20, 24, 25 and 27 August 2009 inc and 19-23 October 2009 inc
Place:	Melbourne
Division:	GENERAL DIVISION
Category:	No Catchwords
Number of paragraphs:	236

Counsel for the Applicant: Mr R Garratt QC with Mr D Bailey

Solicitor for the Applicant: Wilmoth Field Warne to 8 October 2009,
then Browne & Co

Counsel for the Respondent: Mr E N Magee QC with Mr A P Young

Solicitor for the Respondent: DLA Phillips Fox

**IN THE FEDERAL COURT OF AUSTRALIA
VICTORIA DISTRICT REGISTRY
GENERAL DIVISION**

VID 141 of 2008

BETWEEN: CASTEL ELECTRONICS PTY LTD (ACN 074 561 087)
Applicant

AND: TOSHIBA SINGAPORE PTE LTD (REG NO 197 401 688Z)
Respondent

JUDGE: RYAN J

DATE OF ORDER: 28 SEPTEMBER 2010

WHERE MADE: MELBOURNE

THE COURT ORDERS THAT:

1. There be judgment for the applicant in the sum of \$2,613,127.
2. The respondent's cross-claim be dismissed.
3. The further hearing of these proceedings be adjourned to a date to be fixed in consultation with the parties for receiving submissions on the questions of interest on the judgment sum and the costs of the proceedings.
4. The time for filing and service by either party of a notice of appeal herein be extended until the expiration of 21 days from the making of final orders in respect of the matters referred to in paragraph 3 of this Order.

Note: Settlement and entry of orders is dealt with in Order 36 of the [Federal Court Rules](#).
The text of entered orders can be located using Federal Law Search on the Court's website.

**IN THE FEDERAL COURT OF AUSTRALIA
VICTORIA DISTRICT REGISTRY
GENERAL DIVISION**

VID 141 of 2008

BETWEEN: CASTEL ELECTRONICS PTY LTD (ACN 074 561 087)
Applicant

AND: TOSHIBA SINGAPORE PTE LTD (REG NO 197 401 688Z)

Respondent

JUDGE: RYAN J
DATE: 28 SEPTEMBER 2010
PLACE: MELBOURNE

REASONS FOR JUDGMENT

FACTUAL AND CONTRACTUAL HISTORY

1. The applicant, Castel Electronics Pty Ltd (“Castel”) which was incorporated on 25 June 1996 has, since that date, carried on in Australia the business, formerly conducted by a predecessor company, of a wholesaler and distributor of electrical and electronic products including television receivers, audio products, white goods including air conditioners and associated goods. As a result of the introduction to Australia of high definition digital television broadcasting and the projected phasing-out of analogue television broadcasting, a demand was created from about 2003 for set-top boxes which enabled the digital signal transmitted by television broadcasters to be captured and displayed through an analogue television receiver. As well as effectively converting analogue television receivers into digital receivers, more advanced set-top boxes incorporated a recording function which enabled programs to be recorded, rewound and replayed in more varied, complex and sophisticated ways than had been available using traditional VCR recorders to record material received by analogue television receivers.

2. The respondent, Toshiba Singapore Pte Ltd (“TSP”) which is incorporated in Singapore is a wholly-owned subsidiary of Toshiba Corporation (“Toshiba”) and Toshiba Home Appliance Corporation (“THAC”) both of which are incorporated in Japan. Toshiba has, for many years, been a large-scale manufacturer of electrical and electronic equipment and from about August 1997 arranged for TSP to distribute most of its products throughout Asia including to Russia and the Middle East. Pursuant to that arrangement, TSP became the supplier to Castel of many “Toshiba” branded television products. Many of the products so supplied were manufactured by TSP or by companies to which TSP had contracted their manufacture.

The distributorship agreement between Toshiba and Castel

3. Before the advent of TSP, Castel had in 1996 entered into a non-exclusive distribution agreement with Toshiba. That agreement was dated 8 August 1996 and contained, amongst others, the following provisions;

ARTICLE 4 – INCOMING INSPECTION

(1) CASTEL shall send TOSHIBA a written notice of any claim connected with the defect of the PRODUCTS, together with a proper evidence thereof, in time to be received by TOSHIBA within thirty (30) days from the date of the relative bill of lading of the PRODUCTS.

Unless such notice accompanied by proper evidence is received by TOSHIBA within such thirty (30) days period, CASTEL shall be deemed to have waived any claim with respect to the PRODUCTS concerned. If TOSHIBA, after the examination of such alleged claim, acknowledges that any of the PRODUCTS concerned is defective due to the fault or negligence of TOSHIBA or the manufacturer of such PRODUCTS, then TOSHIBA will at its

option in each instance:

- (a) replace, free of charge, such defective PRODUCTS or parts thereof.
- (b) repair such defective PRODUCTS at TOSHIBA's expense, or
- (c) reimburse CASTEL for the expenses incurred by CASTEL in correcting such defective PRODUCTS.

THE FOREGOING STATES THE ENTIRE AND ONLY WARRANTY, EITHER EXPRESS, IMPLIED OR STATUTORY, MADE BY TOSHIBA WITH RESPECT TO THE PRODUCTS OR PARTS THEREOF DELIVERED TO CASTEL PURSUANT TO THIS AGREEMENT, AND ALL OTHER WARRANTIES, INCLUDING WITHOUT LIMITATION THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, ARE HEREBY DISCLAIMED: and TOSHIBA shall not be liable for any special, indirect, incidental or consequential damages.

ARTICLE 5 – DELIVERY, TITLE AND RISK OF LOSS

TOSHIBA shall deliver the PRODUCTS to CASTEL, FOB Japan. Title to and risk of loss of the PRODUCTS purchased by CASTEL hereunder shall pass to CASTEL upon such delivery.

... ..

ARTICLE 7 – MINIMUM PURCHASE

CASTEL guarantees to purchase at least such quantity or amount of the PRODUCTS as set forth in EXHIBIT B, attached hereto, as the minimum purchase from TOSHIBA. For the purpose of this Article, the PRODUCTS shall be deemed to be purchased when delivery of such PRODUCTS has been made in accordance with Article 5 (DELIVERY, TITLE AND RISK OF LOSS) hereof.

ARTICLE 8 – SERVICE OBLIGATIONS

(1) CASTEL shall provide its customers with a prompt and proper service and maintenance in respect of PRODUCTS at its own expense and responsibility.

(2) For this purpose, CASTEL agrees to stock such reasonable quantity of service parts as is required to provide such service and maintenance for the PRODUCTS and agrees to maintain, and shall cause CASTEL's dealers to maintain, appropriate service facilities, including a reasonable number of persons acquainted with installation and maintenance of PRODUCTS who shall be trained and qualified by TOSHIBA (or by CASTEL in case of its dealers).

(3) During the term of this Agreement, TOSHIBA shall supply CASTEL with any available service parts required for the purpose of this Article in accordance with the then current price list for TOSHIBA's service parts, for which prices may be changed from time to time by TOSHIBA. TOSHIBA shall maintain the ability to supply to CASTEL its reasonable requirements for such service parts.

In the event of expiration or termination of this Agreement, TOSHIBA's obligation to supply CASTEL with such service parts, if any, shall remain on condition (and to the necessary extent) that CASTEL shall provide its customers with service and maintenance in respect of PRODUCTS sold by CASTEL prior to such termination or expiration; provided however that in the event of termination of this Agreement by TOSHIBA pursuant to Article 15 (TERMINATION) (1) or (2) hereof, TOSHIBA shall be released from its obligation under (3) of this Article.

(4) CASTEL shall maintain and submit to TOSHIBA, upon its request, field failure report, service report and the service records.

... ..

ARTICLE 10 – MARKETING AND ADVERTISEMENT

(1) CASTEL shall undertake for its own account marketing, sales, advertisement and sales promotions of the PRODUCTS and shall use its best endeavours towards obtaining the largest sales volume of the PRODUCTS in the TERRITORY.

(2) Any advertisement for CASTEL's sales promotion of the PRODUCTS shall be made at

CASTEL's own discretion and expense unless TOSHIBA agrees in writing to share or pay such expense.

(3) TOSHIBA agrees to provide CASTEL with a reasonable quantity of such advertising materials or other sales support as catalogues, leaflets and posters written in English, the quantity of which shall be decided upon by negotiation between the parties hereto. CASTEL shall bear any freight, insurance, tax, duty, assessment and any other charge and/or expense which may be charged or imposed on such materials after delivery thereof to the carrier at Japanese port of shipment.

ARTICLE 11 – INFORMATION AND REPORTS

CASTEL shall furnish TOSHIBA with the following:

(a) Quarterly order forecast of the PRODUCTS at least four (4) months before the beginning of such quarter period.

(b) Reports on monthly inventory and sales results and forecast of the PRODUCTS in a form satisfactory to TOSHIBA by tenth (10th) working-day of the succeeding month.

(c) Information on market conditions and any other information in the TERRITORY which CASTEL shall collect at any time.

... ..

ARTICLE 14 – TERM OF AGREEMENT

(1) This Agreement shall become effective on July 1, 1996 and shall continue to be effective until March 31, 1997 unless sooner terminated pursuant to the provisions of Article 15 (TERMINATION) hereof or by operation of law or otherwise.

Thereafter, this Agreement will be renewed on a year-to-year basis if the parties hereto agree in writing upon terms and conditions for such renewal at least one (1) month prior to the expiration of the original period or any renewed period.

Provided, however, the terms and conditions of any renewed agreement shall be negotiated in good faith substantially based upon the current terms and conditions of the Agreement.

(2) Any shipment made by TOSHIBA after the expiration or termination of this Agreement shall not be construed as meaning an agreement by TOSHIBA to extend or renew this Agreement.

(3) CASTEL shall not make any claim or demand against TOSHIBA for any damage, loss, expense or cost, if any, including but not limited to compensation for goodwill, incurred as a result of or in connection with the expiration and non-renewal of this Agreement.

ARTICLE 15 – TERMINATION

(1) If either party has defaulted in any provision of this Agreement and failed to remedy such default within sixty (60) days after receiving a written notice from the non-defaulting party, the non-defaulting party may terminate this Agreement without any further written notice.

(2) If there by:

(a) an insolvency of either party or

(b) a substantial change in the control or management of either party which is unacceptable to the other party, the other party may terminate this Agreement forthwith upon written notice.

... ..

(5) Any termination of this Agreement under Article 15 (TERMINATION) (1), (2) or (3) hereof shall not prejudice any right and remedy available to the terminating party under law, trade custom or otherwise.

... ..

ARTICLE 20 – ENTIRE AGREEMENT

This Agreement supersedes all prior discussions and writings and constitutes the entire and only agreement concerning the PRODUCTS between parties, and this Agreement may not be changed, altered or amended except in writing signed by duly authorized representatives of the parties.

Exhibit B to that distributorship agreement recited:

Minimum Purchase Quantity

1. The minimum purchase quantity for the first period from July 1, 1996 to March 31, 1997:

Color Television Receivers: (1,000 sets)

2. The minimum purchase quantity for the period(s) subsequent to paragraph 1 above shall be agreed upon between the parties ninety (90) days prior to the end of each current period.
4. On 15 July 1997 the distributorship agreement between Toshiba and Castel was amended and extended by a Memorandum signed by Mr Uchiike, Toshiba's General Manager, International Operations – Information Equipment, Consumer Electronics and Appliances, and by Mr Kwong. It recited;

TOSHIBA CORPORATION, a corporation of Japan, having its principal place of business at 1-1, Shibaura 1-chome, Minato-ku, Tokyo 105-01, Japan (hereinafter called "TOSHIBA") and CASTEL ELECTRONICS PTY LTD, a corporation of Australia having its principal place of business at 103-119 Gipps Str., Collingwood Victoria 3066, Australia (hereinafter called "CASTEL") hereby agree as the following in connection with a Distributorship Agreement dated August 8, 1996 made between the parties hereto (hereinafter called "ORIGINAL AGREEMENT").

1. The term of the ORIGINAL AGREEMENT shall be renewed for one (1) year period from April 1, 1997 to March 31, 1998.
2. The EXHIBIT A of the ORIGINAL AGREEMENT shall be revised to read as follows:

**EXHIBIT A
PRODUCTS**

1. Color Television Receivers (including Projection TVs)
2. CCD Cameras and their Peripherals
3. Time Lapse VCRs
4. Digital Still Cameras
5. Home Appliances

(Washing Machines and Cloth Dryers, Vacuum Cleaners, Electric Fans and Ventilating Fans, Electronic Irons and Hair Dryers, Refrigerators, Water Coolers, Electric Kitchen Appliances, Accessories of the above Home Appliances)

CASTEL shall recognize that those products added to the PRODUCTS under this Memorandum are or will be manufactured by TOSHIBA, TOSHIBA's subsidiary or TOSHIBA's subcontractor elsewhere in the world. Notwithstanding the provisions of Article 3 (Individual Order), Article 5 (Delivery, Title and Risk of Loss) and Article 6 (Prices and Terms of Payment) (1), the parties hereto may separately discuss and agree on the terms and conditions for the ordering schedule, delivery point, quotation of the prices (except the payment by means of a letter of credit) or the like for those newly added products.

3. The EXHIBIT B of the ORIGINAL AGREEMENT shall be revised to read as follows:

--

EXHIBIT B

Minimum Purchase Quantity

1. The minimum purchase quantity for the period from April 1, 1997 to March 31, 1998:
 - (1) Color Television Receivers: 1,000 sets
 - (2) CCD Cameras and their Peripherals: N/A
 - (3) Time Lapse VCRs: N/A
 - (4) Digital Still Cameras: N/A
 - (5) Home Appliances N/A

4. This Memorandum shall become effective on April 1, 1997.

5. All other terms and conditions of the ORIGINAL AGREEMENT shall remain unchanged and in full force.

5. The distributorship agreement between Castel and Toshiba was renewed again for the period from 1 April 1998 to 31 March 1999. As explained by a covering memorandum enclosed with a draft of the renewed agreement, the changes which it incorporated were by way of extending the agreement until 31 March, 1999, adding "DVD Video Players" to the products list and deleting for the period of the extension any requirement for minimum quantities to be purchased by Castel of any of the products in the products list.

6. By a further renewal for the period from 1 April 1999 to 31 March 2000 of the distributorship agreement between Castel and Toshiba, provision for the supply of electric fans, ventilation fans and air conditioners was deleted from that distribution agreement and future supplies of those products for Castel were to be sourced either from Toshiba Home Technology or Toshiba Carrier Corporation.

TSP becomes the main supplier to Castel of Toshiba products

7. After Castel had been advised in August 1997 that many of its Toshiba products were to be supplied in future by TSP, Castel followed a practice of submitting purchase orders to Toshiba in Japan or TSP or Toshiba Visual Products Pty Ltd in Singapore according to which company was the appropriate source of the relevant product. Payment for the goods to be shipped FOB from Tokyo or Singapore as the case might be, was made in US dollars by letter of credit in favour of the appropriate supplier. Later in the relationship between Castel as Australian distributor and Toshiba and TSP as suppliers, a practice was developed whereby each month Castel submitted a Purchase Sales Inventory ("PSI") which indicated, on a monthly basis, Castel's projected requirements for Toshiba products for the ensuing six months, "sales" or actual purchases by Castel for the month in question and sales of Toshiba products which had been made by Castel in the same month. As well, in another column, were identified Castel's orders for the ensuing month in respect of each Toshiba product. Another column indicated the "inventory" or stock on hand of the same product held by Castel. Upon receipt of each month's PSI, Toshiba or TSP, as the relevant supplier, issued a pro forma invoice for the goods for which a firm order had been indicated in the PSI for a particular month.

8. In about October 1997, Toshiba advised Castel that, henceforth, Toshiba colour television products would be shipped to Castel from Singapore by TSP. From that time, most of Castel's requirements were met by TSP, although Castel continued to obtain certain smaller volume "Toshiba" branded products from Toshiba in Japan and "Toshiba" wide-screen rear projection television receivers from Toshiba UK.

The advent of the set-top box and the development of the J35

9. In order to enable customers in Australia with the existing analogue television receivers to receive digital television broadcasts, manufacturers, including TSP, developed “set-top boxes” which could be positioned on top of analogue receivers and convert a digital signal to a format in which it could be viewed using those receivers. TSP’s first version of a set-top box was the “S23” which was later followed by its “S25”. Neither the S23 nor the S25 had features which markedly distinguished it from competitors’ set-top boxes which were also present on the Australian market at that time.

10. By email in September 2003, Mr Ronald So of TSP advised Mr Kwong, the Managing Director of Castel, that TSP proposed to introduce to the market an improved version of the “S25” set-top box with high definition capacity. The email gave details of some specifications of the new model and invited Mr Kwong to indicate the price for which Castel expected to be able to sell it. Mr Kwong responded by indicating the prices at which competitors’ set-top boxes were selling in Australia and suggesting that the “best”, i.e. undiscounted price, for which the new “Toshiba” unit could sell in Australia would be AUD\$999 “on introduction in August [2004]”.

11. In the “Toshiba” colour television manual for 2004, issued to Castel in April of that year, it was indicated that the J25 set-top box would be available from October 2004. In July 2004, Mr Kwong of Castel attended a “World Tour” in Singapore mounted by TSP to promote its forthcoming range of “Toshiba” products including the J35 set-top box and the “DLP” rear projection television receiver. In the “Toshiba” manuals and product brochures, as well as orally by Mr So in the course of the “World Tour” it was represented that the J35 was capable of receiving high definition television digital signals in all Australian display formats and was capable of recording and replaying high definition television broadcasts. It was also asserted that the J35 would be available for sale on the projected launch date in October 2004 or “such later date as will allow sufficient time to exploit the J35’s innovative character.”

12. Also at the “World Tour” in Singapore in 2004 TSP offered and promoted for the Australian market the “DLP” range of television receivers utilising digital light processing (“DLP”) technology which had been developed by Texas Instruments in the United States of America and had been incorporated in “Toshiba” television receivers which were already being sold in that country. Attractive features of the DLP receivers were that they offered large screen sizes (up to 72 inches) and incorporated a “Phoenix” lamp which had a longer life than that achieved by other lamps.

13. In December 2004, TSP provided Castel with a sample J35 set-top box and, early in 2005 issued a brochure containing the specifications for a J35 and detailing what were seen to be its attractive features including its 180GB Hard Disk Drive (“HDD”) which it was said;

... brings you the finest picture quality” and “the solution of high and standard definition recording and playback. With such a large capacity HDD, you can enjoy great convenience and freedom to capture 18 hours of high definition or 49 hours of standard definition of superior quality just like live screening.

14. Castel placed its first commercial order for J35s with TSP for delivery in January 2005. That was ordered in the PSI format described at [7] above and was for 2,380 units. However, that order was not filled according to its terms because delays had been encountered by Zinwell Corporation (“Zinwell”) a Taiwanese company to which TSP had subcontracted production of the J35. As a result, only 40 units were shipped to Castel in February 2005 with the stipulation that they were not to be re-sold

but were for display purposes only. That difficulty had been foreshadowed in an email dated 13 December 2004 from Mr So to Mr Kwong of Castel which recited;
Before the field [tests] in progress now in Australia, Toshiba and Zinwell engineers did the evaluation [sic] of the HDD-J35 samples in Singapore last week. The overall performance is not so satisfactory which requires a modification of hardware. 100 sets cannot be produced in Dec and the subsequent production will likely be affected, too. Before the final result of Australian field test, Zinwell cannot give us a recovery schedule. We will keep on inform you the progress closely.
We apologize the inconvenience caused. We also seek your understanding of the uncertainties and difficulties involved in developing leading technology.

15. Later, on 12 January 2005, Mr So forwarded to Mr Kwong by email a revised delivery schedule which provided for delivery of 2,280 units between 24 and 29 February and a further 2,280 units to be delivered at “end March”. The launch of the J35 which had been deferred until March 2005 was further delayed because of the need to replace the software in the units which had been shipped to Australia. To enable that to be done, the units were returned to Zinwell and, after re-working were again sent to Australia in time for a launch on the Australian market in April 2005. After that launch, Castel placed with TSP further orders for commercial quantities of J35s.

16. After the release of the J35s for sale in Australia, numerous complaints about them were made by retail purchasers and referred to Castel’s service department. According to Mr Kwong, nearly every fault reported to Castel was “generic” in the sense that it was common to a batch of J35s as imported to Australia rather than being a “one-off” or isolated occurrence. The proliferation of complaints required Castel to divert to responding to customer grievances members of staff who would otherwise have been engaged in visiting retailers and promoting sales. Each “generic” fault required all units in a given batch to be rectified. Notice of the occurrence of the fault was given to TSP but, as each new “generic” fault was identified, units in each preceding batch had to be recalled for repair or upgrade to correct the new fault. According to Mr Kwong, “at least 54 generic faults of an epidemic nature” were encountered over the two years which followed the Australian launch of the J35. Mr Kwong acknowledged, however, that many of the “epidemic” faults were identified in close proximity to each other so that the number of recalls was limited and faults were rectified in patches. Other “one-off” faults in the J35 were identified from time to time but were not regarded as “epidemic”. Nevertheless, the volume of “epidemic” defects revealed by consumer complaints during April and May 2005 were so large that, on 20 May 2005 Mr Kwong wrote to Ms Violet Oh of TSP in these terms;

HDD-J35

Re your email for the above we would not be able to take any more units for May because we have now stopped sales of the unit, as there are huge number of complaints from both retailers and consumers on the product. Please refer to you QC [Quality Control] division as Victor has been in contact with them over the past weeks. As to when we can resume delivery will depend on when we can rectify the problems and how we address the units (approx 2,000 units) already in the market.

17. After further correspondence from Castel, Mr Sato of TSP indicated to Mr Kwong by email dated 7 June 2005 that he believed that the major software problems with the set-top boxes had been solved but that Castel’s request “to recover returned sets of 1,549 from Taiwan by air by middle of June and another deliver of

1,526 by sea at the end of June” could not be met in so short a time and that to be on the “safe side”, Mr Sato would return them only as a July order. By the same email, Mr Sato agreed to accept payment from Castel on 60 day terms for July and August and indicated that Zinwell would bear the air freight charges. Despite that reassurance, Castel continued to encounter problems with the J35 units even after they had been reworked. That prompted Mr Kwong to write on 5 July 2005 to Mr Sato in these terms;

HDD-J35

After 2 weeks of monitoring of the product in the market with the “reworked & upgraded” unit, we now find that we may have a SERIOUS, problem in hand. As a precaution I have suspended all further sales until we can identify the cause of the problems mentioned below. For the past 2 weeks since the “re-release” our staff have been attending, in increasing frequencies, to “fire-fighting” the complaints in the market re defects in the unit. I enclose herewith samples of the complaints as illustrated in our staff memos etc.

The complaints may be identified as follows: -

- a) Drop out of picture
- b) Audio dropouts
 - c. Freezing of picture (some customers are experiencing more freezing than before the upgrade)
- d) Memory loss
 - e. Interference to picture caused by switching off and on of other electrical products in proximity of the unit.
 - f. Significant heat generated by the unit causing cabinet housing unit to be “hot” - concern of consumers that unit may spark a fire (though exaggerated) but we did receive a complaint that a Formica cabinet shelf had warped attributing the cause to the heat generated by the J35.

At this stage of our preliminary survey it would seem that the cause of the above appears to be heat-related though we received several complaints of freezing after only half an hour usage. I am, of course, no engineer, but from my observation it would seem that most of the problems mentioned above (except perhaps for audio drop) seem to appear when the unit is “heated up”. This is especially relevant if the J35 is housed in an enclosed area like a cabinet, and more so, if other appliances like an amplifier are enclosed with it.

During the tests conducted when Toshiba and Zinwell personnel were here even though tests lasted weeks the units were then not housed in enclosed cabinets - Albeit foams were used to retain the heat of the units during testing. No abnormality was found then.

It is noted on page 3, 4 & 5 of the owner’s manual that usage is restricted to operation temperature of –5°C to 40°C. It has been noted that in most of the faults experienced in the situations mentioned, the units were in environments exceeding the 40°C - (in enclosed cabinets etc). I do not know if all the above faults were heat - related.

On the practical front, someone buying an expensive Set Top Box like the J35, would be those who have expensive entertainment set up at home – like appliance cabinets etc. Products like the J35 are normally “hidden” away in these cabinets. In such situation, heat can only build up and if the tolerance level of the J35 cannot meet such environment then one can understand why the faults arose. Also in now reading the user manual (page 5) the term “fan noise” is quoted. As we now know the fan has been eliminated in the unit. Why? No idea. In fact in the course of the exercise, Victor was the one who requested it) louvers to be incorporated in the cabinet top ii) heat sync to be added, but have no idea why the fan was dropped. However, the above contention is made on the basis that the cause of the faults is heat related.

The above is not attributing blame but to highlight the situation and circumstances leading to the release of the unit. It is imperative that urgent remedies are put in place, as it is the

situation has sapped more confidence in the brand than anything else in the past. In the meantime, as a holding exercise, we are advising all complaints that they should not house the J35 in a confined environment and to then see the result thereafter. Castel is, of course, conducting similar tests here to determine the cause of the faults. There is limit to our capability in this situation. May I suggest that a couple of senior personnel from Zinwell and some from Toshiba to come to Melbourne to assist us in working out a solution for this issue - and we need to attend to this URGENTLY.

18. After a response by Ms Oh, Mr Kwong again wrote to TSP on 8 July 2005 making, amongst other assertions, this comment on the J35;
Until we are able to resolve the technical issues and quell the retailers & consumers complaints, there is no reason to take any more stock. We have stopped all sales and we need URGENT attention as to how to resolve these issues first. It is first a marketing issue on how and what to inform our customers to calm their concern. The technical resolution is important but such can come subsequently. If we cannot resolve the retailers/consumers concern we not only cannot sell them the J35 but also any other products!

19. A meeting was held in Melbourne on 12 July 2005 between River Chiang of Zinwell, Mr Chey of TSP and representatives of Castel to evaluate the problems with the J35 and Mr Kwong hoped to be able, on 14 July 2005, to make a decision "as to the on-going sales activities of the J35." In the meantime, he wrote, on 13 July 2005 to Mr Sato of TSP requesting him "to hold any more shipment of J35 to us – whether we paid for or opened [letter of credit] for. If there is to be any reworked such should not be done here but at Zinwell."

20. In about mid-September, Castel learned that a rival producer of set-top boxes, Sony, was about to launch on to the market its own version of the J35 which was also to be manufactured in Taiwan by Zinwell. That prompted Mr Kwong of Castel to complain to TSP by email dated 15 September 2005 in which Castel expressed a belief that Toshiba had prior rights to the models which had been developed for Castel in collaboration with Zinwell and that similar models would not be available to competitors until Castel had enjoyed exclusive rights to sell the models in Australia for 12 months. Mr Kwong's email concluded;

As you are aware both Toshiba personnel & Castel staff have struggled over the past 9 months with considerable effort expended to come to a stage (only today) to substantially resolve all the bugs to be able to feel somewhat comfortable now to sell the J35 – we have over 5,000 units of the HDD-J35 to sell and possibly another 3,700 sold into the market to be recalled and modified. In addition to this we consented to take the HDC26H to sell. Now on the back of this problem we now learn that Sony was to release its HD-HDMI unit next month utilizing the same Broadcom chip (BCM – 7038), which both Toshiba & Castel staff helped to perfect but which we have not even launched (C26H).

Castel is landed with a huge headache and Sony is given the right to sell an equivalent product into the market! Ronald emailed me today to say that the main board power supply & cabinet is different. Of course such have to be different but the main brain is exactly the same & so too is the picture quality. This is very unprofessional on Zinwell's part. If Sony is to sell the unit, Castel must have at least 6 months to 1 year to clear our stocks before an identical competitor model is introduced here as in the case of the S23 & S25.

For your information it is well known that Sony does not have technical facilities here in Australia. They have shut off all these years ago. On this venture, it would appear that Zinwell have used Toshiba & Castel's facilities to do all the field tests etc and then sell off the developed product to Sony to compete with us!

I hope you can look into this urgently. We here are very unhappy over this matter & the lack of professionalism & morality on Zinwell's part.

21. Mr Sato of TSP responded on 19 September 2005 to the last-mentioned email contending that the Sony set-top box to be produced by Zinwell would be quite different from, and inferior to, the "Toshiba J35" but indicating that TSP could not restrict the use by Zinwell for Sony of a "Broadcom" IC chip as that was the property of the US manufacturer, Broadcom. In the same email, Mr Sato observed;

As for the Quality issue for J35, I do apology for many troubles. I have to admit that the problems are bigger than we expected. However, Zinwell accepted to have goods returned and modify them at their expense. As for this product, we suffered lot as a pioneer of this kind of category and we just started to talk of new STBs and IDTVs, which is, in the long run, very important for us and as I mentioned everything does not go to other party. No one can make same products by just having the same IC.

22. Despite that attempt to reassure Castel, Mr Kwong had some misgivings about the extent to which development and improvement of the J35 had been utilised by Zinwell for the benefit of Sony. In his witness statement, Mr Kwong expressed these misgivings as follows;

I have since learnt, on a further review of the Castel discovered material and the TSP discovered material, that the statement from Mr Sato omitted important information which TSP knew about the Zinwell Sony product and apparent sharing of intellectual property that had the consequence that the Sony product benefitted from the Castel J 35 experience resulting in a superior product to the J 35 while Castel continued to struggle with the J 35 problems. Due to the many faults encountered by Castel with the J-35, two significant improvements had been incorporated into the Sony equivalent unit. These were the replacement of ribbon cables with wire and the incorporation of an exhaust fan to reduce heat emanating from the J-35, which did not have an exhaust fan. Zinwell knew about the need for such improvements as a result of the complaints Castel had encountered with the J-35 since its introduction in February 2005.

23. Notwithstanding the optimism expressed on behalf of TSP, mainly by Mr Sato, that the defects which had plagued the J35 had been overcome, faults continued to emerge after the re-launch of the product, to the extent that Castel estimated that each unit which it sold had to be re-worked or returned for rectification on average 2.6 times after the first sale. Even with the release in October 2005 of the C-26 set-top box, similar defects to those encountered with the J35 continued to manifest themselves. The C-26 set-top box was intended to have features similar to the J35 but without the latter's hard disk recording function. Castel placed orders with TSP for delivery of C-26 units between September 2005 and August 2006. The first delivery of 1,000 units was made in October 2005.

24. By mid-2006, Castel had concluded that the continuing deficiencies of the J35 were so profound that the model would never be merchantable in Australia. That followed a visit to Melbourne by Mr Y C Liu of Zinwell after which Mr Kwong emailed Mr Sato of TSP in these terms;

Mr Y.C of Zinwell had been here for a approx a week during which I discussed with him several issues re the update of the J35. Following my visit to Taipei, the following additional faults were detected.

Defects

1. Hard Disk drive not registering

Solutions

Software provided to fix issue. This has been incorporated with the Loader 6.1

- | | |
|-------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2. Cable connection defect | discussed in Taipei.
Y.C discussed this during his latest visit. Such had contributed with various failures on units supposedly “fixed” at Zinwell factory. Zinwell has forwarded a small quantity of cables for us to swap over. |
| 3. Minor Intermittent connection problem. | Y.C. also detected some occasional loss transmission problem which he attributed to hardware quality issue. He has taken 4 units back to Taiwan for further analysis & ascertain cause of defect. |

The above are 3 ADDITIONAL faults found following the 6.1 Loader software. In view of the above I have asked (mentioned to you in my previous memo), Y.C to arrange for 2 technicians, a software & a hardware personnel, to be stationed here for a 3-6 months duration to ensure that any issues surfacing can be quickly analysed and rectified. The presence of Y.C over the past week has proven that such support is absolutely critical for if it had not been for his presence, we could potentially face another back-lash from retailers/consumers re endless faults with the unit. Please let me know Zinwell response to this issue.

In view of the above we will need to slightly change our switch to S36 ? and this is because we are unable to deliver replacement units of J35 to customers with faulty units quick enough. After all the deliveries made to us, the latest being the 200 units received yesterday (which needed to be checked here due to the cable problem mentioned above), Castel has 392 units (pus 4 taken by Y.C) in Zinwell. This excludes the 1090 units now in transit-at-sea due to be converted to S36. Initially it was intended that of the 200 units now held in Taipei and to be modified with the Loader 6.1 and change of cable, would be air freighted to Perth & Brisbane. We now require these units to be air freighted to MELBOURNE instead on 4/7/06. Additionally, the 192 units + 4 units should be modified as J35 (instead of S36) to be similarly air freighted to Melbourne as soon as possible (please provide dates when this is ready for shipment).

25. That prompted the laconic email reply from Mr Sato, also dated 27 June 2006 that;

I would like to ask Zinwell to buy back all J35 from the market again.

26. In similarly apologetic tone Mr Sato wrote on 5 July 2006 to Castel’s Service Manager, Mr Victor Hew;

Regarding recent incidents I am sorry for our inadequate action. I owe you too much about field test and this quality checking. I will study how to improve and to manage these matters before releasing the goods.

27. On the same date, Mr Sato wrote to River Chiang of Zinwell who was then apparently still in Melbourne conducting field testing of the J35;

Zinwell just arouse the concern about all related products and if so, I will step down about these matters and leave everything between Castel and Zinwell for all matters. I have decided to freeze all STB projects and delivery. Please ask your staff to return to Taiwan. It is just shame to Toshiba Brand and myself.

28. Within about two months, Mr Sato left TSP and took up duties at Toshiba’s office in France. He advised Castel by email of 7 September 2006 of his impending

transfer and that his responsibilities within TSP would be taken over by Mr Murakani as Department Manager, Ms Oh as Sales Manager and Mr So as Manager, Product, Planning and Marketing with Mr Yamamoto taking over as General Manager “as concurrent.”

Mr Hew’s role in developing and modifying the J35 and C26

29. Mr Victor Hew was the service manager for Castel from 1990 and has been its Service Director since December 1996. From his perspective, the development of the J35 for sale in Australia began in about December 2004 when research and development engineers employed by TSP and engineers employed by Zinwell visited Australia and carried out field testing of the J35 including its recording and playback functions. As defects were identified, they were notified to Zinwell in Taiwan which immediately made recommendations for rectifying the fault, usually by means of a software upgrade.

30. After Castel began selling the J35, numerous complaints from retail customers came to Mr Hew’s notice from about April 2005. He later prepared a schedule of faults which had been discovered in the J35. That schedule summarised each of the faults and what was done by Castel in response to each complaint about a fault. Some faults were rectified by the software upgrade prescribed by Zinwell and made available to customers by Castel after approval had been obtained from TSP’s research and development department.

31. Mr Hew calculated that, in the period from July 2005 to June 2006, Castel received 8569 units of the J35 from Zinwell of which 2,520 were production units and 6,049 were units which had been reworked. As further defects in the units received from Zinwell were identified, a red sticker was attached by Castel to each affected unit. That served to indicate that the unit in question had been provided with a software upgrade V70-RV1. Later, red stickers on which the marking “CC” had been made disclosed that the units concerned had been fitted with a more recent software upgrade, R71T10. As further faults manifested themselves, the rectifying software upgrade was identified in a similar manner. One fault, which Mr Hew considered to be a serious unresolved defect which was never overcome by any of the software upgrades, was the “lock-up” of the set-top box.

32. Mr Hew’s definition of an “epidemic failure” was one occurring in more than 3% of a product line. He characterised the “lock-up” fault as occurring in more than 100% of the J35 units because it recurred, sometimes more than once, even after a unit had been returned to Zinwell to be reworked.

33. On 8 February 2006, TSP advised Mr Hew by email of a major production fault in the circuit boards installed in the J35 units which resulted in a failure rate of approximately 1.5% of 9,000 J35 units tested. According to Mr Hew, an acceptable failure rate should have been between 2 and 5 for every 10,000 units. In his opinion, the higher failure rate identified by Zinwell should have resulted in a complete recall of all units fitted with the affected circuit boards.

34. In early March 2005, Castel had received delivery by airfreight of 1,520 J35 units. It was also given instructions by email from Mr Tsang of TSP on 7 February 2005 for upgrading the software of those units after they had arrived in Australia. However, it was later discovered, in March 2005, that three capacitors in the main circuit boards of all 1,520 units were defective and all had to be returned to Zinwell for rectification. At the end of March 2005, Castel agreed to the temporary elimination of certain features of the J35 in order to bring about a saleable product. At that time, Zinwell’s estimate was that solving the extant faults in the J35 would require four

more weeks, i.e. to 27 April 2005. Three hundred new units which were sent to Castel by Zinwell arrived in Melbourne on 27 April 2005. Other new units arrived in Brisbane and Perth on 29 April 2005.

35. On 28 April 2005, Mr So of TSP advised Mr Hew that new top covers for the J35 with holes for ventilation would be sent to Castel on 21 April 2005 and that, on 26 April, new software would be released, subject to all critical problems having been fixed, and three Zinwell engineers would visit Castel's premises to rework 1,500 J35s by downloading new software into them.

36. Mr Huang of TSP arrived in Melbourne on 21 April 2005 but tests which he carried out the next day revealed that each of four test J35s was not performing correctly. In the last week of April 2005, Castel began distributing to customers J35s which it knew to be defective. It expected complaints and they came almost immediately. A new defect in the J35 emerged when it was discovered to be incapable of recording broadcasts from the "WIN" television station. That was notified immediately to Zinwell.

37. On 9 May 2005, Mr Hew advised Mr Chey of TSP of a "freezing" problem with the J35. He acknowledged under cross-examination that some of the defects then remaining in the product would not have been apparent to all end users because of the nature of their television receivers or other equipment.

38. On 2 June 2005 Mr Hew, together with Mr Kwong, met with Mr Y C Liu of Zinwell to discuss further development and reworking of the J35. Mr Liu undertook to rework 1,557 units and airfreight them to Castel by 13 June 2005. On 16 June 2005, Mr Hew sent to Mr Liu of Zinwell an email in these terms;

Thanks very much for visiting us to solve the remaining problems.

At last, the F.Forward/F.Rewind freezing problem is solved.

I hope no more problems from now on.

For your information, Mr Chey called me yesterday wanting to know whether you have completed the rework.

I told him you have completed approximately 800 units and I will continue what is leftover. I do not know why he called me to ask about the rework. He said he would call River.

Anyway, again I thank you personally for all the assistance you have given to me. Hope to see you again. Maybe in Taiwan.

39. The "approximately 800 units" referred to in that email had come from Castel's warehouse. They were sold after being fitted with new software.

40. At the time of Mr Kwong's letter to Mr Sato of 5 July 2005 quoted at [17] above, all stocks of J35s held by Castel were defective. Further testing of the J35 was carried out by Mr Tsang of TSP in September 2005 and Mr Hew noted some of the test results. Even at the end of that year, Castel was still trying, with Zinwell's assistance, to remedy defects in the J35 and was continuing to sell those units which it believed did not suffer from major faults.

41. Mr Hew also recounted faults affecting the "Toshiba" C26 set-top box which were similar to those detected in the J35 units. The C26 was the same as the J35 but without its HDD (hard disk drive) recording capacity. Some of the same defects may have affected both models.

42. As a result of the many complaints received by Castel from consumers of "Toshiba" products affected by "epidemic" faults, Mr Hew deposed that his service department had to take on 35 additional staff. As well, the seven existing service staff members were distracted from their normal duties in relation to other products in the Castel range and were overworked in trying to cope with the additional workload.

43. Several of the “bugs” identified in a list supplied to Castel by TSP on 7 February 2005 were previously unknown to Mr Hew. Nor was he aware, at the time, of the “bugs” lists which had been created in early 2005 by TSP and Zinwell in relation to the J35 set-top box as described at [154] and [155] below. He only undertook the installation of software upgrades when specifically instructed to do so by Zinwell or TSP. Generally, those upgrades were installed by Zinwell or TSP personnel on their visits to Melbourne. Mr Hew accepted that his service department, from time to time, provided facilities and labour to assist the visitors but disavowed any active participation by Castel in developing or field testing the J35. Occasionally, Castel, on request from TSP, field-tested software on sample set-top boxes and reported the results to Zinwell and TSP.

44. The internal classification by TSP of “bugs” as “AAA”, “AA”, “A” etc, was unknown to Mr Hew until TSP gave discovery in these proceedings. However, he knew that, as at the third week of March 2005, there were significant unsolved problems with the J35 although he was unaware of the details. That was partly due to difficulties in communicating with the visiting Zinwell engineers who spoke only Mandarin, whereas Mr Hew’s two languages were Cantonese and English.

Termination of Castel’s Distributorship of “Toshiba” Products

45. By about October 2006, it was apparently seen on both sides that the arrangement between Toshiba and TSP on the one hand, and Castel as their Australian distributor on the other, could not be sustained in light of the distress and dissatisfaction which had been caused by the failure of the J35 and C26 set-top boxes and the recurrent lamp problems with the DLP television receiver. The termination of the relationship was first discussed at a meeting on 9 November 2006 at Castel’s Melbourne premises. That meeting was attended by Mr Sato, who, from July 2002 to September 2006 was the Manager, Sales and Marketing for TSP and later became Chief Specialist in Toshiba’s Global Production Department, Mr Yamamoto, who succeeded Mr Sato as TSP’s Manager, Sales and Marketing, and Mr Murakami, who, it will be recalled, had taken over in September 2006 as TSP’s Department Manager.

46. There was a further meeting in Melbourne on 16 November 2006 attended by Mr Osumi, a director of TSP. Later, Mr Yamamoto and Mr Osumi met two of the directors of Castel, Mr Kwong and Mr Eric Ho in Hong Kong on 2 December 2006. Mr Yamamoto and Mr Murakami attended a further meeting in Melbourne on 11 December 2006 mainly to discuss Castel’s stock requirements on the assumption that it would continue to distribute Toshiba products until 31 March 2007. There was also discussion of price reductions which might be allowed to Castel as it ran down its distributorship.

47. On 5 April 2007, at a further meeting in Melbourne, a termination agreement (“the Termination Agreement”) was executed between Castel, TSP and Toshiba. The Termination Agreement recited that, in it, “Toshiba and TSP shall be jointly or severally called “Toshiba”.” It contained the following clauses:

1. Castel Electronics Pty Ltd (“Castel”) has until recently been the Australian Distributor for Toshiba AV products under a distribution agreement dated 8th August 1996 as renewed and sale and purchase transactions (collectively the “Distribution Arrangements”).
2. Castel and Toshiba agree that the Distribution Arrangements ended on 1st April 2007. Castel and Toshiba have a number of issues outstanding between them relating to the cessation of the Distribution Arrangement. They have agreed to resolve some of those issues in the manner set out below.

3. Castel and Toshiba have agreed to resolve all claims which Castel may now or in the future have against Toshiba except for the following matters : -
 - a. all claims (including fixture claims) for warranty, quality and consumer issues (including indemnity or claims in respect of liabilities to consumers under Australian Law) for certain of the products namely Toshiba brand television receivers and set top boxes including but not limited to J35, STB, DLP and C26 (together with all other products in which epidemic failure (i.e. failure more than 3 percent of such product purchased from Toshiba) has occurred) purchased by Castel from Toshiba.
 - a. ongoing warranty costs and fees to be borne by Toshiba or TAP for Toshiba brand TVs, DVD products and other AV products distributed by Castel on or before March 31, 2007, which would be borne by Castel;
 - b. the claims against Toshiba that Castel has in respect of all damages and losses (whenever arising) and expenses to Castel's business arising from the conduct, representations, actions and/or omissions, if any, of any of Toshiba (including their officers, servants, agents and subsidiaries) affecting Castel for the period commencing 1 January 2007 to 31 March 2007.
 - c. interest on the delayed payments being one or more of those matters comprising Solved Disputes.

(the "Unresolved Disputes").

Those claims (except for the unresolved disputes) are called "Solved Disputes". Toshiba will pay Castel :-

- a. Outstanding price adjustment of LCD TVs: US\$525,000
 - b. Compensation for the termination of the Distribution Arrangements: US\$1,000,000
- c. Reimbursement of advertising costs used in 2006B for DVD products: A\$327,768;
- d. Reimbursement of costs and fees incurred by Castel to resolve certain quality issue of DVD products in the past: US\$78,409.
- e. Reimbursement of any retrenchments costs (A\$900,000), advertisement costs (A\$550,000), and various service claims, (A\$363,946) - A\$1,813,946
4. All of the above amounts are to be paid to Castel not later than 11/04/2007.
 5. Castel will cooperate with Toshiba to ensure a smooth transition for the distribution of Toshiba TV, STB and DVD products.
 6. Castel shall provide Toshiba Australia Pty Ltd ("TAP") with the following information (and in respect of that information that is the intellectual property of Castel, which is clearly identified by Castel, on a non-exclusive basis) to ensure a smooth transition for the distribution of the products at latest in respect of items (a) and (b), 18 April 2007 and for all other matters, 30 April 2007
 - (a) customer list, sales price list and sales conditions;
 - (b) trade inventory lists;
 - (c) after sale service records;
 - (d) certificates for technical standards;
 - (e) any other information held by Castel necessary for the smooth transition, which Toshiba or TAP reasonably request.
 7. Castel shall continue to provide the after sales service of the products until close of business 31 May, 2007 and thereafter Toshiba shall cause TAP to assume all future after sales service for the products. In respect of epidemic failure products Toshiba shall direct Castel as to the manner of providing after sales service.

8.

(a) Toshiba and Castel have agreed for the purchase of certain of Castel's stock which the parties shall separately identify and indicate their costings and date of transfer. The list must be provided by Castel to Toshiba by 10 April 2007. Payment for the stock shall be made to Castel on 11 April 2007. The stock shall be inspected by Toshiba during the week commencing 16 April 2007 at a time and place to be agreed. After Toshiba's inspection any adjustment, if necessary, shall be made within one week after inspection.

(b) Castel shall continue to hold stock comprising spare parts for products in order to discharge its after sales service obligations referred to in Paragraph 7 above. Toshiba will purchase all Castel's remaining stock of spare parts on 31 May 2007 at USD300,000.

9. On receipt by Castel all of the above amounts, and in consideration of the performance of the covenants by the parties, then

a. Castel shall release Toshiba, any of its shareholders, directors, employees, agents, subsidiaries including TAP and affiliated companies from any and all manner of action or actions, cause or causes of action, in law or in equity, suits, debts, liens, contracts, agreements, promises, liability, claims, demands, damages, losses, costs, expenses or fees of any nature whatsoever, known or unknown, fixed or contingent, which they now have or may hereafter have in relation to or arising out of only the Solved Disputes.

b. This letter may be used by Toshiba as conclusive evidence that Castel accepts those payments in full and final settlements of all of the Solved Disputes.

48. It will be noted that cl 3 of the Termination Agreement identified four categories of disputes ("the Unresolved Disputes") which were not settled by the Termination Agreement. The Unresolved Disputes were the subject of a further agreement ("the Unsolved Disputes Agreement") also dated 5 April 2007 which similarly recited that, in it, Toshiba and TSP "shall be jointly or severally called "Toshiba".

49. The Unsolved Disputes Agreement repeated cll 1 and 2 from the Termination Agreement and contained the following further provisions:

c. Castel and Toshiba have agreed to set out the remaining issues between them which are detailed in the following manner:-

a. all claims (including future claims) for warranty, quality and consumer issues (including indemnity or claims in respect of liabilities to consumers) for certain of the products namely Toshiba brand television receivers and set top boxes including but not limited to J35, STB, DLP and C26 (together with all other products in which epidemic failure (i.e. failure more than 3 percent of such product purchased from Toshiba) has occurred) purchased by Castel from Toshiba;

b. ongoing warranty costs and fees to be borne by Toshiba or TAP for Toshiba brand TVs, DVD products and other AV products distributed by Castel on or before March 31, 2007, which would be borne by Castel;

c. the claims against Toshiba that Castel has in respect of all damages and losses (whenever arising) and expenses to Castel's business arising from the conduct, representations, actions and/or omissions, if any, of any of Toshiba (including their officers, servants, agents and subsidiaries) affecting Castel for the period commencing 1 January 2007 to 31 March 2007.

d. interest on the delayed payments being one or more of those matters comprising Solved Disputes.

(the "Unresolved Disputes").

The above definitions shall not be construed as an admission of any liability caused by each item of the Unresolved Disputes.

4. Toshiba shall pay USD\$2,000,000 ("Interim Payment Amount") to Castel not later than 11th April 07 as an interim payment for "Unsolved Disputes".

5. These arrangements are entered into by the parties for the purpose of accelerating the negotiations about the Unsolved Disputes only, and is not intended to constitute and shall not be construed as an admission that either party is to any extent liable for any breach of contract or violation of law.

6. The parties agree to negotiate in good faith in order to resolve the "Unsolved Disputes" as expeditiously as possible. If despite such negotiations the Unsolved Disputes are not resolved within 60 days from the date of this letter by a binding agreement in writing, nothing in this letter prevents the parties from taking such action as maybe available to them.

7.

(a) If pursuant to Clause 6 the parties reach a binding agreement on the terms of the full and final settlement of the Unsolved Disputes specified in this letter or the Unresolved Disputes are otherwise determined by whatever other steps the parties may take, and if that determination requires payment by Toshiba to Castel, then the Interim Payment Amount shall be appropriated to the said payment. If such determination results in Toshiba having to pay less than the Interim Payment Amount to Castel or Castel having to pay an amount to Toshiba, then Castel shall return to Toshiba the excess or the whole amount of Interim Payment Amount, as appropriate.

(b) If the parties do not reach a binding agreement in full and final settlement of the Unsolved Disputes as contemplated by this letter Castel may retain and use the Interim Payment Amount received pursuant to this letter until the final resolution of the Unsolved Disputes.

8. Without limiting the generality of any of the foregoing, the parties acknowledge and agree that upon reaching agreement on the terms of a full and final settlement of the Unsolved Disputes, the parties will document the terms of such a settlement by entering into a comprehensive further settlement agreement embodying all of those terms.

50. As contemplated by cl 6 of the Unsolved Disputes Agreement, the parties continued further negotiations after 5 April 2007 but no further resolution was achieved of the issues outstanding between them and in March 2008 Castel issued the present proceedings.

CASTEL'S CLAIM AS PLEADED

51. By its amended statement of claim, Castel alleged that, from time to time, it purchased substantially all of its requirements for Toshiba products from TSP on a regular monthly basis from September 1997. It next alleged, relevantly, that, from September 1996 until April 2007, it promoted Toshiba products in Australia and sold them to retailers and repaired and serviced the Toshiba products.

52. It was then alleged in paragraph 14 of the amended statement of claim: On receipt by the Applicant of each pro forma invoice, alternatively on receipt by the Applicant of the commercial and shipping documents for each shipment, a contract for the sale of goods came into existence between the Applicant and the Respondent (hereafter called "a sales contract").

53. Paragraph 15 of the amended statement of claim invoked, by virtue of the fact that Castel and TSP had their respective places of business in Australia and Singapore,

the United Nations Convention on Contracts for the International Sale of Goods (“the CISG”). The following terms were said to be implied in each sales contract by operation of the CISG:-

- (a) that the Respondent as seller was obliged to deliver goods of the quantity, quality and description required by the sales contract (article 35(1));
- (b) that the goods had to be fit for the purposes for which goods of the same description would ordinarily be used (article 35(2)(a)); and,
- (c) that the goods would have and retain for a reasonable period of normal use by consumers their specified qualities and characteristics.

Castel then invoked, further or alternatively, the warranties of fitness for purpose and merchantable quality implied by [s 19\(a\)](#) and (b) of the [Goods Act 1958](#) (Vic) (“the [Goods Act](#)”).

54. Reference was next made in the amended statement of claim to the introduction in Australia of high definition digital broadcasting and the demand which that created for digital television receivers, set-top boxes capable of receiving digital television broadcast signals and reproducing them on the screens of analogue television receivers, wide screen television receivers able to receive high definition signals and integrated high definition digital television receivers.

55. In paragraphs 23 and 24 of the amended statement of claim Castel alleged that TSP had made to it representations about the J35 to the effect that;

- (a) it was being developed and would be released in July 2004;
- (b) it would be capable of receiving high definition television digital broadcast signals in all relevant Australian display formats;
- (c) would be capable of recording and replaying high definition television broadcasts;
- (d) would be more powerful than the existing [S25](#) set-top box;
- (e) would most likely be the “most wanted set-top box in the market”;
- (f) would be available by the launch date set by TSP or such later date as would allow Castel sufficient time to exploit the innovative character of the J35 before competitors could introduce competing products into the market.

56. Each of the representations set out above was said to have been repeated by TSP’s entering into each sales contract for the supply of J35s to Castel and causing them to be delivered in Australia to Castel. As well, it was pleaded that, in reliance upon those representations, Castel made substantial purchases of J35s from TSP. It was then pleaded in paragraphs 31 and 32 of the amended statement of claim that, in February 2005, serious defects manifested themselves in the J35 as a result of which the proposed launch of the product on the Australian market had to be delayed. The emergence of further defects after the installation of replacement software in the J35s and numerous complaints by consumers from about May 2005 were alleged in paragraphs 33 and 34.

57. It was next alleged in paragraph 36 of the amended statement of claim that TSP made further representations to Castel that the problems earlier discovered in the J35 had been substantially resolved and it remained superior to competitors’ actual and proposed products.

58. Paragraph 37 of the amended statement of claim alleged that, in reliance on the representations set out at [55] above and the further representations summarised at [57] above, Castel purchased a further 4,040 J35s from TSP. Paragraph 38 then recited a litany of further defects alleged to have appeared between July 2005 and August 2006 in the J35s supplied to Castel by TSP most of which had to be returned for repair or exchange, some more than once.

59. Paragraph 41 of the amended statement of claim alleged that representation (f) set out at [55] above was untrue because:

In or about September 2005, the Applicant discovered that Zinwell, the manufacturer of J 35 units for the Respondent, was manufacturing and supplying a product with similar characteristics to the J 35 for Sony that was directly competitive with the J 35.

60. It was next alleged that each of the representations and further representations alleged as described at [55] and [57] above was misleading and deceptive and that TSP had no adequate basis for making it.

61. A further set of representations about the Toshiba DLP television receivers ("the DLP representations") was to be found at paragraph 44 of the amended statement of claim in these terms;

Between mid 2004 and September 2004 the Respondent represented to the Applicant that it would make available to the Applicant for sale in the Australian market a series of digital light processing television receivers ("DLP's") and, that the DLP's would have the following characteristics:

- (a) they would be large rear projection television receivers utilizing DLP technology developed by Texas Instruments of United States of America and licensed to Toshiba for the manufacture of DLP television sets;
- (b) they would have a long lamp life; and,
- (c) they would be superior prestigious products.

62. As with the J35 representations, the amended statement of claim alleged that, in reliance on the DLP representations, Castel placed orders for DLPs with TSP which sold and delivered 2,250 of them to Castel between December 2004 and October 2006. It was then alleged in paragraph 51 that from January 2005 serious faults appeared in the DLPs supplied to Castel by TSP as a result of which Castel "was obliged to accept returns of the DLPs from its retailers and refund the purchase prices paid to [Castel]".

63. It was further alleged in paragraph 53 that the DLP representations were misleading and false in that TSP lacked any adequate basis for making them.

64. Another set of allegations directed to the C26 set-top boxes was introduced by paragraph 54 in these terms:

Between May 2005 and February 2006 the Respondent represented to the Applicant that it would make available to the Applicant for the Australian market a new product (the HDC 26 set top box) in two versions ("the C 26"), and that the C 26 would have the following characteristics: ("the C 26 representations"):

- (a) it would be a state of the art set top box with features long awaited by consumers;
- (b) it would have substantially the same capacities as the J 35 was meant to have save for a recording function;
- (c) the C 26 would be free of defects; and
- (d) it would be superior to a competitive set top box product marketed by Sony with a Broadcom IC chip incorporated into a set top box.

65. As with the J35 representations and the DLP representations, the amended statement of claim alleged that, in reliance on the C26 representations, Castel made

substantial sales contracts with TSP for the purchase of 12,000 C26s. It was then alleged in paragraph 60 that, after delivery, serious defects appeared in the C26s and in paragraph 61 that the C26 representations were misleading and false in that TSP lacked any adequate foundation for making them.

66. A cause of action for contravention of [s 52](#) of the [Trade Practices Act 1974](#) (Cth) (“the [Trade Practices Act](#)”) was next pleaded in paragraph 62 of the amended statement of claim which alleged;

By making the J 35 representations, the further J 35 representations, the DLP representations and the C 26 representations the Respondent engaged in conduct in trade or commerce which contravened [section 52](#) of the [Trade Practices Act 1974](#) and the Applicant thereby suffered loss and damage in Australia.

67. Products other than the J35s, the DLPs and the C26 which had been purchased by Castel from TSP were alleged in paragraph 64 of the amended statement of claim to be defective at a rate of more than 3% which was said to have been recognised as a matter of customary dealing between Castel and TSP as the maximum tolerable incidence of defective products. Those other products were called “the other epidemic failure products” and were said to have been unfit for their intended purpose or to have been of unmerchantable quality. Breaches of the sales contracts in respect of the various goods already described were then alleged in these terms in paragraphs 65, 66 and 67 of the amended statement of claim:

65. Further or in the alternative, the supply by the Respondent to the Applicant of the J 35 products, the DLP products, the C 26 products and the other epidemic failure products with the hereinbefore pleaded defects was a breach of the terms of the sales contract relating to the particular goods.

66. The breaches of the sales contracts occurred in Australia by reason of the products being delivered to the Applicant and the defects being found there in purported performance of the applicable sales contracts.

67. Further or in the alternative, the supply of the J 35 products, the DLP’s the C 26 and the epidemic failure products with the aforesaid defects was a breach of each of the hereinbefore pleaded implied terms of the applicable sales contracts under the CISG and/or the law of Victoria.

68. The allegation of loss and damage suffered by Castel was to be found in paragraph 68 of the amended statement of claim which recited;

In dealing with the defects in the goods the subject of the J 35 representations, the further J 35 representations, the DLP representations and the C 26 representations and the epidemic failure occurrences on other products the Applicant incurred substantial costs and expenses it would not otherwise have incurred but for the said misleading and deceptive conduct, and breaches of contract.

69. Paragraphs 69 to 74 of the further amended statement of claim then advanced an additional claim for damages sustained by Castel as a result of not having consummated the Harman Option discussed at [70] to [95] of these reasons. The essence of that claim was encapsulated in the last two paragraphs of the amended statement of claim which alleged:

73. In or about June 2004 the Applicant determined not to take up its opportunity to acquire the Harman International distributorship for Australia by reason that the Applicant was satisfied in consequence of the J 35 representations and DLP representations as to its ability to achieve its profit projections for the 2005 financial year and subsequently.

74. The Applicant lost the opportunity to acquire and profit from the Australian Harman International distributorship and any other supplementary business by reason of relying upon the said misleading and deceptive conduct constituted by the J 35 representations and DLP representations and the consequences thereof, and thereby suffered further loss and damage.

THE HARMAN OPTION

70. In 2003 Mr Kwong conceived an ambition, as he put it in his witness statement, “to extend Castel’s business to audio products.” That stemmed partly from Castel’s involvement in the formation of a group of specialist Hi-Fi retailers known first as “Australian Consumer Electronics Specialists” and later as “AV Specialists.” Almost all of the retailers who became members of that group were strong supporters of the “Toshiba” products distributed by Castel and Mr Kwong estimated that at least 75% of the members of AV Specialists would have supported “Harman” brand products had Castel become the Australian distributor of those products. To further Castel’s ambitions to expand its product range, Castel appointed James Chay as General Manager of a new air conditioning division and Paul Clarke as General Manager of a new audio division.

71. In September 2003, Mr Kwong, accompanied by Paul Clarke, visited the offices of Harman International (“Harman”) in Paris where they met Phillipe Rinckenberger, Harman’s Sales Director – Distributor Market and Cyril Vincienne, Harman’s Area Sales Manager for the Middle East, Africa and Oceania. Mr Kwong and Mr Clarke then made a “presentation” to the Harman representatives on 24 September 2003. That gave details of Australia’s population distribution, the market conditions for selling various types of television receivers, DVD, CD and Mini Disk players and digital still cameras.

72. As well, the Castel presentation identified key categories of the major brands of audio and video products in Australia and the market share enjoyed in various categories by the major brands. Part of the power point presentation recited “Castel is interested in distributing the Harman Kardon brand in the Australian market. JBL and Infinity are also of interest.”

73. As a result of the meeting in Paris in September 2003, Mr Cyril Vincienne of Harman visited Castel’s premises at Preston in Victoria to appraise its resources and operations in Australia. A further meeting occurred at Harman’s European headquarters in France on 13 and 14 April 2004 when Mr Kwong and Mr Clarke made a further presentation to Mr Rinckenberger, Mr Vincienne and several other Harman executives. That presentation drew attention to the strength of the Australian economy and its prospects for growth. It also emphasised that Castel was “ready for expansion” and expressed its interest in “Harman Kardon, JBL home and car and Infinity home and car products” saying;

We are prepared to openly discuss any opportunity to secure these brands either by direct negotiation with Harman International or by way of acquisition of the current distributor, Convoy International.

The presentation also indicated the resources which Castel would dedicate exclusively to selling and servicing the Harman brands in Australia. As well, it outlined Castel’s general marketing programs for 2004 and what Castel would offer Harman International by way of improved sales promotion, a leading parts and service network and increased volumes of sales. That presentation acknowledged the existing presence in Australia of Convoy

International (“Convoy”) as a distributor of certain Harman brands, and outlined the expected impact on the Australian market if Castel were to become the distributor in place of Convoy.

74. However, after the meeting in April 2004, Harman offered to appoint Castel to be its Australian distributor of “Infinity” brand speakers and car audio products and indicated its willingness to extend the distributorship to further brands after Castel had demonstrated a period of successful trading in the “Infinity” products.

75. Nevertheless, Harman was not prepared to displace Convoy as the distributor of Harman’s brands, which it was then distributing (Harman, Kardon and JBL). That had been made clear to Castel as early as 2003 when Mr Vincienne wrote to Mr Paul Clarke as follows:

Dear Paul,

How are you?

Have you received and reviewed the samples of Infinity car audio products? If so, I would be interested to know the outcomes of your investigations.

A proposal was submitted to you on October 22nd which was explaining the type and amount of support Harman was prepared to grant Castel. I have not heard from you on this specific topic and would be interested to study your detailed business proposal.

Harman already does a significant business on JBL car products in Australia and that we will not jeopardize. The decision which consists of changing our distributorship will be taken if the performances of the current distributor are not satisfactory while considering all existing options. However, Castel is not active on this market yet and I am convinced that you have an opportunity to penetrate it very successfully with Infinity.

Wouldn’t it be an exciting challenge for both of us to position Castel as one of the leading distribution company in this field in Australia?

I look forward to reading your advices.

76. Mr Clarke responded to Mr Vincienne’s email of 6 November 2003 by an email of his own on 7 November 2003 in these terms:

By now, you would have received my email response to your proposal sent on 28th October. With respect to your decision to make only Infinity available to us, we decline your kind offer at this time until we are able to secure another brand of car audio from which we can plan a more effective launch strategy. As presented in our plan, we would be committed to invest significant money and resources to launch car audio to appeal to a larger audience rather than start in a niche manner.

We respect the business your current distributor provides Harman, and as mentioned at our meeting, our interest in carrying the complete Harman range and providing you with an established distribution network, we propose to you, is another option.

Regarding the samples, I understand they are still in your system in the Netherlands. Could you kindly arrange to retrieve these as we would not be requiring them at this time.

Michael and I thank you for your time to date and we hope we may be able to continue our discussions in the not too distant future.

77. Harman would only install Castel as distributor of the Harman and JBL products if a totally satisfactory arrangement could be reached between Castel and Convoy.

78. Mr Kwong thought that, if Castel were limited to distributing only some Harman brands, there would be insufficient income to justify acquisition of the new line of business. In Mr Kwong’s opinion, an additional \$20 million in annual turnover would be needed to justify the acquisition.

79. In light of the intimation by Harman that Castel would need to reach an accommodation with Convoy, Castel, on 22 April 2004, entered into negotiations with Mr McInnes, the Chairman and Managing Director, and Mr Matthews the Technical Marketing Director, of Convoy. At that time, Convoy's business consisted of the distribution of Harman and JBL products, principally in New South Wales with limited activity in other States of Australia. Convoy was also a distributor of "Monster" brand cables in which Castel had no interest. Castel believed that Convoy's sales of Harman and JBL products amounted to about \$3 million per annum.

80. At a meeting on 22 April 2004, Mr McInnes of Convoy indicated that he regarded the value of Convoy's goodwill attached to the Australian distributorship of the Harman and JBL products as in the order of \$6 million. He also stipulated that, in the event of acquiring that part of Convoy's business, Castel would have to take over Convoy's liability to support warranties to purchasers of Harman products which had been distributed by Convoy.

81. Mr Kwong regarded Mr McInnes' indication as only an "opening gambit" and suggested that Convoy's goodwill attaching to the Australian distributorship should be valued independently by one of the "Big Four" accounting firms. Mr McInnes rejected that proposal and suggested that an alternative should be formulated by his mergers and acquisitions advisers. Mr McInnes then left Australia for Europe where he had consultations with representatives of Harman. On his return, he advised Mr Kwong that Convoy would then agree to a valuation of the goodwill of Harman's business being conducted by KPMG (one of the "Big Four" accounting firms) but would not necessarily be bound by the figure arrived at by that valuation.

82. Mr Kwong has deposed that, in or after May 2004, he had estimated that sales of the Toshiba J35s and DLPs could generate revenue of up to \$20 million per annum for Castel, but to achieve that result Castel would have to deploy its sales staff to servicing the new Toshiba products as well as the existing lines distributed by Castel. That would leave Castel with no capacity to support a new line of Harman audio products. As well, he considered that the \$5.7 million which he had budgeted for supporting the new Harman products would have to be used for the promotion and support of the J35s and DLPs.

83. In his witness statement, Mr Kwong explained as follows the thought processes which led him, between May and June 2004, not to proceed with the Harman Option;

162. The position reached between Castel and Convoy at the end of April 2004 was that Convoy was willing to withdraw from selling Harman goods for an appropriate price. I was prepared for Castel to pay a figure of the order arrived at by a major accounting firm plus a sensible amount of premium, if necessary. There was more work to be done to reach agreement as matters stood at the end of May 2004.

163. Because of the assurances of TSP regarding the imminent launch of its new J-35 and DLP products I took the view that Castel should pursue that relationship rather than continue to negotiate with Convoy. If I had known in the second half of 2004 or early 2005 that Toshiba or TSP did not have a reliable product of the represented capacity of the J-35, Castel would have concluded a deal with Convoy and Harman to take over the distribution of Harman products in Australia. I know of no reason why such negotiations would not have been successful at that time.

164. Castel withdrew from the negotiations with Convoy in June 2004 and committed itself to taking advantage of the J-35 and DLPs. I was mindful of Castel's long relationship with TSP and the standing of Toshiba branded products to that point and of the considerable promise of its proposed products.

If I had known that TSP was not in a position to supply essentially fault free J-35 and DLP products Castel would have pursued and concluded a Harman distributorship or other distributorships. There was no point in Castel taking on Toshiba TV products which had not been sufficiently developed or tested to meet the digital broadcasting needs of consumers in the Australian market.

165. Castel's relations with Harman remained on a friendly basis after May 2004 and in June 2004 Mr Rinckenberger wrote to me confirming that the Infinity brand was still available for Castel to distribute in Australia.

84. Under cross-examination, Mr Kwong indicated that Castel had never paid for goodwill when taking over the distributorship of a new brand but had always started from scratch. His view was that Convoy's business would, at best, be only marginally profitable if conducted on a national basis. In one proposal to Convoy, Castel had suggested that it would allow \$100,000 compensation to Convoy in return for taking over its Harman brands but if liabilities assumed by Castel in respect of outstanding warranties should exceed \$20,000, the \$100,000 compensation would be reduced by the amount of the excess.

85. Mr Kwong further stated that Mr McInnes of Convoy had claimed that Convoy's margin on its Harman products was \$2 million per annum which led him, McInnes, to suggest a takeover price of three times that figure, i.e. \$6 million. Castel declined to entertain any thought of obtaining Convoy's Harman brands in that way. Instead, Castel would leave it to Harman to take Convoy out of the equation but, if Harman's loyalty to Convoy should preclude that course, "we understand completely".

86. On 23 April 2004 Paul Clarke sent an email to Mr Rinckenberger and Mr Vincienne of Harman which recited, amongst other things:-

We felt it important to provide you with a summary of our meeting with Geoff and Alex and a number of proposals for your urgent consideration.

Before going into a summary, it is important for you to gain an understanding of the general tone of how we were welcomed at Convoy and of the initial discussions.

Alex was not in a mood for small talk and asked immediately if Michael was a person who could make a decision on behalf of Castel, otherwise the meeting would not proceed.

After satisfying his question, Alex presented us with a copy of a confidentiality agreement. After clarification of a clause, discussions commenced.

Alex was in a power play mode from the first minute.

We were asked to confirm our meeting content and discussions with Harman to date. Alex was not looking at me whilst I was talking, rather critically absorbing what I was saying.

We disagreed on some of the points you and I versus you and he spoke about prior to our visiting you, however this was dismissed as unimportant as interpretations can easily be made. Alex asked of our intentions.

We suggested we were only interested in HK and JBL, not Monster and B&W.

Alex was animated in stating he was of the opinion we were to talk of a takeover of Convoy.

We confirmed we would be interested and that again a misinterpretation may have been made. We offered to take on his staff and absorb them into Castel.

Alex then stated that Convoy was not for sale, however the transfer of the two brands was an option - at the right price.

Alex suggested Monster and B & W would not want to deal with Castel anyway without giving any reason for this conclusion.

Michael made an offer to take on any staff who would be allocated to JBL and Harman.

Alex rejected Michael's offer, suggesting that Convoy had growth plans with Monster and B & W and perhaps in other areas.

Alex expected us to make an offer on the day as this was what was believed to have been suggested by Harman.

We explained this would not be possible as we did know his company's financials. Alex has a figure in mind based on a turnover figure at 50% margin, with no expenses being allocated or a breakdown of each brand's contribution. On takeover, Castel would take all stocks and spares at his landed costs and Castel would be fully responsible for all warranties on Convoy sales to date of takeover [3 years labor and parts and an additional 2 years on parts!]

This goodwill figure is unrealistic in our opinion as it is purely based on emotion and not standard business practices.

Alex was keen to tell us about other agencies Convoy has traded for goodwill in the past. Alex painted a picture for us from known negotiations where the transfers of agencies were good and of those not so good, with things like spare parts ending up in the sea, stock issues, etc.

This perhaps was a subliminal suggestion of how our transfer should or should not happen. Michael suggested [as we have discussed with you] both Convoy and Castel appoint an independent accounting firm to ascertain an objective value of what goodwill payment should be made if any.

Initially, Alex was against this proposal as he said how could an accountant possibly understand the goodwill value of his business. Alex did admit to it being a decision from the heart!

After a series of exchanges, Alex decided to agree with our proposal provided Castel pay the accountants. Alex would reimburse half however should the value be acceptable and the transfer takes place. Terms of reference however would need to be agreed by both parties.

Castel agreed to pay Convoy the "fair" value as a minimum.

Alex stated the value presented by the accountant would not necessarily be accepted and if the value was below his figure, we would be advised of the shortfall. Castel would then have to decide if it was viable. Alex suggested that a possible alternative would be that Harman pay the shortfall as a gesture of support to the new distributor. We did not pursue this suggestion, nor would Castel accept it, if offered.

We will appoint KPMG as the accounting firm, which we believe is Harman's chosen auditors, should the terms of reference to determine the value of goodwill be accepted by Alex.

Alex initially was not prepared to consider apportioning the value of the two brands away from Monster and B&W, nor in taking expenses into consideration. Towards the end of the meeting Alex did concede however that if expenses were to be taken into account he intimated that the allocation of them to the Harman group products would be well below 50% of Convoy operating expenses!

Reading between the lines, it would appear that Alex's demand would be unacceptable and perhaps another course of action be taken.

Alex verbally provided us with his SOH number of finished goods and parts [approx A\$950] This number was considered small by Alex in ratio to Castel's overall business.

Alex was passionate about how successful an organization Convoy was and of their stock turn ratios and cash flow. Castel would operate differently and hold substantially more stock on hand to compensate for increased demand.

When asked the terms of your contract with Alex, he pointed out the agreement was only by handshake. Alex did mention he of course has exceptional contacts within Harman at the highest level. Sidney Harman and his daughter were mentioned.

As you can see so far that Alex was the dominant one in these discussions, often repeating Convoy's success and how we would have an easy entry with the Harman brands.

Alex stated that Convoy would provide a small window of opportunity in which to negotiate the transfer and to have a decision made prior to July 1st 2004, with payment made July 1st 2004. Stocks could be transferred across prior, if all is agreed to.

The issue of goodwill is the sticking point for us as a business is only as good as it's current success, not the future, nor the past, as you would appreciate.

We feel that Castel has approached this proposed transfer of brands in a professional and understanding manner and our discussions with Harman have been deliberate, but transparent. In the event that Alex cannot agree on the terms of reference to value the brands business and accept our offer, we respectfully ask Harman's consideration and confirmation to one of the proposals listed below.

Castel would agree to grow the JBL and HK business by a minimum 50% over Convoy's current purchases by year 3 of our agreement. Add to this Infinity home and car. ***We would have an internal target to double the current purchases by year 3.***

Proposal 1.

Harman choose to terminate Convoy from July 31st and appoint Castel as new distributor. This would mean that no goodwill payment would be made to Convoy and the transition would be of an angry nature. We are prepared to accept this as we have experience in handling past challenges as we had to do with our terminating Sansui. We would treat any malice with a positive approach and move on. The goodwill Castel has developed with at least 90% of common retailers would enable us to ride out any difficult issues. We would work with Harman closely on stock forecasts and in getting the product to market quickly.

Proposal 2

As above regarding goodwill payment is concerned, however Harman to negotiate and confirm a transfer date of 1st January 2005, with any stockholdings sold and delivered to Castel by 30th October, 2004. If this is confirmed in the positive, Castel would take on Infinity home and car audio products immediately and support the brand with an enthusiastic promotional program. If there would be any change to the agreement from the agreed transfer date, we would return all Infinity stocks and cease the distributorship.

We would ask for your sensitivity in reading between the lines of this communication and once again reiterate our keen desire to market these brands and grow each others business in the short, medium and long term.

Proposal 3

A third alternative relates to our suggestion put forward to Alex that the two parties could meet in your presence and try to work out an agreed basis to proceed, but this was quickly dismissed by Alex as unworkable.

Could you please review at your earliest convenience and come back with your action plans. On the subject of working out the terms of references for the independent accountants [in view of the early negativity expressed by Alex], we have second thoughts as to the usefulness of spending approx \$40k for the accountants to do the evaluation. We feel it is not being viewed seriously by Alex as he has his own "from the heart" value which he seems to want to hold to essentially regardless of what the accountants arrived at. We await your advice on this and your comments as to the next steps to be taken [original emphasis]

87. During the first half of 2004, Castel was still endeavouring to ascertain the value of Convoy's business as a Harman distributor. On 10 May 2004, Mr Clarke sent a further email to Mr Vincienne which included this passage:

We look forward to speaking with you tonight our time to discuss your meeting with Alex in more detail.

We are more than happy to present a detailed business plan to you and will do so after discussing the next steps tonight.

In the meantime, we believe we have provided Harman with a good background of our intentions to date and have summarised the current status of the components of the business plan [attached]. I have also attached a selection of slides which may be of useful background for our discussion tonight.

In speaking with Cyril on Friday evening, it was obvious that Alex is still willing to relinquish the brands, however is maintaining a desire to receive a goodwill payment.

As discussed with Cyril, any payment would be based on the due diligence performed by an independent party and of the value judgement. We would not need to be privy to Convoy's operating structure, only the accounting firm and Alex would need to know the finite details of his operation. We would be guided by the accounting firm's evaluation.

This would however cost us \$70k to initiate.

There are some important aspects to consider against a goodwill payment;

1. How established is Castel in the market to be able to move forward quickly with minimal assistance from Convoy [see attached slides]
2. The book value of stock on hand - could be hidden costs
3. The book value of spare parts - could be hidden costs
4. Any undertakings to retailers which may not be presented at the time of transfer
5. Outstanding warranties - as Alex has stated he would not be responsible for any warranties from date of transfer
6. Any other liabilities not openly described and accounted for.

All the above points should be noted and taken into account in the computation of a "goodwill" figure. We would estimate that if the above is in fact not substantiated these costs could add up to \$200 - \$400k! This is based on the assumption that Alex chooses to relinquish the brands without further "goodwill" being imposed.

Michael Kwong would also ask you to kindly consider another assessment of "goodwill" as follows;

We have requested access to records by independent accountants and the fact that such is denied would seem to me that Convoy's alleged profitability may not be what it was touted to be. For your information we had often canvassed with other wholesalers in Australia and it is that if one's brown goods turnover is less than \$A20 million p.a. it is difficult to make a profit. For a specialised audio brand the number may be reduced to \$A15, due to the product mix likely including higher GP products. To be profitable at this reduced level, something has to be compromised, i.e. doing business on a shoe string, e.g. hand to mouth stock levels, tight credit and very low brand exposure [limited advertisements]. As we pointed out to Alex, one can make money out of any volume of turnover but the criteria is whether such turnover is representative of the brand image in the market.

Alex mentioned that his turnover on the Harman brands approximates \$8 million and his stocks were \$A700k [exc. spare parts]. At his stated 6 times annual stock turn rate we would deduce that his real turnover would be \$A6million. [\$700k at 30% GP = \$1 m x 6 times is \$6 million]. At only \$1.8 million GP we cannot see there would be much left on the bottom line to satisfy all S.G & A costs. At such turnover, as explained above, the business will be marginally profitable at best. Thus the question of "goodwill" is really overblown. However, Castel would be prepared to pay some "compensation" but such will need to take into account what & how the stocks [to be taken over] is valued and the outstanding warranty and any provisions for rebates etc & contingent liabilities relating to the Harman brands as conducted by Convoy at the date of transfer.

Coming back to Friday night's discussion, we thank you for the top ten list sent by Cyril, however we would have expected a more detailed list to work with, i.e.

1. Unit purchases by Convoy / TDJ of the last series models [2003] in Australia versus Harman sales globally.
2. Unit purchases by new range models [2004] by Convoy and TDJ versus Harman globally.

3. Harman's global forecast % by top ten models for the next 6 months [based on distributor forecasts]. We would expect a global similarity in the popularity in most models.

Michael and I will be in Asia from this Sunday until Wednesday the 19th May. If you were able to confirm your acceptance to Castel becoming the distributor of the Harman brands in Australia, would it be possible to meet with you in either Japan or Singapore on the 20th to formalise the business and marketing plans?

We look forward to discussing the above [and the attachments] during our telecon this evening [our time].

88. Despite Castel's apparent inability to agree on terms with Convoy for the takeover of the latter's business, Mr Clarke, on 25 May 2004, sent a further email to Mr Rinckenberger and Mr Vincienne which recited, amongst other things:-

As pointed out in the workings (computations attached) we would emphasise that because of the low volume of Harman business conducted there is no goodwill to be paid for the transfer. As a stand alone, Convoy / Harman products would not survive as a national distributor.

Castel will be prepared to take on the distribution together with Infinity audio and car sound as its infrastructure will be able to absorb various fixed costs and thus their costs' impact will have little effect on Castel. More important however, for Harman as well as Castel, is the fact that it is our desire to increase the \$ turnover by at least (50%) within 3 years (guaranteed) with our own in-house target to be 100% increase within the same period. At these volumes therefore we will then be able to see some return on investment.

We recognize that Convoy has helped to develop the brand, though it is arguable whether they have done enough. For this, as mentioned in earlier communication with you, we have allocated \$500K to "compensate" Convoy as well as to promote the Harman brands over the next 6 months. Because of the fact that there is no goodwill due and in order to effect a smooth transfer, Castel will offer \$100,000. Such an offer will mean:

- a. That Harman outstanding warranty at Convoy at handover date will not exceed \$20,000 but if it so exceeds the compensation payment will be reduced accordingly.
- b. That all stocks on hand will have a value when sold will yield Castel a net GP margin (average) of not less than 32.5%.
- c). That all spares are being valued at cost less obsolescence and depreciation.
- d. That Convoy will assist in a smooth transfer of stocks and its service personnel will provide one week's training at Convoy's premises for 2 of Castel's technicians.
- e. That Convoy will transfer all service manuals and literature etc to Castel upon transfer.
- f). That Harman will assist in a smooth transfer of the distribution.

We would also respectfully ask if it would be an option that the above offer be effected through you rather than for Castel to make a direct offer to Convoy.

Should the offer be accepted, we would like to arrange a telecon asap to work through the process and discuss the next steps in driving sales as quickly as possible.

I look forward to hearing from you once you have had time to digest the material.

89. Under cross-examination, Mr Kwong explained that passage as an assurance that Castel, if granted the Australian distributorship of the Harman Kardon and JBL brands, would increase turnover on those brands to between \$7.5 million and \$8 million in three years. That would allow Castel to "about break even" whereas, to generate a return on its investment, it would need an increase in sales of 100% to \$12 million over three years.

90. It seems that, shortly after the date of the email of 25 May 2004, Castel abandoned any thought of purchasing Convoy's distributorship of the Harman Kardon

and JBL brands because Mr Clarke wrote in an email to Mr Rinckenberger of 28 May 2004:

By now you may have read an e mail from Alex giving detail of his telephone discussion with Michael at 2.45pm today our time.

Before I discuss the above, Alex may have forwarded you a copy of an e mail sent to Michael earlier today at 11 am. In this e mail, Alex surprisingly came round to our way of thinking and states "To be completely honest, we have absolutely no idea as to the value of the agencies which is why we have suggested to go down the track of the latest proposal we have made to you, which we agree, substantially reflects the valuation principles in your original proposal to us."

Back to the 2.45pm telephone call.

Alex claimed his margin is \$4 million per annum, which he stated \$2 million is made on Harman brands. He stated to Michael as this is the case he wants 3 years value of profits - ergo \$6 million!

As you would appreciate, this was duly declined by Michael.

We now have concluded any thoughts of obtaining the Harman brands via this option.

Gentlemen, we leave it to you. As stated many times, we would be very excited to manage your brands in Australia and build your business.

We would consistently argue we could do a better job than is currently being done by Convoy.

If you decide to come with us, it would be great. If your loyalty to Convoy continues, we understand completely.

It has been a pleasure dealing with you to date. We look forward to hearing from you in due course.

91. On 4 June Mr Rinckenberger replied by email:

As you can imagine, we spent a lot of time to review all risks and opportunities of both alternatives.

The decision was not easy to take but at this stage we are still thinking that moving all our Brands from Convoy to Castel Electronics presents more risks than opportunities as the conditions of a smooth transition are not fulfilled. Based on this statement and on the fact that Harman does not have, at this stage, the dedicated infrastructure to offer you shortly all needed support in terms of training and marketing support, we prefer to maintain the current Distribution structure.

However, we learned a lot and we are still thinking that both companies are sharing the same culture and philosophy. If you might be interested, we are ready to grant you the Distribution Rights of Infinity Home and/or Car. By getting this Brand in Australia you could demonstrate your ability of developing an Audio Speaker Brands matching perfectly with the new screen generation. If you should not be interested, we would understand and accept your position as well.

Whatever your decision will be, we really enjoyed the time we spend together and at all discussions related to the business we had. Despite the fact we are not ready to move totally in the direction you were expecting, we think that we should keep in touch in the near future.

The truth of today is not always the reality of tomorrow.

92. On 4 June 2004 Mr Clarke sent this final email to Mr Rinckenberger:

As mentioned in my previous e mail we would respect your decision either way.

We have also enjoyed the meeting we have held to date, however are obviously disappointed the decision was not in our favour.

Regarding Infinity, we would accept this brand if somehow you could possibly OEM [original

equipment manufacture] part of the HK range and rebadge selected models as Infinity. We really must have an electronics brand to support the speaker packages and ranges.

93. When cross-examined about that end to the discussions between Castel and Harman, Mr Kwong indicated that it would be far too expensive for Castel to pay between \$2 million and \$3 million dollars to acquire Convoy's business on top of the \$5.7 million which he had allowed for spending to establish the new business and introduce the resources necessary to sell and service the Harman products throughout Australia.

94. In the light of the whole of the evidence about the Harman Option, I am satisfied that it was foreclosed to Castel by early June 2004 because Castel was not prepared to pay anything, or anything like the amount which Convoy was asking, for the goodwill attaching to its Harman distributorship and Harman was not prepared to terminate that distributorship or transfer it to Castel without a payment of compensation acceptable to Convoy. I am not persuaded that any of Castel, Convoy or Harman contemplated, after 4 June 2004, the revival of the Harman Option upon payment to Convoy by Castel of \$6 million or any other amount.

95. It is significant in this context that no evidence was called on behalf of Castel from Mr Paul Clarke who, it will be recalled, had been specially recruited to manage Castel's proposed new audio division. It emerged in evidence that Mr Clarke was no longer employed by Castel, but there was no evidence to indicate that he had been deployed to assist in the conduct of some other, existing, facet of Castel's business, as would have been consistent with the assumption that Castel had foregone the Harman Option in reliance on some representation by TSP. Nor was any evidence adduced from any representative of Harman or Convoy that the Harman Option could readily have been revived after June 2004 had Castel thought fit. In any event, neither Mr Kwong nor anybody else on behalf of Castel gave evidence to suggest that, at any time after June 2004, it gave any thought to reviving the Harman Option.

WAS ARTICLE 4 OF THE TOSHIBA – CASTEL DISTRIBUTORSHIP AGREEMENT IMPORTED INTO THE DISTRIBUTORSHIP AGREEMENT BETWEEN TSP AND CASTEL?

96. On behalf of TSP it was contended that, in 1997, Castel agreed to deal with TSP on terms substantially the same as those set out in the distributorship agreement between Castel and TSP, including Article 4 which is reproduced at [3] of these reasons.

(i) Evidence of Mr Majima

97. TSP's contention was said to be borne out by the evidence, first of Mr Majima, the Chief Specialist of Toshiba's Corporate Audit Division. Mr Majima had seen a signed distributorship agreement between Castel and Toshiba in or about June 1997. That agreement, Mr Majima said, was renewed and amended on 15 July 1997. Later in 1997, Mr Majima claimed, he told Mr Kwong that, with necessary modifications, the Toshiba-Castel distributorship agreement would apply in respect of all TSP's dealings with Castel from 1 October 1997. According to Mr Majima, Mr Kwong said that he understood and did not object.

98. Mr Majima next attested to a meeting with Mr Kwong on 29 August 1997 at which he reminded Mr Kwong that TSP had taken over Toshiba's Asian Headquarters and that, from 1 October 1997, Castel should direct all its orders (except for projection

colour television sets) to TSP and should provide monthly PSIs to TSP in respect of the products so ordered. Mr Majima further claimed that, at that meeting, he had reiterated that the Toshiba-Castel distributorship would apply, with all necessary modifications, between TSP and Castel to which Mr Kwong replied that he understood and agreed. Under cross-examination, Mr Majima agreed that he had no occasion in the ten years since 1997 to recall his conversations in that year and that he had no notes of those conversations. He also acknowledged that it was part of his duties with TSP in 1997 to negotiate the terms of distributorship agreements as he had done with other distributors in Israel and Indonesia. Each of those agreements had been for a term of one year with renewals to be negotiated and had been prepared by Toshiba's Legal Department in Tokyo. Each had been signed by a representative of TSP at the level of director or higher. At that time, Mr Osumi was a director of TSP. Although a distributorship agreement between Castel and Toshiba had been renewed in 1997 until March 1998, and had been signed on behalf of Castel and Toshiba, Mr Majima thought that it covered supply of all Toshiba products, including by subsidiaries such as TSP, and no other agreement was needed. That view, he claimed, was shared by Toshiba's Legal Department and had been affirmed by him, Majima, to Mr Kwong. 99. Mr Majima acknowledged that he had seen Mr Kwong's note of the meetings of 29 August 1997 and had handed it to a subordinate "to check the details". That note, which was headed "Minutes of Meeting Held At Toshiba Singapore's Office 9.00am to 11.00am On 29.8.97", recited:

Present: Mr Majima

M Kwong

Mr Majima mentioned that from 1.10.97 he would be responsible for the sales & production of Australian requirements, besides other countries in the region.

He pointed out on the followings:

1. **2170RA**

New 21" CTV which will replace the 2160RE. Picture quality will be better than the 2160RE with New IC. Tooling for this new model is ready with sample being produced in November 1997.

Sound will be Mono – 5 RMS

Indicative price is US\$195. AV Stereo

The 2175 model is stereo and this is mainly for Russian & Japan markets – stereo comes with 20 RMS.

2. **2970 – AV Unit**

2975 – Stereo & Text

New Prices are US\$490 & US\$530 respectively.

Both are likely to be available (Asian Edition) in November 1997.

3. Commercial film for TV Commercial will be available in October '97

100. Mr Majima had seen, in draft, in June or July 1997 the document signed by Castel on 15 July 1997 which is reproduced at [4] above. He was not consulted by Ms Yanagisawa about the amendments made to that document. He, Majima, had never had a conversation with Mr Kwong about arranging a separate agreement between TSP and Castel. He merely told Kwong of his view that the existing Castel-Toshiba agreement would cover products to be supplied by TSP to Castel. Mr Majima also acknowledged that the only overseas companies invited to Toshiba "World Tours" were existing distributors.

(ii) Evidence of Ms Yanagisawa

101. Ms Yoko Yanagisawa was, in 1996, a Group Manager for Toshiba. In April of that year she was involved in negotiating with Mr Kwong a distributorship agreement between Toshiba and Castel. Her recollection was that the main points of contention were the place where any arbitration of a dispute was to be conducted and the mode of payment by Castel. Ultimately, agreement was reached and embodied in the document dated 8 August 1996 which is partly reproduced at [3] above. That agreement was renewed by an amended document expressed to remain in force for one year from 1 April 1997 to 31 March 1998. The amendments provided for the extension of the distributorship to new products with no stipulation of minimum quantities to be purchased by Castel of those products.

102. In August or September 1997, Ms Yanagisawa met Mr Kwong in Tokyo and told him of the transfer of Toshiba's Asian operations to TSP in Singapore. As well, she advised Mr Kwong that henceforth orders and PSI reports should be directed to TSP and letters of credit for purchases should be in favour of TSP. According to Ms Yanagisawa, she also told Mr Kwong that nothing else would change because the terms of the agreement between TSP and Castel would be the same as those already existing between Toshiba and Castel. She further said that Mr Kwong agreed to deal with TSP on that basis or did not disapprove of the proposal and she confirmed the arrangement by the following fax dated 25 September 1997;

As we explained Mr. Kwong at Tokyo, we will transfer almost of all Tokyo business function of CTV business to Toshiba Singapore Asian Head Quarter on coming 1st Oct. According to that big change, I, Yanagisawa, am newly assigned as Manager of "Overseas Sales & Marketing Group/Visual Imaging System Department".

Since 1st Oct. Mr. Majima whom you know well will be in charge of Oceania business. Could you please communicate everything with Mr Majima as we did. If you need some information from Tokyo, Mr Majima will transfer all to whom concerned in Tokyo.

Especially for PSI, could you please inform your latest with the sales result of the previous month by every 1st weekend to Mr Majima.

If you have any order for the products made in Japan, the shipment will be arranged directly from Japan and ask you to open your L/C directly to Japan. Since 1st Oct. MS. Ghieko Yabashi/Deputy Manager of Regional Operations-Asia Group will be in charge of shipment from Japan.

(Thus, she is waiting for your L/C information for Nov shipment)

Also Ms. Yabashi will arrange ENC documents and samples and you can ask information for the time being.

I appreciate very much for your warm and kind relationship.

In Overseas Sales & Marketing Group/Visual Imaging System Department. I will be in charge of LCD projector sales in Asia & Oceania.

I am happy as I will have lots of opportunity to visit your country again and am looking forward to seeing you soon.

Thank you very much again and see you soon.

103. A copy of Mr Kwong's notes of the meetings in which Ms Yanagisawa participated was sent to her and noted, amongst other things that exclusivity was "not practical", that there should be "6 months Projection - 3 months order - Japan 6 - (CRT - 3 months) Singapore 4". Agreement was also noted as having been reached on a warranty period and "share of advertisement".

104. Ms Yanagisawa acknowledged under cross-examination that the distributorship agreement negotiated with Mr Kwong had to be approved by a General Manager, Mr Akimura, and such agreements had to be in writing for a term of twelve months,

usually from 1 April to 31 March of the following year. She believed that the same rules applied to TSP's distributorship agreements.

105. On 14 May 1997 Ms Yanagisawa had sent a memorandum to Mr Kwong which explained as follows the transfer of the Asian operations to TSP;

We decide to transfer our Tokyo function to Asean / Oceanian market to Toshiba Singapore in Oct so that we can act quickly to the emerging market. Tokyo function means that budget/sales, product/business plan, PSI, shipment and marketing.

To start in Oct. Mr Majima will leave for Singapore next weekend. He must be busy as he should build up system and routine as soon as possible. Up to then, naturally, we like to support him.

As Mr Majima will take responsibility for price since Oct. we can not confirm now however could you please plan at the same price level as current. At this moment unfortunately we cannot find any seed (sic) to reduce our production cost as the source of materials are not changed.

...

Anyway we have enough time and will continue to inform how we keep communication and the matters which we should transfer to Mr Majima.

106. In June and July 1997 Ms Yanagisawa prepared a renewal agreement with amendments for execution by Toshiba and Castel. After it had been agreed, she passed it to Mr Hagino. Ms Yanagisawa recalled speaking to Mr Majima about the draft version of the distributorship agreement noted at [100] above and told him of her discussions with Mr Kwong. She took part in a meeting between Mr Kwong and Mr Hagino in Tokyo on 27 August 1997 and a second meeting on the same day involving Mr Yajima, Mr Kwong and Mr Hagino. Mr Kwong sent her a copy of his notes of those meetings which she found to be "almost accurate". The notes were in the form of typed minutes, the first headed "*Toshiba-Castel Meeting Co-ordination Division – Minutes of Meeting Held on 27.8.97 9.30a.m.-10.00 a.m.*" and the second headed "*Toshiba-Castel Meeting CTV Division Minutes of Meeting Held At Toshiba Tokyo Office On 27.8.97 10.00 a.m to 11.30 a.m (2nd meeting 5.00 p.m to 5.30 p.m).*" The first set of minutes recorded the presence of Mr Masumoto, Mr Hagino and Mr Kwong and recorded discussion of the distribution of VCRs in Australia by Brashs/Deo Deo, the existing agency for projectors under the auspices of Toshiba's Imaging Department and a "CES" show apparently to be held at Las Vegas in the United States from 8 to 11 January 1998. The second set of minutes recorded the presence of Ms Yanagisawa, Mr Hagino and Mr Kwong. That second set of minutes recorded the discussion between the participants as follows;

1. Reporting-Function & Production Deadline

YY explained that effective 1.10.97 all CTVs (including PJs) will be handled out of Singapore under Mr Majima who will report directly to Japan. PSI for September due no later than 4.9.97 should be forwarded to YY. This will be the last PSI to Japan. Subsequent PSIs should be directed to Singapore by 4th of each month in readiness for Singapore to determine Its production at meeting on the 7th of each month.

2. PJ Prices & CTVs

MK stated that Toshiba PJs continue to have significant market share - 20% to 25% even though it is the most expensive brand in the country. Even with the proposed reduction of prices for the 48PJ5UE (later 48PJ7UA) to \$6999 it is over 40% higher than the Philips unit marketing between \$4599 to \$4999.

MK also mentioned that 9 months ago Australian market was only 150 units of PJs per month and Castel was selling 40 odd units. Total July '97 market was 350 units while Castel's share was 79 units. Such increase has been the result of cheaper intrants such as Philips and the

greatly reduced prices of previous market leader Pioneer (70% of market share) of its 50" PJ from \$10,999 to \$6999. Samsung has also entered the market with 2 models viz, 46" & 52"

3. CRT CTVs Programme For Next 12 Months.

a/. 3370 – 100 Hz (81cm)

Available in March / April '98 with an approximate price of US\$1000 (Retail A\$3299) – Made In Singapore.

b/. 3770 – 50Hz (94cm)

Available in June / July '98. Made in UK. Price as yet unknown but hope to have retail of \$4499 to \$4999.

c/. 2170 – (Replacement for 2160RE)

Sample unit available in November with production in March '98.

d/. 2160RE

Production will cease in September. It is possible to secure some additional units from Singapore. Would need to follow up with Majima if such is needed for Australia.

e/. 2988UE

This model will be discontinued as production facility has been shifted from Japan to China, specifically for the Chinese market only.

f/. 2989UA

This model will continue to be produced in Singapore. MK said that Victor Hew has forwarded his comments of small "quality" concern as against the German brand "Metz" to Sato. YY said that she was not aware of this but requested MK to forward copy of such report to her to follow up.

g/. 2980DE

This model has also been discontinued and instead its cabinet will be used to house the new 2975 model which will have only 2D or 3D picture enhancement quality. Details will be with Mr Majima. Production will commence for Asian countries in October '97.

The new low end model 2975 is to be used to compete with Panasonic new Sofia serie & Sony's E&J serie.

h/. 2999-100Hz

A new high end model will be produced with sample available in September. This unit will have centre speaker, which will considerably enhance voice sound as against the muffled sound of current stereo units. It will also have additional 4 speakers.

Made in Japan this unit sample will be available in October and will have super Crystal Tube –costing approx US\$1200 (Retail A\$3999!) – It will be a Flag ship model. It will have colour temperature of 7000 to 10000. This unit is to be used to show Toshiba's technology / quality and sell of other units from it.

2nd Meeting With CTV Division

Present: Mr Yajima

Ms Y. Yanagisawa

Ms Hagino

M. Kwong

MK explained the Australian market which he said has been down (retail sale dropped) with the government reducing interest rates 5 times of 0.5% per occasion over past 12 months to stimulate economy.

MK said that while CRT CTVs prices have contracted (up to 20%) PJ sales have been good though prices have also dropped (about 10%) due to entrants of cheaper products viz Philips, Samsung & reduction of prices by Pioneer & GE.

Mr Yajima & YY said that they would like Castel to clear its CRT TVs stocks by end of year so that the new models could then be introduced.

MK said that to counteract the perception of “lower quality product” due to the shift of production venue from Japan to Singapore of the “7” series, Castel would increase its warranty from 12 months to 2 years. Additionally it may need to reduce its prices as follows;

	<u>Original</u>	<u>PJ5UE (July)</u>	<u>PJ7UA</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>
48”	8999	7999	6999
55”	10999	9999	8999
56”	11999	—	9999
61”	11999	10999	9999

YY agreed to adjust the “7” series prices as follows:

	<u>PJ5UE (July)</u>	<u>PJ7UA</u>
	<u>US\$</u>	<u>US\$</u>
48”	2000	1900
55”	2550	2450
56”	3100	2750
61”	2900	2700

MK said that while PJ margins are good this will help in defraying the exceptionally low margins now for the CRT CTVs.

YY also said that Japan has decided to abandon the development of 71” PJ as requests for same is not sufficient for the capital outlay. Instead it has decided to enhance the present range to include LCDs and hopefully to add another model size ie. 44” to the present 4. All such products will be available from mid 1998 to end 1998.

YY said that she would forward the new circuitry documents to Victor Hew by the end of August so as to enable him to secure EMC approval for the “7” serie.

YY also suggested to MK to ask Majima for the catalogues for the new “7” serie.

(iii) Evidence of Mr Hagino

107. Between May 1996 and April 1999, Mr Hagino was Deputy Manager of Toshiba’s International Operations and Appliances Division (“IOIA”) which was responsible for co-ordinating Toshiba’s international businesses, including arrangements with international distributors. He arranged Mr Kwong’s visits to Tokyo and became friendly with him. In October 2000, Mr Hagino was transferred to Malaysia where he remained until March 2007. During that time he met Mr Kwong several times at “World Tours”. Mr Hagino was responsible for the renewal and amendment of the distributorship agreement between Toshiba and Castel. Mr Kwong consented to that renewal by fax on 10 June 1997 and later signed the document.

108. Mr Hagino also attended parts of the meetings in Tokyo with Mr Kwong on 27 August 1997. He heard Ms Yanagisawa explain to Mr Kwong the effect of the transfer to TSP of Toshiba’s Asian operations. She requested Castel to send future PSI reports to TSP for goods ordered from it and to open letters of credit in favour of TSP. Mr Hagino also claimed that he heard Ms Yanagisawa explain that “nothing else would change because the terms of the agreement between TSP and Castel would, with necessary modifications, be identical to those set out in the Distributorship Agreement” [between Castel and Toshiba]. According to Mr Hagino, Mr Kwong said words to the effect that Castel would deal with TSP in respect of Toshiba’s CTV products on the basis, and in the manner, which Ms Yanagisawa had described.

109. Mr Hagino was involved in arranging annual renewals and amendments of the distributorship agreement between Toshiba and Castel and consulted with Mr Majima of TSP about them, including the minimum product purchase quantities and amounts. The draft renewal and amendment for 1 April 1998 to 31 March 1999 was sent to Mr Kwong by fax on 21 April 1998 and he faxed back his acceptance of it. It was later signed on behalf of Toshiba and Castel. Some products described in paragraphs 2-6 in the box concerning Exhibit A to the agreement were to be supplied by Toshiba whereas those described in paragraph 1 in the same box (colour television receivers including projection television sets) were to be supplied by TSP. On 2 February 1999, Mr Hagino sent to Mr Kwong a draft renewal with amendments of a distributorship agreement to expire on 31 March 2000. That was sent under cover of a memorandum which recited “we talked with related divisions of Toshiba and concluded that we would like to extend the agreement with the same terms and conditions of current one except some minor changes as follows”. According to Mr Hagino, his reference to “related divisions of Toshiba” included TSP. The memorandum summarising the renewal of the distributorship was dated 30 March 1999 and signed on behalf of Castel by Mr Kwong and on behalf of Toshiba by Mr Yuchiike, the General Manager of Toshiba’s IOIA Division. Mr Hagino claimed that products of the kind described in item 1 of Exhibit A to the renewed agreement were to be supplied to Castel by TSP.

110. On 15 May 2000, Mr Hagino sent Mr Kwong a fax attaching a draft memorandum for amendment and renewal of the distributorship agreement for the year ended 31 March 2001. That memorandum recited that “CTV Div (TSP AHQ) and DVD Div would like to set the ‘minimum purchase amount’ as follows;”.

111. By a further fax message on 30 May 2000, Mr Hagino advised Mr Kwong of his (Hagino’s) consultations with TSP. The memorandum embodying the 2000 renewal with amendments was later signed in June 2000 on behalf of Castel and Toshiba.

112. In his oral evidence Mr Hagino acknowledged having received Mr Kwong’s minutes of the meeting of 27 August 1997 noted at [106] above and confirmed that those minutes contained no misstatements or mistakes. He further claimed that the renewal expressed to end on 31 March 2001 was proposed to be subject to a minimum purchase amount of \$US 10 million and that Mr Kwong wanted the “world target” reduced to US\$7 million.

Resolution of the issue

113. Counsel for TSP contended for a finding that Article 4 of the Toshiba-Castel agreement had been imported into the distributorship agreement between TSP and Castel. They urged the Court to prefer the evidence of Mr Majima, Ms Yanagisawa and Mr Hagino to that of Mr Kwong which they said had been shown to be faulty in significant respects, and dependent on his having refreshed his memory from correspondence and his minutes of the meeting of 27 August 1997.

114. It was next argued on behalf of TSP that, from 10 October 1997 until the end of its relationship with Castel, the relationship had been conducted on the basis that the terms of the distributorship agreement between Toshiba and Castel operated between TSP and Castel. This was said to be exemplified by Castel’s provision of PSI reports as provided in Article 11 of the agreement reproduced at [3] above and the performance by TSP of its marketing and promotional obligations under Article 10(2) of that agreement. Similar conduct at the end of the relationship was said to be constituted by the recitals of the Termination Agreement which is set out at [47] of these reasons.

115. According to Counsel for TSP, the effect of the importation of Article 4 into the agreement between TSP and Castel was to exclude from each contract between those parties for the sale of goods the implied terms of merchantability and fitness for purpose arising from the CISG or [s 19](#) of the [Goods Act](#). It is clear that a formal written distributorship agreement like that which subsisted between Toshiba and Castel was never brought into existence between Castel and TSP. That was obviously contrary to the practice usually followed within the Toshiba organisation to which Ms Yanagisawa and Mr Hagino attested and which was for distributorship agreements to be renewed annually with any necessary amendments and executed by an appropriate high-ranking executive in a form prepared or approved by the Toshiba Legal Department. That TSP was not usually excused from that general practice is evidenced by the fact that Mr Majima on behalf of TSP had concluded standard form annual agreements with distributors in Israel and Indonesia as noted at [98] above. In the absence of a formal distributorship agreement, the terms of the contract to which TSP and Castel were each a party is to be gathered partly from oral statements made from time to time on their behalf, partly from correspondence and other documents and partly by implication. The only oral statements which even approach an agreement that TSP and Castel were to be bound by the terms, *mutatis mutandis*, of the Toshiba-Castel distributorship agreement are the statements which Mr Majima ascribed to himself and Mr Kwong as set out at [98] above and which Ms Yanagisawa said she made orally on August 1997 as set out at [102] above and the response attributed by her to Mr Kwong.

116. The making of those statements received some support from the evidence of Mr Hagino noted at [108] of these reasons. However, I am unable to find that the statements were made in the terms suggested in the evidence or, if they were, that they were intended then and there to have binding contractual force. In my view, Ms Yanagisawa and her colleagues in August 1997 expected, consistently with the corporate practice outlined at [98] and [104] above, that a formal written distributorship agreement would be brought into existence between TSP and Castel. Moreover, it is likely that they expected that such an agreement, when executed, would be in a form similar to that already subsisting between Toshiba and Castel and contain some of the same terms and conditions.

117. However, those expectations, whether effectively expressed to Mr Kwong or not, did not suffice to incorporate by reference into any partly oral contract between TSP and Castel a term to the effect of Article 4 of the Toshiba-Castel distributorship agreement. (It is to be borne in mind in this context that the latter agreement was ambulatory in the sense that it was expected to be renewed and varied each year. Accordingly, it would have been necessary to stipulate in any oral agreement for the Toshiba – Castel agreement to govern the relationship between TSP and Castel, not only that it was subject to any necessary modifications but also that what was being incorporated was the Toshiba – Castel agreement **as renewed and varied from time to time.**)

118. I also regard it as improbable that there was any oral agreement to the effect contended for by TSP because no reference was made to it in Mr Kwong's minutes of the meetings of 27 August 1997 or in any other more or less contemporaneous document brought into existence on either side. Nor have I been able to discern anything in the conduct of the parties before or after August 1997 to support the implied importation into any contract between TSP and Castel of any term to the effect of Article 4 of the Toshiba-Castel distributorship agreement. There is no evidence that claims made for defective goods supplied by TSP to Castel were ever processed within the time limits imposed by Article 4 or otherwise in accordance with

that regime. Finally, I do not regard the provision of the termination agreements of 5 April 2007 as impliedly recognising that any previously existing contract between TSP and Castel contained a provision to the effect of Article 4. It is true that the recital to those agreements stipulates that “TC [Toshiba] and TSP shall be jointly or severally called “Toshiba”.” However, the collective reference in the plural to “the Distributorship Agreements” in cl 1 of those agreements, I consider, clearly recognises that the parties, or at least Castel and TSP, were contractually bound by provisions arising from “sale and purchase transactions” which were outside the “distribution agreement dated 8th August 1996 as renewed”, first mentioned in cl 1.

119. For the reasons outlined in this section, I have concluded that no limitation or exclusion to the effect of Article 4 operated to preclude Castel from relying on any implied warranty of merchantable quality or fitness for purpose arising by force of the CISG or [s 19](#) of the [Goods Act](#).

CASTEL’S CAUSES OF ACTION ESTABLISHED BY THE EVIDENCE

(a) Breach of contract

120. It is common ground that, on the issue by TSP of commercial and shipping documents after acceptance of an order from Castel for “Toshiba” products, a contract for the sale of goods (a “sales contract”) came into existence. Acceptance of that proposition led Counsel for TSP to contend at par 43 of their written submissions; For Castel to succeed upon its claims in respect of each relevant contract for the sale of goods made between TSP and Castel, it must establish:

- (a) what the terms of the contract were;
- (b) in what respect, if any, the terms of the contract were breached;
- (c) what loss, if any, it suffered as a consequence of the breach of that contract;
- (d) that the loss was, or ought to have been, in the contemplation of TSP at the time of conclusion of the contract; and
- (e) that it (Castel) took such measures as were reasonable to mitigate that loss.

121. It was also not disputed that, to the extent that it was capable of applying to them, the CISG governed the terms of each sales contract. Counsel for TSP expressly referred to *Roder Zelt-Und Hallenkonstruktionen GMBH v Rosedown Park Pty Ltd & Anor* (1995) 57 FCR 216 where von Doussa J said, at 222:

The parties were agreed that the contract for the sale of the goods was one to which the Convention applied. That Convention has become part of the law of Australia, and, relevantly for the purposes of this case, part of the law of Victoria by virtue of the [Sale of Goods \(Vienna Convention\) Act 1987](#) (Vic). The Convention applies to contracts for the sale of goods between parties whose places of business are in different contracting States (Art 1). Both Germany and Australia are contracting States. Dr Hoene’s affidavit expresses his opinion upon the application of the Convention to the facts of this case as disclosed to him in correspondence and affidavit material most of which was introduced into evidence at trial. However in so far as the contract is governed by the Convention, which is now part of the municipal law of Australia, the meaning of that law, and its application to the facts, is to be determined by this Court. It is not a matter for expert evidence. The Convention is not to be treated as a foreign law which requires proof as a fact. However the Convention governs only the formation of the contract of sale and the rights and obligations of the seller and buyer arising from such a contract;

122. Similarly, Australia and Singapore have, at all material times, been “Contracting States” within the meaning of the CISG. That has the effect that the CISG governs the rights and liabilities of Castel and TSP under each sales contract to the exclusion of any operation which the [Goods Act](#) might otherwise have; see *Summit Chemicals Pty Ltd v Vetrotex Espana SA* [\[2004\] WASCA 109](#).

123. The provision of the CISG which is principally applicable to Castel’s claim is Article 35 which provides, so far as is relevant;

- (1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract.
- (2) Except where the parties have agreed otherwise, the goods do not conform with the contract unless they -
 - (a) are fit for the purposes for which goods of the same description would ordinarily be used;
 - (b) are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller’s skill and judgement;

Those provisions have been treated by Australian courts as imposing, effectively, the same obligations as the implied warranties of merchantable quality and fitness for purpose arising under [s 19](#) of the [Goods Act](#); see *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [\[2003\] VSC 108](#) at [\[235\]](#), *Ginza Pte Ltd v Vista Corp Pty Ltd* [\[2003\] WASC 11](#), at [189]-[191] and *Summit Chemicals Pty Ltd v Vetrotex Espana SA* [\[2004\] WASCA 109](#).

124. The goods the subject of the sales contracts were audio visual products, particularly television receivers including DLP sets and set-top boxes including the J35 and C26 models. Goods of that description would ordinarily have been used for receiving television and audio signals in all available Australian formats and reproducing them with sufficient clarity and sound quality to be reasonably acceptable to an ordinary viewer. As well, the J35 and C26 set-top boxes would ordinarily have been used to receive digital television and audio signals and convert them to a form in which they could be viewed and heard with reasonable clarity on an analogue television receiver. An ancillary use to which the J35 and the C26 set-top boxes would ordinarily have been put was that of recording and storing digitally transmitted television programs so that they could be replayed as and when required by the viewer, again with reasonable clarity of picture and quality of sound.

125. Another particular purpose within the meaning of Article 35(2)(b) which I find was expressly or impliedly made known to TSP at the time of the conclusion of each sales contract was that of Castel’s selling the goods by wholesale in Australia to retailers who usually sold goods of that description for use by members of the public.

126. I find that there were clear, persistent and recurrent breaches by TSP of the implied warranties imported into each sales contract as discussed at [123] to [125] above. Indeed, Counsel for TSP did not seriously contend that the goods in question were generally fit for the purpose for which goods of the same description would ordinarily have been used. Nor did they submit with any force that goods in the relevant categories were generally fit for sale by Castel by wholesale to Australian retailers who normally dealt in goods of that description.

127. The reluctance of Counsel for TSP to contest a finding to the effect just indicated is entirely understandable because the evidence in support of such a finding was overwhelming. Nor was that evidence gainsaid by any of the witnesses from within TSP’s own ranks who were intimately involved in developing or selling the “epidemic” products or endeavouring to put them in a condition in which they would

be fit for resale in Australia. To make good that observation, it is convenient at this point to review the evidence of the three principal witnesses called on behalf of TSP who gave evidence of that kind.

Evidence of Mr Sato

128. Mr Sato, a Chief Specialist in Toshiba's Global Production Department, who was Manager, Sales and Marketing for TSP from July 2002 to September 2006, gave evidence that, in May 2005, Castel had to stop selling J35s until the defects which had been discovered in them had been substantially resolved. Similarly, Castel declined to take any deliveries of the C26 until all problems had been fixed. Mr Sato also recalled that a development schedule for the J35, prepared as at 5 August 2004, provided for mass production in December 2004. Mr Sato was displeased by that schedule because he wanted the product on sale in shops in time for the Christmas selling season. He was told, presumably by engineering staff from TSP and Zinwell, that production had to be delayed until safety testing could occur.

129. Mr Sato acknowledged that he was aware of a general practice whereby TSP maintained "bugs" lists of defects in products under development in which problems were sorted into categories designated AAA, AA, A etc, in descending order of the urgency of the need for rectification. After he was advised by TSP engineers in January and February 2005 that problems kept cropping up with the J35, Mr Sato learned that a "recovery plan" prepared by River Chiang of Zinwell provided for mass production runs of the J35 in February 2005. Set-top boxes being sent to Australia at that time, Mr Sato realised, were not fit for sale but were for display purposes only. There were major "bugs" remaining in the J35 as at 1 March 2005 which Zinwell was promising to fix by 11 March 2005. However, Mr Sato acknowledged, Mr So had no confidence that would happen and he, Sato, shared Mr So's distrust of Zinwell's ability to meet deadlines. A new deadline of 29 April 2005 was imposed but Mr Sato concluded, in the light of experience, that there should have been more testing of the J35 before it was sent to Australia for sale. In June 2005, Mr Sato wanted Zinwell to buy back all the stock that was then in Australia. He also acknowledged that, even in November 2005, problems were still being encountered with the J35.

Evidence of Mr So

130. Mr So has been employed by TSP since 2003, first as an Assistant Marketing Manager and later as the Assistant Department Manager of TSP's Consumer Electronics Department. In the latter capacity he reported, first, to Mr Sato and, after September 2006, to Mr Yamamoto, TSP's Director and General Manager of Sales and Marketing.

131. From mid 2003, Mr So was involved in the planning and development of the J35. That work included consultations with Castel about the price for which the new product could be sold in Australia. Mr So also assisted, in October 2003, in producing TSP's CTV Manual for 2003-2004. That Manual, he said, did not furnish a production schedule or specification chart for the J35 "because details of its development and production remained uncertain."

132. Also in October 2003, Mr So participated with Mr Sato in a meeting with River Chiang of Zinwell after which Zinwell was commissioned to "design, manufacture, test and supply" the J35. Discussions between TSP and Zinwell continued until the end of 2003 when Mr So advised Mr Kwong of Castel of the Australian retail price

proposed by TSP for the J35 and asked him whether it would be marketable at that price. He also advised Mr Kwong of some of the specifications of the J35.

133. Mr Kwong asked, among other things, what the FOB price to Castel of the J35 would be and, when he was told that it would be US\$470, he replied that such a price would be far too high for Castel to market the unit in Australia. Later, after some negotiation, TSP extracted an offer from Zinwell to develop and supply the J35 for US\$340 per unit. That apparently enabled an acceptable FOB price to be put to Mr Kwong and Zinwell indicated in March, and again in May, 2004 that mass production of the J35 would begin in October of that year. Accordingly, Mr So included details of the J35 in TSP's CTV Manual for 2004 which was issued on 16 April 2004. He also promoted the J35 at TSP's "World Tour" on 23 July 2004 which was attended by Mr Kwong. Mr So claimed that all his statements made to that date by way of promoting the J35 "reflected accurately the information which I had received from Zinwell, the developer and manufacturer of the HDD-J35 set-top box, and which I believed." He also expected, on the basis of Zinwell's proposed commencement of mass production in October 2004, that the J35 would be available for sale in Australia by November 2004. Later, Zinwell revised its production schedule to provide for mass production of the J35 to commence in November 2004. That was reiterated to Mr So by River Chiang of Zinwell on 4 October 2004.

134. Mr So acknowledged that, in an email which he had sent to Mr Kwong on 10 October 2004, he had stated that the maximum life of the lamps in Toshiba's DLP television receivers was 6,000 hours, if used on the 120 watt setting and 8,000 hours, if used on the 100 watt setting. That assurance had been based on information obtained from Masao Daikuhara of Toshiba in Japan.

135. Later, in October and November 2004, Mr So advised Castel that the launch of the J35 was then expected to occur in December 2004 contingent on the success of field tests to be conducted in Australia with the assistance of Mr Hew of Castel. Mr So also acknowledged sending Mr Kwong the apologetic email of 13 December 2004 which is set out at [14] above, and advising him two days later of a revised schedule culminating with the production of 1,880 units on 21 February 2005 to be delivered on 25 February. Mr So later, on 11 January 2005, sent Mr Kwong a further revised schedule indicating that production would commence on 26 January and result in production of 2,280 sets "around 25" March for delivery "End March". Despite the optimism of that email, Mr So was forced to concede in a further email to Mr Kwong of 26 January 2005 that "During the field test in Australia just now, our engineers still found out quite some bugs". Later, on 3 February 2005, Mr So sent a further email to Mr Kwong advising him of the sending of a maximum of 40 sets for demonstration purposes only.

136. Eventually, on 2 March 2005, Mr So sent Mr Kwong an email of 2 March 2005 regretfully advising him that the launch of the J35 had to be further deferred because "some critical bugs cannot be solved at the moment". After acknowledging Mr Kwong's request on 5 April 2005 for perforated tops to be fitted to all J35s including those already in Australia, and his, So's, request to Mr Kwong on 25 April 2005 to send back "1,520 sets and 1,600 top cover[s] to Zinwell asap", Mr So claimed that "it was Castel's decision alone to launch the Toshiba HDD-J35 set-top boxes on the Australian market in April 2005. Castel did not do so with my approval."

137. On 27 April 2005, Mr So received from Mr Kwong an email which recited, amongst other things:

HDD – J35

Thank you for your emails on the 26/04/2005 and 28/04/2005 on this subject. It has been rumoured that Topfield will be releasing its equivalent product in June though my belief is

that it is likely to be a couple of months later. However, if the competition is in the market in June, it is important that we should push for the sale of this unit as hard as possible. Some 10% of the sale to date has been coupling the J35 with our visual products.

To enable us to maximise the sale of the product I would like you to assist in implementing the followings (sic): -

a. The balance 1,425 units which were to be sent by sea freight should now be air-freighted to us as follows: -

1. To Brisbane 220 units
2. To Melbourne 1225 units
1425 units

Because of the already late arrival etc, I would ask you or Zinwell to pay 50% while Castel will pay 50% of the airfreight cost.

b. The un-modified stocks we have on hand here of 1540 units will be loaded on a 40ft container to return to Zinwell with vessel "Kapitan Sepykh" sailing on 8th May and arriving in Keelung on the 25th May. On the basis that the factory takes 5 days to rework them we would like you to also airfreight them to us - Again on the shared 50/50 basis on the airfreight:

Please note that we will try to stack as many of the new covers in the container as possible with the balance sent back by LCL.

c. The 760 units ordered for May production. It is disappointing to not know when the units were to be produced. We would need these urgently and Castel will pay for them to be air freighted to us. Please advise when is the production date for these.

Note: At this stage both the lots b) & c) above should be airfreighted to Melbourne unless new instruction are given prior to dispatch.

d. We would like to confirm the following NEW orders to be placed for late May production

- i) 760 units to be shipped to Perth
- ii) 760 units to be shipped to Brisbane
- iii. 1520 units (or more if such can be fitted into 40ft container) to Melbourne.

Thus a total of 3040 units plus for May production to arrive in Australia no later than mid June. Please note that this 15/06/05 date is very crucial as if we cannot make it by then generally, retailers will not want to take stock before 30th June (Australian financial year). This non arrival will also affect sales of LCD/Plasma/DLP end for June.

Please confirm this. Thanks.

e. For June production, if the above (d) can be confirmed, we will order 1520 units (or more if such can be fitted into the 40 containers).

f. We will need your confirmation for a) to e) above before we can provide you with July and August requirements.

138. Under cross-examination, Mr So accepted that TSP had been responsible for finalising the specifications of the J35 and that the timetable for its development had been worked out by TSP and Zinwell in conjunction. He had seen the "bugs" list in which the "bugs" had been ranked "A", "B" and "C" but he lacked the technical expertise fully to understand it. Mr Chey had kept him informed of progress in developing the new product which was expected to take five months.

139. Mr So recalled telling the Toshiba "World Tour" Conference in Singapore on 27 July 2004 that the J35 "will be likely the most wanted set-top box in the market," that it had a unique recording function and was expected to be launched at the end of 2004.

140. Mr So further conceded that, by October 2004, he was concerned that Castel "in the worst case" might seek compensation from TSP. By the beginning of 2005, he was aware that major and minor "bugs" were still being encountered in the J35 and he

arranged for all units to be shipped to Melbourne where Castel had workshop facilities for carrying out the necessary upgrade of their software. He arranged for a commercial invoice for 500 J35s to be raised against Castel on 1 March 2005 and one for a further 720 units on 2 March 2005. Both invoices were paid by letter of credit. By mid-March 2005, Castel had lost sales of the J35 and had thrown away expenses of advertising it at a time when it had no saleable units.

141. Mr So acknowledged that TSP was not happy with Zinwell's revised timetable for production of the J35. Indeed, TSP's Managing Director, Mr Ozaka, was "very angry" but TSP had to "accept the reality" and pressed for the model to be delivered to the market by the end of April 2005. Even when River Chiang of Zinwell advised delivery of 900 units to Melbourne, Perth and Brisbane by air on 27 and 28 April 2005, Mr So knew that there was still work to be done on those units but thought that it could be done using a laptop computer without the need for a workshop.

142. Mr Chey told Mr So on 27 or 28 April 2005 that Castel was beginning to sell the J35s which had newly arrived in Australia. He also told him that the software in those units was not ready but he, So, did nothing about it. As a result, Mr Kwong of Castel ordered more J35s on 29 April 2005 but, even then, was not told by TSP that the units were not ready for the Australian market.

Evidence of Mr Chey

143. The principal witness called on behalf of TSP in relation to technical matters was Mr Chey Ching Kwong, the Assistant Manager of TSP's Asian Department. To avoid confusion with Michael Kwong, the director of Castel, I shall refer to Mr Chey Chung Kwong as "Mr Chey".

144. Mr Chey confirmed the evidence of other witnesses that, in March 2004, Zinwell had proposed a development and production schedule for the J35 which projected the commencement of mass production in the latter half of October 2004. That was later revised to occur in November 2004. A yet further revision allowed for the first Australian field tests between 10 and 17 December 2004 with mass production to commence on 22 January 2005. After some limited field testing in Singapore had disclosed "some problems with picture quality", further significant defects were revealed by the Australian field tests between 11 and 14 December 2004 which, Mr Chey suggested, Mr Hew of Castel had "monitored and was involved in".

145. Mr Chey recalled that, on 11 January 2005, Mr So of TSP advised Mr Kwong of Castel by email that production of 80 J35s would commence on 26 January followed by larger amounts in February and March 2005. On the same date, Mr Tsang of TSP requested the assistance of Mr Hew of Castel in verifying that certain problems, which had been identified with the J35 engineering samples, had been solved. Mr Hew replied by detailing various defects which had been found by one of Castel's sales managers to exist in the J35 and saying "I think the two samples are not ready for performance test. Do you agree?"

146. Mr Chey further attested that, on 2 February 2005, Mr So of TSP pressed Mr River Chiang of Zinwell for 50 J35 sets to be sent to Castel by air within the week as demonstration models which, he acknowledged, could not have been sold to end users but had to be reworked either by Castel or Zinwell. On 7 February 2005, Mr Tsang of TSP sent to Mr Hew of Castel an email with four attachments, one of which was a "list of known problems" with the J35.

147. On 14 February 2005, Mr Chey advised Mr Hew that he [Chey], had heard from River Chiang of a "major bug" in the software for the J35. Castel also discovered for itself various defects in the demonstration models of the J35 which had been sent

to it by Zinwell. Although shipments of large quantities of the J35 had been arranged to occur from 1 March 2005 onwards, Mr Chey acknowledged on 1 March 2005 to his TSP colleagues that “there are major bugs [which he identified] remaining.”

Presumably, that acknowledgement led Mr So to advise Mr Kwong in terms of this email dated 2 March 2005;

We regret to inform you that the launch of HDD-J35 has to be postponed for some more time. The main reasons are some critical bugs cannot be solved at the moment. The most critical bugs are, but not limited to, listed below.

- Long hours recording causes the STB to hang and the HDD to be formatted which leads to contents loss.
- Playback of long file is not smooth and becomes intermitent (sic).
- Index Playback is not functioning.
- HDCP is not fully working which output unencrypted contents.

We cannot release the goods into the market, otherwise, they may end up to be recalled which will spoil Toshiba’s brand image. Although Zinwell promise to fix the problem by the end of next week (11 Mar), we really have no confidence on them after so many times of broken promise. If possible, please discuss with your retailers to postpone the launch for another month. In the meantime, we will push Zinwell to speed up the completion of software as the soonest time. ...

148. Despite intensive reworking in March 2005 by Mr Y C Liu and other Zinwell personnel of the J35 software and continuing field tests undertaken during the same month by Mr Henry Huang of TSP, Mr Chey noted that;

From Mr Huang’s reports to me it became apparent that, even in the last week of March, the HDD-J35 set-top boxes were suffering from significant unresolved problems.

The major “bugs” were summarised in an email of 31 March 2005 from Mr Chey to Mr River Chiang of Zinwell to which was attached a list of “all remaining bugs.” Mr River Chiang responded by email of 3 April 2005 proposing a three week timetable for remedying, between 4 and 29 April 2005, the remaining problems with the J35.

149. On 18 April 2005 Mr Chey sent a further email to Mr River Chiang expressing disappointment at Zinwell’s lack of progress in overcoming the problems and appending a list of “bugs” which Mr Chey then regarded as remaining unresolved.

After the discovery of the three defective capacitors noted at [34] above, the rectification of the J35s was delayed by the need to ship all units back to Zinwell for repair. Although 300 units were sent by Zinwell to Castel by air on 26 April 2005 and Mr Hew was able, on 27 April 2005, to email to Mr Chey that “the major bugs saga is over” he noted some other “very important issues” which still required attention. In that email, Mr Hew asserted that “we all agree not to delay in delivery to our customers any longer.” However, Mr Chey claimed that he had not authorised Castel to commence selling any J35s because both he and Mr Hew knew that they were not free of defects. Mr Chey further claimed that, from May 2005, “Castel often communicated directly with representatives of Zinwell” in respect of attempts to remedy defects in existing and revised versions of the J35 and arrangements for, and details of, shipments of J35 and C26 set-top boxes from Zinwell to Castel. Copies of direct communications between Castel and Zinwell were often supplied to Mr Chey during the remainder of 2005.

150. Under cross-examination, Mr Chey conceded that almost every promise made by Zinwell about the development of the J35 had been broken. Mr Chey kept Mr So

informed to that effect. By November 2004, Mr Chey knew that there would be no field testing of the J35 although he had been advised by River Chiang on 3 November 2004 that “Jonathon” the Zinwell engineer was projecting mass production to start on 22 January 2005. TSP began testing for “bugs” in about December 2004 and Henry Huang of TSP compiled a “bugs list” in light of that testing. Although River Chiang was a sales director of Zinwell, and not an engineer, he made clear to Mr Chey the difficulties which Zinwell was facing which had been created by use of the new 7038IC instead of the 7035 chip which had been used on the [S25](#) set-top box.

151. The first J35s for testing were received in Singapore in early December 2004 and were brought to Castel’s premises in Melbourne for testing. At that time, Mr Chey was concerned to “avoid Castel from seeing the bad picture quality and unstable J35.” The model which TSP tested in December 2004 did not have an operative recording function. The report of the test went from Henry Huang to Mr Chey and disclosed that the software was unstable, but these matters were not conveyed to Castel through Mr Hew.

152. On 12 December, Mr Chey was aware that Ronald So had written to River Chiang of Zinwell saying that it was impossible for Toshiba to accept a further two month delay in development of the J35 and, on 9 December 2004, that it was “a tragedy.”

153. In Mr Chey’s experience there are always some interruptions in the progress of any development project. He did not seriously doubt the competence of Zinwell which had performed satisfactorily for TSP on two major projects in the past. Because the hardware of the J35 was not ready, the unit could not be sent for safety certification. As at 13 December 2004, the problem was with the hardware and it was regrettable that the main circuit board had not been made stable by that date. The driver in the 7038IC needed to be released in stable form for the J35 to work.

154. Mr Chey differentiated between “performance testing” and “engineering testing”. He regarded the testing which had been carried out at Castel’s premises in Australia as performance testing despite his view that the J35 was not ready for it. He considered that performance testing has to be completed before a unit is ready for mass production and performance testing of the J35 was still being carried out in 2006. When referred to Mr Huang’s “bugs” list of 31 May 2005, Mr Chey indicated that “A” category bugs had to be eliminated before mass production. He acknowledged that TSP had never acquainted Castel with the engineering problems in the J35, as distinct from performance problems, but maintained that they were hard to distinguish. He accepted that Castel had never been in a position to evaluate for itself whether the engineering problems were hard or easy to solve.

155. Mr Chey recalled a meeting of TSP sales and technical personnel on 28 February 2005 at which it was revealed that, despite an intention to ship 1,320 J35s to Melbourne, they were still subject to critical “bugs”. Arrangements were made to send the whole delivery to Melbourne because that was where Castel’s workshop was and there were no sufficient workshop facilities in Brisbane or Perth. Mr Chey recalled that a revised “bugs” list dividing them into AAA, AA and A etc, had been prepared on 14 February by Mr Tsang and that Zinwell hoped to rectify all AAA and AA category “bugs” together with A category “bugs” by 3 March 2005. Later, on 11 March 2005, “bugs” were reclassified as “L” (low), “M” (medium) and “H” (high). “H” category bugs had to be solved before mass production. The “bugs” list was maintained for TSP by Mr Tsang and communicated to Zinwell. In Mr Chey’s view, a product suffering only from “L” level “bugs” could be released onto the market. However, he acknowledged that, on 14 March 2005, Mr Sato had sent an email suggesting that the project might have to be restarted from the beginning. On 31

March 2005, Mr Chey supplied River Chiang with a list of all remaining “bugs” and the date on which each had been found. There were major “bugs” in the J35 which only Broadcom, as the supplier of the Integrated Circuit could resolve. New “bugs” were still being found up to the end of March 2005. As at 13 April 2005, the sets which had been sent to Castel had to be returned to Zinwell and on that date Mr Chey emailed Zinwell that “our MD (Mr Ozaka) is very angry.” Some software was received by 15 April 2005 but it did not solve the problems and there was no basis for thinking that, by the end of that month, Zinwell would have fixed all the problems. The three faulty capacitors had been discovered on about 23 April 2005. Fixing them, Mr Chey thought, would solve the recording and playback problems but that could not be done by Castel; it would have to be done by Zinwell in Taiwan. An email from River Chiang to Mr So of 25 April 2005 suggested that the J35 was ready for delivery on 26 and 27 April with consignments to be split between Melbourne, Perth and Brisbane.

156. On Mr Chey’s understanding, the new stock being sent to Castel would have new capacitors and it was contemplated that all the “A” level “bugs” in the “bugs” list as at 25 April 2005 would be fixed in the new production to occur in May. On 25 April, TSP was still testing the software but the new stock was being airfreighted to Australia so that TSP’s testing was going on even as the units were being sold.

157. Mr Chey understood that the mass production contemplated for the end of April and beginning of May 2005 was of the hardware forming part of the J35. He was hoping, at the end of April, that the software would not be distributed to retail users but did not tell Mr So of that hope. On 26 April, testing was taking place at Castel’s premises on units which had the new capacitors. Development notes were transmitted electronically to TSP in Singapore by Henry Huang. Those notes showed that, even with the new capacitors, the J35s were not ready for release to the market. Mr Chey refused to make TSP’s list of defects available to Y C Liu of Zinwell because it was a “check list” which was Toshiba property and not a mere “bugs” list.

158. In Mr Chey’s view, there were other critical issues apart from the recording/playback problem which had to be resolved before the J35 could be released to the market. One such issue concerned the Line 1/Line 2 input. Mr Chey did not regard that as an “A” bug. Testing continued after the morning of 27 April, although Mr Hew of Castel had told Mr Chey that Castel was going to start selling J35s. Mr Chey denied having told Mr Hew after 27 April that the “major bug saga” could not be regarded as over. In the various lists of “bugs” exchanged between TSP and Zinwell, there was always at least one “A” bug and “A” bugs were never completely eliminated from the J35.

159. Mr Chey recalled that testing of the J35 had occurred at Castel’s premises in June 2005 when everybody approved its release to the market. Problems were still surfacing with the J35 and C26 in November 2005. One C36 was sent to Zinwell for further evaluation. Although Mr So was insisting that “whatever we release from now on must be in perfect condition”, that never happened.

Conclusion on the existence of breaches of contract

160. The comprehensive evidence of Mr Kwong and Mr Hew which I have rehearsed between [15] and [44] above has been substantially confirmed by the evidence adduced on behalf of TSP from Mr Sato, Mr So and Mr Chey. The totality of the relevant evidence establishes to a very high degree of satisfaction that the J35 was never developed to a point where it was reasonably fit to be offered for sale to Australian retailers or in the Australian retail market for set-top boxes. Although less

comprehensive, the evidence also establishes to a considerable degree of probability that there were similar breaches of the implied warranties in respect of both the DLP television receivers and the C26 set-top boxes.

161. There were tentative suggestions by some of the witnesses called on behalf of TSP that Castel had contributed to the breaches to which I have just referred by inadequate efforts itself to rectify the “epidemic” products, particularly the J35, or, by insufficient monitoring of the attempts by TSP and Zinwell engineers to correct the defects. However, I am satisfied by the evidence of Mr Hew, who was a careful and impressive witness, that Castel personnel did no more than facilitate the work of the visitors from TSP and its contractor, Zinwell. Similarly, I do not regard decisions by Castel to launch the “epidemic” products, especially the J35, on the Australian wholesale market as prompted by anything other than a desire to keep faith with its retailers and protect the reputation of the “Toshiba” brand. Castel’s endeavours in this respect, although largely unsuccessful, were reasonably seen as likely to mitigate the damage flowing from the breaches which I have found TSP to have committed of the successive sales contracts. In my view, the deficiencies in the J35 and the other “epidemic” products were essentially attributable to a desire by TSP, understandably encouraged by Castel, to be among the first in the Australian market with an advanced set-top box having a capacity to record and play back the television programs which it converted from digital format. However, that desire on the part of TSP was not tempered, as it should have been, by a proper appreciation of the need to develop, before mass production, a prototype demonstrated by exhaustive testing to be completely effective in Australian conditions. The absence of an appreciation of that kind was, I consider, the main factor contributing to the breaches of the sales contracts which I have found.

(b) Representations in contravention of [s 52](#) of the [Trade Practices Act](#)

162. Counsel for Castel indicated in written submissions that its claim for loss and damage was put on two alternative bases; a claim for damages for breach of contract (“the expectation claim”) and a claim (“the reliance claim”) for damages caused by misleading and deceptive conduct in contravention of [s 52](#) of the [Trade Practices Act](#). Extensive submissions were made about the effect of representations alleged to have been made by TSP about the J35, the DLP and the C26. It was contended on behalf of Castel that they were continuing representations which had been made with respect to products which had been developed and tested partly by TSP and partly by Zinwell on its behalf. Counsel for TSP on the other hand, contended that, to the extent that they had been made, all the representations alleged by Castel were as to future matters and attracted the application of [s 51A](#) of the [Trade Practices Act](#) and so were not to be taken to have been misleading if TSP had reasonable grounds for making them. Some of the alleged representations, it was said, were mere puffery which should not be elevated to the status of potentially misleading conduct; see *Pappas v Soulac Pty Ltd* ([1983](#)) [50 ALR 231](#), at 234.

163. It was further contended on behalf of TSP that the making of some of the alleged representations was conduct outside Australia thereby attracting the application of [s 5](#) of the [Trade Practices Act](#). That section extended [Part V](#) of the [Trade Practices Act](#) to the engaging in conduct outside Australia by, amongst others, bodies corporate incorporated or carrying on business within Australia. However, sub-ss (3) and (4) of [s 5](#) provide;

(3) Where a claim under [section 82](#) is made in a proceeding, a person is not entitled to rely at a hearing in respect of that proceeding on conduct to which a provision of this Act extends by

virtue of subsection (1) or (2) of this section except with the consent in writing of the Minister.

(4) A person other than the Minister, the Commission or the Director of Public Prosecutions is not entitled to make an application to the Court for an order under subsection 87(1) or (1A) in a proceeding in respect of conduct to which a provision of this Act extends by virtue of subsection (1) or (2) of this section except with the consent in writing of the Minister.

164. In reliance on those sub-sections, Counsel for TSP contended that Castel was not entitled, without the prior consent of the Minister, to rely at the hearing of this proceeding on extra-territorial conduct alleged against TSP. That point was not raised in TSP's amended defence.

165. In my view, it is unnecessary to resolve any of the controversies which have been raised about the application of the [*Trade Practices Act*](#) to the facts of the present case. That is because the representations in question, many of which are co-extensive with the implied warranties of fitness for purpose or merchantable quality arising under the CISG, are relied on only in support of the alternative reliance claim. For the reason explained at [94] above, the alternative reliance claim cannot be made out because the Harman Option ceased to be available to Castel on 4 June 2004 before the making of almost all of the alleged J35 representations, the further J35 representations, the DLP representations and the C26 representations and independently of any act or forbearance by Castel in reliance on any of those representations. It follows that an assessment of Castel's claim for damages must be confined to its primary expectation claim in respect of the alleged breaches of the sales contracts.

THE MEASURE AND QUANTIFICATION OF CASTEL'S EXPECTATION CLAIM FOR DAMAGES FOR BREACHES OF THE SALES CONTRACTS

166. The *prima facie* measure of damages where goods do not conform with the contract, whether as a result of a breach of the implied warranty of fitness for purpose or merchantable quality or for some other reason, is the difference between the value of the non-conforming goods at the time of delivery and the value which they would have had at that time had they conformed with the contract. Thus, Article 50 of the CISG provides:

If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time. However, if the seller remedies any failure to perform his obligations in accordance with article 37 or article 48 or if the buyer refuses to accept performance by the seller in accordance with those articles, the buyer may not reduce the price.

167. However, Article 74 recognises that damages recoverable for breach of a contract are not confined to the loss of profit on the non-conforming goods but extend to consequential losses. The same article imposes a foreseeability test by way of limiting the damages, whether represented by loss of profits on the goods or consequential losses, to those which were reasonably foreseeable at the time when the contract was concluded. Article 74 provides;

Damages for breach of contract by one party consist of a sum equal to the loss, **including loss of profit**, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the

conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract [emphasis added].

Mr Acton's analysis of Castel's claimed loss

168. Mr Acton, a financial and management consultant, who has the degree of Master of Business Administration from the Stanford Graduate School of Business, is a Fellow of the Institute of Company Directors and a Fellow of the Australian Institute of Management. He has served as a company director in Australia and has held corresponding positions on other boards and advisory panels and committees. He divided Castel's alleged losses as a result of the failure of the "epidemic" Toshiba products into two claims, the "Expectation Claim" and the "Reliance Claim" to which reference has already been made at [162] and [165] above.

A. THE EXPECTATION CLAIM

(i) The cost of dealing with defective products

169. Mr Acton quantified this aspect of the alleged loss by imputing the "increased costs" incurred by Castel in dealing with the defective Toshiba products. He then calculated an amount said to represent the effect of the cost of dealing with the "problem" products on sales by Castel of other products. In addition, he took into account the estimated gross margin which Castel would have earned from sales by Castel of other products. To that he added the estimated gross margin which Castel would have earned from sales of the "problem" products had they not been defective and compared it with the gross margin actually earned on those products in the relevant period.

170. Thus, for the year ended 30 June 2005, Mr Acton calculated the costs to Castel of rectifying the J35 set-top boxes at \$663,540. In the succeeding two years he assessed the same costs at \$2,445,666 and \$2,242,958 making a total for the three years in which those costs were regarded as having been incurred of \$5,352,163. Similar calculations were made in respect of the C26 set-top boxes and the DLP television receivers making a total increased cost of \$7,431,843 for all of those three products in the three years in question.

171. Thirteen other "Toshiba" products were identified by Mr Acton as having resulted in Castel's having incurred additional rectification costs as early as the year ended 30 June 2003. Other such costs were identified for each of the succeeding financial years up to and including 30 June 2007, making a total for all of the thirteen other products of \$1,280,097.

172. Mr Acton's calculations which I have just summarised were based partly on an estimate of the amount of time spent by Castel's sales staff in visiting customers and retailers to rectify problems as they were discovered and the non-salary costs such as motor vehicle expenses referable to that activity. Another integer in this calculation was the estimated cost of time spent by Castel's internal service staff in rectifying units, returning them to Zinwell as required and returning the reworked products to consumers. A different method was applied to calculating the cost of the time of service staff devoted to rectifying "epidemic" products other than the J35 and the C26 by assuming that each service job on one of those products required the same amount of time.

173. A cost was attributed by Mr Acton to handling of “epidemic” problems by Castel’s warehouse staff by expressing the total amount of extra time devoted to handling those products as a proportion of the total quantity of products handled in Castel’s warehouses. As well “fixed costs that [could] not be explicitly attributed to particular products or activities” such as office space, depreciation and the like were allocated “according to the role of these activities in a representative year” which was selected by Mr Acton as the year ended 30 June 2005. Advertising and promotional costs were not allocated because they were not regarded as attributable to specific products.

174. I accept that the costs of rectifying defective or non-conforming goods can be a head of damage under Article 74 of the CISG, either because they operate to reduce the profit on the goods or because they are incurred as a consequence of the breach. However, such costs are only recoverable if they would not have been incurred but for the breach. Costs which would have been incurred in any event as a necessary incident of the purchaser’s business cannot be claimed to reduce the profit which would have been derived had the goods conformed with the contract. Thus, the fact that sales staff, who were part of Castel’s permanent business establishment, spent time in visiting customers and retailers to rectify or recover defective goods does not mean that the value of that time is a cost, in the relevant sense, of rectifying the goods. The hypothesis that it is such a cost rests on the assumption that the time of the sales staff, if not devoted to the defective goods, would have been spent on other, profit-making activities. That assumption has not generally been made out on the evidence in this case.

175. However, I except from that observation the expenses incurred in putting on extra staff or using outside contractors specifically to rectify the defective goods. In this context, it is to be remembered that Mr Hew gave evidence, recounted at [42] above, that Castel’s service department had to be increased from seven to 35 to handle complaints generated by “epidemic” faults.

176. Also to be excluded from any calculation of the costs of rectifying or handling defective goods are costs of extra time spent on the “epidemic” products by Castel’s warehouse staff and the “fixed costs” such as office space and depreciation which Mr Acton allocated to this component of Castel’s damages. That is not to say that extra costs incurred in “non-profit” centres of Castel’s business like the warehouses should not be recovered if it can be demonstrated that they were incurred only because of the need to handle defective goods. I instance, as an example of an “extra cost” of this kind, extra wages paid to warehouse staff for overtime which would not have been worked but for the demands of handling the defective goods, returning them to Taiwan and receiving them back into Castel’s store.

177. The evidence does not permit a precise calculation of the difference between the extra expenses of handling and rectifying defective goods and the cost imputed by Mr Acton to time spent on those activities which would have been incurred by Castel in any event as an expense of maintaining its permanent business establishment. However, a difficulty in apportioning expenses, which have clearly been incurred, between amounts properly allowable as damages and those which are not does not excuse a court from making the apportionment.

178. As a Full Court of this Court observed in *Enzed Holdings Ltd v Wynthea Pty Ltd* [1984] FCA 373; (1984) 57 ALR 167, at 183:

Counsel for the appellants relied on a number of other authorities to which we do not find it necessary to refer. The principle is clear. If the court finds damage has occurred it must do its best to quantify the loss even if a degree of speculation and guess work is involved. Furthermore, if actual damage is suffered, the award must be for more than nominal damages.

We should add that we can see no reason why this principle should not apply in cases under the [Trade Practices Act](#) as well as in cases at common law. We emphasize, however, that the principle applies only when the court finds that loss or damage has occurred. It is not enough for a plaintiff merely to show wrongful conduct by the defendant.

In support of that proposition the Full Court cited *Callaghan v William C Lynch Pty Ltd* [\[1962\] NSWLR 871](#) where a Full Court of the Supreme Court of New South Wales pointed out, at 877;

Many cases illustrate that uncertainty in the quantification of damages, either in cases of contract or tort, does not prevent an assessment; provided that some broad estimate can be made.

179. In a joint judgment in *Commonwealth v Cornwell* [\[2007\] HCA 16](#); [\(2007\) 234 ALR 148](#), the High Court cited the classic exposition of the principle in *Chaplin v Hicks* [\[1911\] 2 KB 786](#), when observing, at [65]:

It shows that, by reference to established law, and well understood methodology of assessment of damages the respondent did in fact have a measurable valuable interest which he lost by 1977. There was, in short therefore, an assessable, irretrievable loss sustained by the respondent by 1977. The so-called “statutory contingencies”, of incapacity or early death, or retirement, each giving rise to a different, but nonetheless better financial consequence for the respondent if he had not been misled in 1965, are no different in kind from the contingencies with which the courts necessarily deal all the time. Indeed, practically nothing is certain or can be guaranteed in life or human affairs. This is why courts must do the best that they can, and assess damages, well understanding that exactitude will usually be impossible. That it is not possible provides no excuse for failing to do it [*Chaplin v Hicks* [\[1911\] 2 KB 786](#) at 792–3, 795–7 and 798–9].

180. In *Chaplin v Hicks*, Vaughan Williams LJ observed, at 793; In the case of a breach of a contract for the delivery of goods the damages are usually supplied by the fact of there being a market in which similar goods can be immediately bought, and the difference between the contract price and the price given for the substituted goods in the open market is the measure of damages; that rule has been always recognized. Sometimes, however, there is no market for the particular class of goods; but no one has ever suggested that, because there is no market, there are no damages. In such a case the jury must do the best they can, and it may be that the amount of their verdict will really be a matter of guesswork. But the fact that damages cannot be assessed with certainty does not relieve the wrong-doer of the necessity of paying damages for his breach of contract.

181. Mr Magee QC, who appeared with Mr A Young of Counsel for TSP trenchantly criticised the formulation of Castel’s Expectation Claim. He argued that each of the separate sales contracts should have been the subject of a separate claim and the loss claimed to have been suffered as the result of a breach of each such separate sales contract should have been alleged and provided with precision. In support of this contention, Counsel cited *Cassis v Kalfus* [\[2001\] NSWCA 460](#) where Hodgson JA, with whom Powell and Heydon JJA agreed, observed, at [89]:

A large factor in causing the trial to miscarry has been the lack of precision in the appellants’ pleading. It is not acceptable to plead a series of breaches occurring over many years, and then to make a global pleading of damage caused by all the breaches. While it may be appropriate to bring a claim arising out of an ongoing relationship, involving a number of

breaches occurring over many years, and while it could be productive of complexity and repetition to require each individual breach to be explicitly linked to allegations of damage caused by that breach, a pleading should enable definition, in a way fair to both parties, of issues concerning breach, causation and quantum of damage in relation to each cause of action relied on. It may be possible to group causes of action where the damage involved in each of them are substantially the same, so long as this can be done without obscuring issues of causation and quantum of damages arising in relation to each of them. The pleading in this case was grossly inadequate in this regard, and in my opinion would be liable to be struck out.

182. However, in the present case the series of breaches did not occur over many years. Rather, there was, relevantly, a single cause of action in breach of contract. Accordingly, it was permissible, in my view, to group claims in respect of a number of different sales contracts because the damage allegedly caused by each breach was substantially the same and the grouping did not obscure issues of causation and quantum of damage in relation to each breach.

183. I consider that a global approach to quantifying damages was justified in this case because, amongst other reasons, goods the subject of one sales contract were intermixed with goods from another when they were on-sold to retailers and when they were sent back to Taiwan or worked on in Melbourne in an attempt to rectify successive defects as they emerged. The so-called global approach was consistent with that taken by Barker J in *Ginza Pte Ltd v Vista Corp Pty Ltd* [2003] WASC 11 and by Hansen J in *Playcorp Pty Ltd v Taiyo Kogyo Ltd* [2003] VSC 108. In the latter case his Honour, at [290] described the plaintiff's claim as pleaded by noting;

In the statement of claim endorsed on the writ, Playcorp claimed \$10,621,260 as damages in the nature of profits lost as a result of the termination of the distribution agreement. That was the sum which it would have earned as profit if the agreement had run its course from April 1996 to 31 December 1998. Playcorp advised of an increase in the amount claimed to \$11,792,617 in further and better particulars dated 5 May 1998. It was alleged that that sum represented the aggregate of the loss of profit for the financial years ended 1995 to 1997 inclusive, and the six month period ended 31 December 1998.

184. In the present case, the claim for the cost of handling, repairing and replacing faulty goods was built up by Mr Acton first identifying what he called "directly incurred costs paid to third parties such as freight in excess of that normally required to deliver products and contracted service centres" which he said could "be readily identified from payment records".

185. An examination of worksheet CB3 in which Mr Acton analysed these directly incurred costs reveals that some were variously classified as "Admin", "Castel Service", "Field staff", "Warehouse Castel" and "Bonded Warehouse". As well, some of the costs analysed by Mr Acton under this head were incurred in the financial years 2002-2003 and 2003-2004 before there were any purchases of J35s and before problems were encountered with that model or the other "epidemic" products.

186. Mr Acton explained his methodology in calculating the damages claimed by Castel under this head which are referable to sales staff by saying, at p 10 of his principal report:

2. The principal resource impact of the product problems was on staff in the sales and service areas. To calculate the amount of time spent by the **sales force** on these products, I have referred to time-sheets of the period explicitly identifying time spent visiting customers and retailers to rectify problems. This significantly understates the diversion of resources involved, since, rather than selling more product, sales staff had to spend considerable additional time

restoring damaged retailer relationships by telephone and in writing, as is evidenced in correspondence I have been shown. My discussions with sales staff suggest that at least half as much time again was spent in this necessary but unproductive manner, so these times have been increased by 50% (*Attachment Ten*). Costs of the Sales Department have been allocated to epidemic products in total on the basis of the amount of time spent on them in relation to total time available. They have been allocated to individual products on the basis of service department activity (see below) as this gives a good indication of the relative incidence of failures (*Attachment Eleven*). This includes non-salary costs such as motor-vehicles and allowances, since these costs are clearly incurred in line with the staff activities that are being measured [original emphasis].

187. For the reasons explained at [174] above, I do not regard the costs attributed by Mr Acton to “Field staff” (which I take to be sales representatives) as extra expenses which would not have been incurred but for the defects in the J35 and the other “epidemic” products. It follows *a fortiori* that I also disallow the amount which results from Mr Acton’s inflation of this part of the claim by 50% as described in the extract from his report quoted at [186] above.

188. In respect of the expenses claimed under the heading “Castel Service”, Mr Acton, at p 11 of the same report, offered this explanation of his methodology:

3. For the **internal service staff**, the methodology is complex and for the purposes of clarification it is set out schematically in a chart at *Attachment Twelve*. The calculations assess the number of hours spent on each product and express this as a percentage of the total of available working hours in the service area. This percentage is then applied to service department costs to establish the costs for each product.

We have records for the J35 and C26 of how many products needed rectification in each period. The J35 also incurred costs in returning product to Zinwell as shown in *Attachment Thirteen*. As the problems were largely the same ones in each case, Castel’s Service Manager, Mr. Victor Hew, has estimated the average time taken on each occasion. Calculations of Service Department time on the J35 are shown in *Attachment Fourteen* and on the C26 in *Attachment Fifteen*. In addition, service time was spent on both these products when they were returned directly to Castel by consumers and this is calculated in *Attachment Sixteen*. For other epidemic products, including DLPs, I have calculated the number of service incidents for each product from job records, taken the Service Manager’s estimate of the time taken for each product job (*Attachment Seventeen*). As service incidence is difficult to allocate to years, it is allocated according to the length of each period (*Attachment Eighteen*). The sum shows total time spent on these other epidemic products and service department costs are allocated accordingly.

It should be noted that the second method (that applied to products other than the J35 and C26) is simpler but makes the assumption that all service jobs require the same amount of time. For the sake of accuracy, I have taken the more detailed approach in respect of the two major problem products [original emphasis].

189. Were it not for the evidence of Mr Hew, noted at [42] above, that Castel had to take on 35 additional service staff to deal with customer complaints about the J35 and other “epidemic” products, I would have been disposed to take an approach to the claimed expenses of the service department like that noted above in respect of “Field staff”. However, in the light of Mr Hew’s evidence, I have treated as an allowable expense 80% of the figure calculated by Mr Acton for internal service staff. I have also allowed in full his calculation of expenditure on “Service agent / Parts” which I

have assumed to be referable entirely to expenditure on external service contractors and spare parts used in attempting to rectify to the J35 and the other “epidemic” products. Likewise, I have allowed in full the claim for freight which Mr Acton identified as “in excess of that normally required to deliver products.”

190. Mr Acton appears to have made some apportionment of the expenditure claimed in respect of expenses incurred in handling epidemic products. He explained that apportionment as follows, at p 11 of his report:

4. The time spent on these products by **warehousing staff** has been calculated on the basis of their product volume adjusted for their failure rate since failures required double handling. For example, *Attachment Twenty-Two* shows that the J35 product was handled 63,905 times, while without an abnormal level of failures, it would have been handled 17,534 times. This adjusted sum is then expressed as a proportion of the total quantity of products handled in Castel’s warehouse (*Attachment Twenty*) and in its bonded warehouse (*Attachment Twenty-One*).

Confidential Attachment Four shows the total equivalent number of staff that was devoted to the problem Toshiba products. In all of these calculations, staffing levels are expressed as fractions of a full-time person for one year. In many situations this might not reflect management reality and full-time staff numbers can only consist of whole numbers of staff. In the case of Castel, reasonably high turnover and the regular use of part-time and casual staff enables management to tailor its resources more precisely to its needs [original emphasis].

However, that explanation does not demonstrate that the whole of the warehouse staff costs referable to the “epidemic” products would have been avoided, eg, by “regular use of part-time and casual staff” had the defective products conformed with the contract. I have therefore reduced by 50% the amount attributed by Mr Acton to “Warehouse Castel” and “Bonded Warehouse”.

191. For the reasons explained at [174] above, I have rejected Mr Acton’s assertion that administrative costs should be taken into account in calculating the profit which Castel would have made had the “epidemic” products not been defective. Nothing has been established in the evidence to found the assumption that TSP’s breaches of contract caused Castel to incur extra expenses in the form of interest. Moreover, as noted at [209] below, I consider that any allowance for interest can more appropriately be reflected in an order under [s 51A](#) of the [Federal Court of Australia Act 1976](#) (Cth) (“the *Federal Court Act*”). I have therefore similarly disallowed that part of the claimed costs of dealing with the defective Toshiba products.

192. In the result, I have assessed Castel’s damages under this part of its expectation claim as follows:

<u>Castel Service</u>	2004/05	113,789	
	2005/06	349,383	
	2006/07	<u>628,986</u>	
		1,092,158	
	less 20%	<u>218,432</u>	873,726
<u>Freight</u>	2004/05	15,959	
	2005/06	235,586	
	2006/07	<u>148,023</u>	399,568

<u>Service agents / Parts</u>	2004/05	176,164	
	2005/06	126,925	
	2006/07	<u>43,321</u>	346,410
<u>Warehouse/Castel</u>	2004/05	36,327	
	2005/06	49,048	
	2006/07	<u>13,058</u>	
		98,433	
	less 50%	<u>49,217</u>	49,217
<u>Bonded Warehouse</u>	2004/05	31,190	
	2005/06	67,521	
	2006/07	<u>13,910</u>	
		112,621	
	less 50%	<u>56,311</u>	<u>56,311</u>
			1,725,232
			=====

(ii) The cost impact of epidemic products on other Castel sales

193. Mr Acton identified the gross margins which had been received by Castel on sales of other brown goods before the problems with the J35, the C26 and the DLP manifested themselves, noting that “the Gross Margin on these products in 2000/01 to 2003/04 (before the product problems arose) was significantly higher than that experienced once the problems were known in the market place”. He excluded from his calculations of gross margins, sales and margins of air conditioners. In the light of the calculations just described, Mr Acton concluded that Castel’s gross margin on sales of the relevant goods declined from 24.9% in 2003-04, to 20.5% in 2004-05 and 16.4% in 2005-06 before rising in 2006-07 to 19.4%. He explained as follows his methodology in attributing a figure to the loss said to be represented by these fluctuations in gross margins;

Prior to the product problems in 2003/04, margins averaged a little over 25%. I understand this is higher than typical in visual products and resulted from Castel’s strategy of limited distribution and premium positioning based on perception of quality. After the problems were known in the market place, the margin was significantly lower (16-25%, average 20.3%). The vast majority of these sales during this period was of Toshiba brand product. In 2004/05 another brand, Orion, accounted for around one-third of this category, and the following year one sixth before ceasing altogether. Castel carried some high-end Macintosh product as well but this accounted for less than 1% of the sales analysed above, and the remainder carried the Toshiba brand. As Orion products were generally lower margin than Toshiba their withdrawal should have tended to increase average margins over this period. In the absence of any evidence of a market-wide decline in margins for these products at their normal price points, it is reasonable to infer that this decline in margin was caused by an unsuccessful product offering and the need to win back Toshiba business that was deterred by the problems experienced with product performance. This would have taken the form of extra discounts,

free product, cash incentives and additional display materials, all of which costs would have been reflected in a reduction in Gross Margin. It is important to emphasise that this cost is not an opportunity cost. The sales in question actually took place but it seems they only did so at the additional cost of abnormal discounts.

Gross Margin lost comes directly off profits, since the costs of generating the revenue are unchanged by the discount on them. Had Castel's margin on Toshiba products remained at 25%, profits would have been significantly higher, giving rise to additional cumulative lost profit to Castel of \$8,404,217.

194. I accept that it was foreseeable at the time of the formation of each of the relevant sales contracts that recurrent failures, recalls and delays in supplying replacements of the "epidemic" products would have had a repercussive effect in reducing Castel's margins of profit on other "Toshiba" products. Mr Acton's inference that some of the erosion of the profit margin on the non-epidemic "Toshiba" products was attributable to extra discounts, free product, cash incentives and additional display materials is borne out by the evidence of Mr Michael Hall.

195. Mr Hall recounted in a summary way the defects which Castel had encountered with the J35 and noted;

In total, there were some 54 faults that occurred with the J35. The associated software in the units had to be replaced several times.

196. Mr Hall also summarised the difficulties which Castel had encountered as a result of defects in the DLP television receivers and the C26 set-top boxes. He ended his witness statement by saying;

46. The continuing problems with the J-35s, the DLPs and the C-26s did a great deal of harm to Castel's reputation with its retailers according to my dealings with them. The difficulties in selling these products increased as competitors (such as Sony) introduced less troublesome competitive products.

47. In this period retailers often rejected my sales attempts by referring to fault free competitive products and stating their preference for those products over those of Toshiba.

48. As sales of J-35s were often packaged with DLPs and other digital products (such as flat panel TVs) the failure of the J-35s as one of the components had a serious effect on our sales generally.

49. In many cases consumers requested and were given full refunds of the purchase price of defective products and in turn the retailers, who had sold them the products concerned had to receive a refund or some benefit to offset the sales cost.

50. In order to maintain some goodwill with its retailers Castel had to provide various incentives and "sweeteners", such as exchanging other products and providing bonuses (free or discounted price products), to retailers to maintain their support.

197. However, there is an absence of quantitative evidence of the effect on the gross margins on non-epidemic products of the sales expedients to which Mr Acton and Mr Hall have referred. Confidential Attachment 25 to Mr Acton's report shows a very significant decline in the gross value of sales from the 2001 and 2002 financial years to the 2003 financial year when gross profit nevertheless reached a peak of 27.7%. Values of sales were then comparatively stable between 2003 and 2006 before experiencing a significant decline in 2007. These phenomena can be discerned from the following table on p 13 of Mr Acton's principal report;

**Castel's Gross Margin on Brown Goods Products
(Excluding J35, C26, DLPs) – (\$ millions)**

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Sales	54.9	59.9	46.7	32.0	37.8	36.9	25.2
Gross Margin	12.8	14.6	12.9	8.0	7.7	6.0	4.9
Gross margin %	23.3	24.4	27.7	24.9	20.5	16.4	19.4

(Note that sales and margins of air conditions have been excluded from this analysis).

198. It is notable that there was a decline in gross margins on non-epidemic “Toshiba” products which occurred in 2004-2005 before the epidemic products could have had a significant impact and when, as Mr Acton noted in the passage quoted at [193] above, the lower margin “Orion” products accounted for one-third of Castel’s relevant sales. I therefore prefer the inference that the decline was attributable rather to the contraction of the Australian brown goods market from 2003 and increased competition between participants in that market resulting in substantially greater discount by wholesalers. This inference is supported by the increasingly pessimistic descriptions of Australian market conditions which Mr Kwong gave in his monthly PSI reports from 2003 onwards. It is also reinforced by evidence from Mr Michael Hall to this effect;

11. In the 2002-2003 year Castel had to meet increasing competition in the digital field especially in relation to plasma screen television receivers, such as Fujitsu, Panasonic, Pioneer, NEC, LG, Samsung.

12. The plasma television receivers supplied by the Respondent suffered a cost disadvantage in the Australian market as compared to competitive products supplied by Samsung, Panasonic and Sony. The price differential was in some lines more than a thousand dollars. As a result it was difficult for Castel to sell the Toshiba branded sets against competing brands.

...

18. **By June 2005** the problems with the J-35 were adversely affecting Castel’s sales of other Toshiba products, such as LCD Televisions [emphasis added].

199. Evaluating the evidence to which I have just referred in conjunction with Mr Acton’s concession under cross-examination that he had no particular knowledge of, and had carried out no investigation into, the electronic brown goods market in Australia, I find that his estimate of the repercussive effect of the “epidemic” Toshiba products is unduly high. In my view, a more realistic estimate is that, but for the presence of the “epidemic” products, Castel’s margins on its other Toshiba products would have averaged 20% in each of the years 2004-2005, 2005-2006 and 2006-2007 instead of the 25% “hypothetical gross margin” imputed by Mr Acton. Accordingly, on the hypothesis which I prefer, there would have been no loss of margin attributable to the “epidemic” products in 2004-2005 when the actual margin was 20.5% and a correspondingly small loss of margin in 2006-2007 when the actual loss, according to Mr Acton’s calculation was 19.4%. I therefore consider that the damages recoverable by Castel under this head should be confined to restoring the actual margin calculated by Mr Acton for 2005-2006 as 16.4% to the hypothetical margin of 20% which I regard as more consistent with the evidence than Mr Action’s 25%. That requires an increase above the actual margin for that year on non-epidemic products of \$2,195,720 (rounded up).

(iii) Loss of margins on defective products

200. Mr Acton assumed that by contrast with margins on the other products described at [197] above, the new J35, C26 and various DLP models, having been presented as innovative “should have faced less competition for the first few months,” enabling them to be sold at significantly higher margins. However, he detected a rapid erosion in margins on the problem products as their defects became known. That erosion, he said, was illustrated by the following table;

Product Gross Margins by period (%)

PRODUCT	Months 1-3	Months 4-6	Months 7+	Average
DLP – 52JM	38.3	34.7	22.8	30.0
DLP – 62CM	37.9	33.0	34.3	34.7
DLP – 62JM	33.3	33.0	18.5	24.9
DLP – 72CM	39.0	33.0	29.7	33.9
C26 H	10.7	20.1	22.7	19.7
C26HB	10.7	-84.4	10.6	-6.5
J35	34.9	33.6	6.8	24.3

201. By comparison with the decline in margins which had occurred with other Toshiba television products over a similar period, Mr Acton inferred that margins on the problem products should not have declined by more than 1% after the first three months in which they had been introduced to the market. By taking into account the actual gross margins in fact derived from sales of the problem products and setting them against the gross margins which could have been expected to have been achieved had the products been problem-free, Mr Acton arrived at this estimate (to which I have made some arithmetical corrections) of the loss sustained by Castel as a result of diminution in gross margins:

PRODUCT	Actual Gross Margin (\$)	Expected Gross Margin (\$)	Margin Loss (\$)
DLP – 52JM	553,204	740,101	186,897
DLP – 62CM	355,474	378,222	22,748
DLP – 62JM	818,445	1,133,901	315,456
DLP – 72CM	615,924	714,597	98,673
C26H	828,930	877,153	48,223
C26HB	117,038	276,427	159,389
J35	1,162,617	2,507,822	1,345,205
TOTAL	4,451,632	6,628,284	2,176,591

202. Counsel for TSP contended that Mr Acton’s analysis of the loss claimed under this head was flawed because it assumed that the actual margin or profit which Castel expected to make on each category of the epidemic goods remained constant from the date of the first relevant sales contract until the last of the goods in that category had been sold. Instead, Counsel argued Castel’s expectation of the profit to be derived by

it from sales of each consignment of goods should have been ascertained objectively at the time of the “conclusion” of the sales contract related to that consignment.

203. Had that been done, so it was contended, the analysis would have imputed to Castel an expectation of a lower margin of profit at each point when a defect or collection of defects became apparent in the relevant product. However, as I have pointed out at [182] of these reasons, the sales contracts for the epidemic goods were concluded within a relatively short space of time so that it is reasonable to group them together, particularly when assessing a loss of profit, which seems to be the primary head of damage contemplated by Article 74 of the CISG. It follows that I reject the contention advanced in this context on behalf of TSP that:

Castel’s profit expectations and achievable profit margins in respect of the goods which were the subject of an individual sales contract must be looked at objectively in the terms of the CISG, at the time of “conclusion of the contract.” If the costs incurred, and the gross profits achieved, by Castel upon its resale of goods supplied to Castel by TSP pursuant to a previous contract had not met Castel’s expectations, for whatever reasons, then Castel’s expectations relating to costs and achievable gross profits, upon its resale of similar goods in the future would or should have been different.

204. The fallacy in that argument is that Castel’s expectations were not met because the goods did not conform with Article 35 of the CISG. At no stage in the course of the dealings between Castel and TSP in respect of the “epidemic” products can an expectation be imputed to Castel that it would receive, or offer for resale, non-conforming goods from which it would derive a lower margin of profit.

205. TSP relied in resisting this part of Castel’s claim for damages on a report by Mr Jeffrey Hall dated 12 May 2009. Mr Hall has graduate qualifications in accounting and post-graduate qualifications in finance as well as extensive experience in the valuation of businesses and corporate advice particularly in relation to mergers and acquisitions. Mr Hall criticised Mr Acton’s assumption that the J35, the DLP and the C26 “were presented as innovative and should have faced less competition for the first few months, thus enabling significant higher price realisation”. According to Mr Hall, that assumption was not borne out by the evidence. However, my impression of the evidence is to the contrary. Precursors in the Australian market of the J35 and C26 set-top boxes did not have a recording and playback function and the innovative features of the former enabled Mr So to announce to the World Tour in July 2004 that the J35 “will be likely the most wanted set-top box in the market”; see [132] and [139] above. Similarly, the DLP television receivers used innovative technology developed in the United States of America which enabled the use of much larger screens than had previously been available in Australia and were therefore well suited to take advantage of the new demand in this country for a “home theatre experience”.

206. Mr Hall also attacked Mr Acton’s quantification of this component of TSP’s expectation claim as depending on the adoption of a “simple average” decline in margins which may be unreliable. However, consistently with the views expressed above about the circumstances in which a global approach to the assessment of damages can be legitimate, I do not regard this part of Mr Acton’s approach as producing an entirely arbitrary or exorbitant result. Of course, any process of reasoning by inference from a relatively small sample involves an element of speculation. However, as Thomas J observed in *Hardware Services Pty Ltd v Primac Association Limited* [1988] 1 Qd R 393, at 401;

... whilst in some cases a plaintiff will show a certain series of events to be probable, and there may be no basis for assessing other than the maximum damages that would have flowed on that footing, in other cases it would be wrong to overlook the possibility that some other

course may have eventuated in which the plaintiff would not have suffered such damage. In that event it becomes the court's duty to do the best it can, and if necessary temper the award by making an appropriate reduction for such possibilities.

I therefore consider it appropriate to uphold in its entirety this part of Mr Acton's quantification of Castel's expectation claim.

Mr Acton's conclusion on Castel's Expectation Claim

207. At the end of the relevant part of his principal expert report, Mr Acton encapsulated his estimate of Castel's total Expectation Claim in this way:
My estimate of the total cost to Castel of receiving product that did not meet expectations is therefore \$19,292,819, consisting of:

Total Costs of Product Not Meeting Castel's Expectation:

ITEM	\$
Repairs to J35	5,352,163
Repairs to DLPs	931,641
Repairs to C26	1,148,049
Repairs to other epidemic products	1,280,097
Lost Margin on other Toshiba products	8,404,217
Lost Margin on J35	1,345,265
Lost Margin on DLPs	623,775
Lost Margin on C26	207,612
TOTAL	\$19,292,819

As these costs were incurred largely during the financial year 2005-06, they should be brought to present value by inflating them at Castel's marginal borrowing cost, which was around 7% at this time, from 1 January 2006 onwards (sales took place approximately evenly over calendar 2005 and 2006). This gives a cost as at 31 December 2008 of \$23,634,533 (*Attachment Twenty-Nine*).

I observe that Castel might quite reasonably claim that, had the products been suitable, it would have imported many more of them and been able to sell them at high margins for a longer period. As this cannot be established with certainty, this opportunity cost is not included in this claim.

208. By contrast, I have estimated at the following amounts the components identified by Mr Acton as comprising Castel's expectation claim:

(i) Cost of dealing with defective products	\$1,725,232
(ii) Impact of "epidemic" products on Castel's sales of other products	\$2,195,720
(iii) Loss of margin of profit on "epidemic" products	<u>\$2,176,591</u>
	\$6,097,543
	=====

209. I do not accept Mr Acton's contention that the total amount allowed for the three elements which comprise Castel's expectation claim should be "brought to present value by inflating them at Castel's marginal borrowing cost" of around 7%.

There is no evidence of the rate at which Castel was borrowing funds in 2006 or of the amount which it borrowed in that year. In my opinion, any claim by Castel for interest on the amount to which it has established it is entitled should be recognised in accordance with s 51A of the *Federal Court Act*. Sub-section (1) of that section provides;

In any proceedings for the recovery of any money (including any debt or damages or the value of any goods) in respect of a cause of action that arises after the commencement of this section, the Court or a Judge shall, upon application, unless good cause is shown to the contrary, either:

- (a) order that there be included in the sum for which judgment is given interest at such rate as the Court or the Judge, as the case may be, thinks fit on the whole or any part of the money for the whole or any part of the period between the date when the cause of action arose and the date as of which judgment is entered; or
- (b) without proceeding to calculate interest in accordance with paragraph (a), order that there be included in the sum for which judgment is given a lump sum in lieu of any such interest.

The remaining sub-sections of s 51A have no application to the circumstances of the present case.

210. In my view, s 51A empowers the Court to add to the judgment sum for recovery of damages an amount representing interest from the date when the cause of action arose to the date when judgment is entered. The availability of that power obviates any need for including in the amount of damages recovered any allowance for interest incurred or foregone such as that for 7% per annum made by Mr Acton as described at [208] above.

B. THE RELIANCE CLAIM

211. This alternative formulation of Castel's alleged loss proceeded from the assumption that, if it had not carried the J35, the C26 and the DLP television sets, Castel would have acquired the rights to distribute, in Australia, the Harman products identified in the description of the "Harman Option" which is to be found at [70] to [93] above.

212. Mr Acton explained in these terms the methodology which he adopted in calculating the profit which Castel would have made in the years from 2004/05 to 2006/07 and the first six months of the year 2007/08, had it implemented the Harman Option:

In order to establish a profit and loss statement reflecting the distribution of the Harman products in place of the discontinued Toshiba products, three adjustments must be made to revenues and gross margins:

- i. All revenues and gross margins relating to the Toshiba products in question must be deducted.
- ii. Estimates must be made of likely sales, Gross Margins and incremental costs of Harman products for each year.
- iii. The adequacy of the Castel infrastructure to deal with the Harman products in place of the epidemic ones must be established and additional resources added if necessary
- iv. Margins on the remaining Toshiba products must be adjusted to reflect the removal of the negative impact on them of the products that would not have been carried.

213. Mr Acton regarded as reasonable Mr Kwong's estimate that, if Castel had acquired the Harman distributorship including the rights to sell additional lines,

namely the Infinity home speakers and car audio range, Becker car radios and JBL professional speakers, it could have achieved sales of those products growing from \$13 million in the first year, to a steady \$30 million in the third and subsequent years. Mr Acton then imputed a realised gross margin on those projected sales of 32.5%. He regarded that imputation as conservative and as making full allowance “for any discounts required to secure the support of current resellers and secure rapid acceptance in new ones.”

214. Mr Acton accepted that it was likely that Castel would have had to pay a capital sum to Convoy in order to secure the Harman distributorship, but conceded his inability “to assist the Court in attempting to quantify this cost.” However, he did make allowances for Harman-specific costs including legal fees, the purchase or lease of demonstration vehicles, the conduct of “roadshows” and advertising expenses. As well, provision was made in Mr Acton’s calculations for modifications to Castel’s warehouses, new service equipment, demonstration stock and materials for training staff and retailers. (One of his assumptions in this context was that four additional staff members specialising in car audio technology would have to be added to the Castel workforce. After allowing for inflation at the rate of 5% pa of recurrent costs of the kinds just indicated, in the financial years 2007 and 2008, Mr Acton calculated the annual differences in Castel’s actual profit and the profit which would have been derived by his model of Castel’s business expanded to sell the Harman brands.

215. However, Mr Acton, for the purposes of the Reliance Claim, assumed that Castel had not distributed the J35, the C26 or the DLP television sets at all, so that costs incurred in testing, handling, transporting and reworking those products would never have been incurred. A concomitant of that assumption was that some of Castel’s staffing, warehousing and other resources which would have been devoted to those “discontinued” products, were free to be applied to selling and servicing the Harman lines. On that basis, Mr Acton assumed that the four car audio specialists noted at [214] above would replace other staff who would leave Castel as a result of its reduced offering of Toshiba products. These assumptions led him to allow for warehouse staffing to be increased by half a person and service staff to be increased by two persons in 2006-07 to accommodate the required volume of sales and servicing of the new Harman lines, the continuing Toshiba lines and other existing lines in the Castel product range.

216. Mr Acton’s modelling for the Reliance Claim allowed for some costs such as superannuation and motor vehicle expenses to be adjusted in accordance with the model’s allowance for increased staff. Other fixed costs such as legal fees and information technology expenses were assumed to remain at the level at which they actually prevailed in the relevant years. Other costs assessed as likely to have been partly fixed and partly variable were modelled accordingly.

217. This analysis led Mr Acton to assert, at p 25 of his principal report; The resulting total cost structure in the hypothesised scenario is, in my judgement, that necessary to run the business including sales of all Toshiba products except the J35, DLPs and the C26, current TCL products and the new Harman products, and to service other defective Toshiba products.

218. Mr Acton also found it necessary to adjust margins on the continuing Toshiba products which he hypothesised would remain in the Castel range. He assumed that, unaffected by the discontinued products, those continuing products would have been sold at a gross margin of 25%. He justified this aspect of the modelling by observing, again at p 25 of his principal report:

As we have shown in relation to the Expectation Claim, actual results for the years in question show these products as having had Gross Margins in the range of 16-20%, which is consistent with a need to discount Toshiba products in order to counter marketplace discontent with the brand. The analysis assumes that had the discontinued products not been carried, these discounts would have been unnecessary, so in the model the remaining products have been ascribed a Gross Margin of 25%. (It is quite possible that excluding these products would not have prevented all of the margin decline, given other Toshiba products that had failed. In this case the model would not incorporate all this margin restoration, but the remainder of the lost margin would appear in the model as an additional net cost of the other epidemic products making no difference to the resulting total cost to Castel).

219. A further adjustment was made in modelling the Reliance Claim to allow for financing working capital (stock plus debtors net of creditors) for the Harman products after taking account of the eliminated need to provide working capital for the presumptively discontinued Toshiba products. In this respect sales were assumed to be achieved on ratios of a stock holding of 4 months sales, 3.4 months of debtors and 45 days of creditors. After assuming that, after tax, cash profits from the model in excess of actual profits in the relevant years would be available to finance working capital, and allowing for borrowing costs of 7% per annum, Mr Acton deducted the cost of working capital attributable to the discontinued Toshiba products in order to arrive at “the incremental amount of working capital” that would have had to be financed had the Harman Option been exercised.

220. These calculations and assumptions led Mr Acton to conclude, at p 27 of his principal report:

The difference in cumulative before tax profits to Castel between, on the one hand, carrying the range that was carried, including all the epidemic products, and, on the other, discontinuing the J35, DLPs and the C26 and carrying Harman products, is represented by the sum of the annual differences in profit between actual results and those derived in the model of the reconfigured business. This amounts to \$29,916,038,

Differences between the Reliance Claim and the Expectation Claim

221. In the concluding part of his principal report, Mr Acton identified the reasons why the Reliance Claim, on his calculations, differed from the Expectation Claim. In the first place, he noted that the variable and direct staffing costs (sales, service and warehouse personnel of the J35, the C26 and the DLP television receivers were not part of the Expectation Claim which assumed the elimination of those expenses. However, the assumption that the Harman Option had been exercised, gave rise to the consequential assumption that those overhead expenses would be redeployed on sales and service of the Harman products.

222. On the other hand, the cost of continuing to deal with the other epidemic products, (not being the J35, the C26 and the DLP televisions) would have been incurred even if the Harman Option had been exercised. Accordingly, those expenses quantified at \$1,094,894 are a component of Mr Acton’s calculation of both the Expectation Claim and the Reliance Claim.

223. Costs incurred on epidemic products before 1 July 2004 were not covered by the modelling for the Harman Option which could not have been exercised before that date. However, they were incurred in an estimated amount of \$185,203 which has been included in both the Expectation Claim and the Reliance Claim.

224. The estimated loss of gross margin on the Toshiba products other than the J35, the C26 and the DLP was restored for the purpose of modelling the Harman Option and as explained by Mr Acton “is not an additional cost to Castel under this claim.”

225. For the avoidance of doubt, Mr Acton set out in tabular form the points of difference between the Expectation Claim which was calculated to amount in all to \$23,634,533 and the Reliance Claim calculated in an amount of \$33,657,361 from which should be deducted “whatever sum if any the court determines Castel would have had to pay to secure the [Harman] distributorship from Convoy”. In respect of compensation paid or allowed by TSP to Castel, Mr Acton made these observations at pp 29-30 of his principal report;

I understand Castel acknowledges the receipt of \$3,415,406 from Toshiba between February 2005 and April 2007 in part payment of some of these costs. This represents cash payments, and does not include the value to Castel of Toshiba supplying replacement parts for the DLP to a value of \$116,325. That value was reflected in a reduction in Castel’s Cost of Goods Sold thus reducing the claim under the Harman model; had it not been paid, or been treated separately, the Harman model profits would have been larger than actual results by exactly the same amount. Thus it should not be treated as an offset to the Harman claim.

I also note that other sums paid to Castel by Toshiba during this period in respect of other matters, such as the termination of Castel’s distributorship and a contribution to resulting redundancy costs, advertising subsidies or repurchase of stock, are not relevant to the Expectations Claim as they offset other costs than those claimed. Nor are they relevant to the Reliance Claim as they do not differ between the model and actual results. Certain other payments amounting to US\$825,000 and compensating for reduced price realisation on LCD television sets have been included in actual results for the year as an offset to the cost of goods sold. As Gross Margin loss in both the Expectations Claim and the Reliance Claim were calculated by restoring brown goods margins to 25%, these payments have already reduced the gap between the models and actual results by raising the latter and so should not be taken into account as an offset to Castel’s costs. These figures are shown in *Attachment Three*.

This sum of \$3,415,406 should be offset against the total claimed. To make it comparable with Castel’s claims by bringing it to current value as at 31 December 2008, I have applied a rate of 7% inflation from March 2006, that being the approximate midpoint of the period in which payments were received. This takes the value of compensation acknowledged to \$3,910,298.

226. Numerous detailed criticisms of the assumptions and methodology on which Mr Acton’s calculation of the Reliance Claim have been made both by Counsel for TSP and by Mr Jeffrey Hall whose expert evidence was adduced on its behalf. However, it is unnecessary to consider those criticisms or to reach a conclusion as to the validity of Mr Acton’s Harman model. That is because the fundamental hypothesis on which the model rests cannot be sustained. That hypothesis was that Castel would have acquired the Harman and JBL brands in or about 2004 with or without paying a premium or compensation to Convoy for goodwill. However, the hypothesis could not be sustained because of the finding explained at [94] and [95] above that by 4 June 2004 the Harman Option ceased to be available to Castel quite independently of its reliance on any representation by TSP or the “epidemic” goods conforming in 2004-2005 and subsequent years with the implied warranties of merchantability and fitness for purpose.

CONCLUSION

227. As noted at [208] of these reasons, I have assessed the loss and damage sustained by Castel as a result of TSP's breaches of the sales contracts as \$6,097,543. In particulars of loss and damage furnished on 7 March 2008, Castel made allowances by way of crediting TSP for "the following payments received ... by way of partial compensation for its losses":

Date	Amount
(i) 18 February 2005	84,976
(ii) 8 November 2005	195,272
(iii) 5 May 2006	69,000
(iv) 11 April 2007	104,545
(v) 11 April 2007	363,946
(vi) 11 April 2007	<u>2,666,667</u>
Total	\$3,484,406 =====

228. By paragraph 68 of its defence to Castel's amended statement of claim, TSP alleged the making of the payments of compensation numbered (i), (ii) and (iii) in the last preceding paragraph and asserted that those amounts had been accepted by Castel wholly or in part as compensation in respect of various models of Toshiba products. Moreover, it is alleged in sub-paragraphs 68(m) and (n) of the same defence that, in addition to the amount of \$69,000 or US\$50,000 acknowledged by Castel to have been received by way of compensation on 5 May 2005, a further payment was made on the same date and in the same amount and accepted by Castel "in part satisfaction of Castel's claim for compensation in respect of Toshiba model no. HDD-J35 set top boxes." As well, it is alleged in sub-paragraphs (o) and (p) of the same paragraph that, on or about 16 February 2007, TSP paid to Castel a further amount of US\$200,000 which was accepted by Castel in part satisfaction of its "claim for compensation in respect of Toshiba model no HDD-J35 set top boxes."

229. There is next pleaded also in paragraph 68 of the defence the making of the Termination Agreement and the Unsolved Disputes Agreement noted at [47] and [48] above, and the payment thereunder of the three amounts numbered (iv), (v) and (vi) in [227] above.

230. I am not satisfied on the whole of the relevant evidence that TSP made to Castel on 5 May 2006 a second payment by way of compensation of \$69,000 or US\$50,000 as claimed in paragraph 68(m) of the defence. Not only is the making of two separate payments each of the same amount on the same date inherently unlikely but it is contradicted by the evidence of Mr Kwong who relies on an email of 1 April 2006 from Ms Violet Oh of TSP directing that a total payment of US\$504,080.99 was to be applied as sales rebates, advertising and promotional assistance and sundries.

231. The same evidence of Mr Kwong and lack of supporting evidence for the claim of Ms Violet Oh that TSP paid a further US\$200,000 to Castel on 16 February 2007 as part compensation for defects in J35 units have led me to reject that claim which, in any event, has not been pleaded in TSP's defence.

232. I have therefore concluded that the only deduction which should be made from the damages which I have found Castel has suffered as a result of TSP's breaches of contract is the amount of \$3,484,406 which Castel acknowledges having received in

part compensation. When that deduction is made from the sum of \$6,097,543 arrived at in [208] above, it follows that there must be judgment for Castel in the sum of \$2,613,137.

233. By its cross-claim appended to its defence, TSP sought to recover from Castel an alleged overpayment of \$616,673 in respect of stock which TSP had agreed, pursuant to the Termination Agreement, to purchase from Castel as at 11 April 2007. A further element of TSP's cross-claim was a claim for the costs incurred by TSP in taking over Castel's obligations to honour five-year warranty obligations which Castel had assumed to purchasers of Toshiba products sold by it. As well, it was alleged in paragraphs 82 and 83 of the cross-claim that Castel has no entitlement to retain, and is obliged to repay to TSP, the sum of \$2,666,667 numbered (vi) in [227] above which Castel has allowed should be set off against its claim for damages. That amount, it will be recalled, was payable by TSP as interim or provisional compensation pursuant to cl 4 of the Unsolved Disputes Agreement set out at [49] above.

234. The evidence does not support TSP's contention that it overpaid by \$616,673 or any other amount for the stock which it took over from Castel pursuant to the Termination Agreement. Indeed, a reconciliation adduced into evidence on behalf of Castel suggests that it was underpaid by \$75,973 on that account. The sum of \$2,666,667 paid by TSP pursuant to the Termination Agreement has been allowed by Castel and will be set off against the damages recoverable by it. The claim to be indemnified for taking over Castel's five-year warranty obligations was abandoned by Senior Counsel for TSP in the course of his opening address. Accordingly, TSP's cross-claim must be dismissed.

235. I shall receive submissions on a date to be fixed in consultation with the parties in respect of costs and interest. The time for filing and service of a notice of appeal by either party will be extended until the expiration of 21 days after the making of final orders as to those matters.

236. To preserve the confidentiality of any commercially sensitive information which these reasons may disclose, they are made available for the time being only to the parties and their legal advisers. Each party should submit, within seven days of this day, its suggestions as to how these reasons should be redacted or otherwise edited to prevent that confidential information from being disclosed when the reasons are published generally. In the absence of any such suggestions from either party, that party will be taken to have no objection to the unrestricted publication of the reasons.

I certify that the preceding two
hundred and thirty-six (236) numbered
paragraphs are a true copy of the
Reasons for Judgment herein of the
Honourable Justice Ryan.

Associate:

Dated: 28 September 2010

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