SUPREME COURT OF QUEENSLAND

CITATION:	*Lynam & Ors v Arthur J Gallagher Australasia Holdings Pty Ltd* [2017] QSC 240
PARTIES:	**PAUL JOSEPH LYNAM AS TRUSTEE FOR THE LYNAM FAMILY TRUST** (first plaintiff) **BRUCE RIDLEY COPP** (second plaintiff) **JOSEF ROSKER** (third plaintiff) **RICHARD PAUL SMITH AS TRUSTEE FOR THE RICHARD SMITH FAMILY TRUST** (fourth plaintiff) **JOSEF ROSKER AND JULIE ROLDAN ROSKER AS TRUSTEES FOR THE ROSKER FAMILY TRUST** (fifth plaintiff) **PAUL ANTHONY O'LEARY AND MEGAN O'LEARY AS TRUSTEES FOR THE O'LEARY FAMILY TRUST** (sixth plaintiff) **v** **ARTHUR J GALLAGHER AUSTRALASIA HOLDINGS PTY LTD ACN 079 502 800** (defendant)
FILE NO/S:	No 13144 of 2016
DIVISION:	Trial
PROCEEDING:	Application
ORIGINATING COURT:	Supreme Court at Brisbane
DELIVERED ON:	1 November 2017
DELIVERED AT:	Brisbane
HEARING DATE:	8 September 2017; further written submissions 13 September 2017; 16 October 2017
JUDGE:	Dalton J
ORDER:	**Application dismissed**

CATCHWORDS: PROCEDURE – CIVIL PROCEEDINGS IN STATE AND TERRITORY COURTS – PLEADINGS – STRIKING OUT – DISCLOSING NO REASONABLE CAUSE OF ACTION OR DEFENCE – where a share sale contract governed the defendant's purchase of all the shares in a company from the plaintiffs – where the purchase price in the contract included a component to be paid three years after the completion date, which reflected the company's income in that period – where, after three years, one element of that component was a negative amount and the other was a positive amount – where the plaintiffs sought a declaration as to the proper construction of the contract and, in the alternative, rectification of the contract to reflect the parties' common intention – where the plaintiffs argued that the proper construction of the share sale contract, and the common intention of the parties, was that the first element could not be negative, and the two elements were separate payments that could not be set off against each other – where the defendant argued that the contract was carefully drafted and unambiguous – where the defendant argued that the plain meaning of the text did not support the plaintiffs' argued construction – whether the plaintiffs' claims were so untenable that they could not possibly succeed – whether the plaintiffs' statement of claim should be struck out

CONTRACT LAW – INTERPRETATION – ADMISSIBILITY OF EXTRINSIC EVIDENCE IN RELATION TO INSTRUMENTS – WHEN EVIDENCE ADMISSIBLE – TO PROVE INTENTION OF PARTIES – OTHER CASES – where a share sale contract governed the defendant's purchase of all of the shares in a company from the plaintiffs – where the plaintiffs claimed there was ambiguity in the contract – where the plaintiffs sought a declaration as to the proper construction of the contract and, in the alternative, rectification of the contract to reflect the parties' common intentions – where the plaintiffs sought to rely on negotiations towards the share sale contract to support their case – where the plaintiffs argued that the court could have regard to a non-binding term sheet agreed between the parties in interpreting the ultimate contract – whether a court could take negotiations or the non-binding term sheet into account in divining the parties' intentions and interpreting the contract

Australasian Medical Insurance Ltd v CGU Insurance Ltd (2010) 271 ALR 142, cited
Barangaroo Delivery Authority v Lend Lease (Millers Point) Pty Ltd [2014] NSWCA 279, cited
Chartbrook Ltd v Persimmon Homes Ltd [2009] 1 AC 1101, cited
Codelfa Construction Pty Ltd v State Rail Authority of NSW

(1982) 149 CLR 337, cited
Electricity Generation Corporation v Woodside Energy Ltd & Ors (2014) 251 CLR 640, cited
General Steel Industries Inc v Commissioner for Railways (NSW) (1964) 112 CLR 125, applied
Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd & Anor (2015) 256 CLR 104, applied
Prenn v Simmonds [1971] 1 WLR 1381, cited

COUNSEL: LF Kelly QC, with DM Turner, for the defendant/applicant
DP O'Brien QC, with RR Ivessa, for the plaintiffs/respondents

SOLICITORS: Fisher Jeffries for the defendant/applicant
Mullins Lawyers for the plaintiffs/respondents

[1] This is an application to strike out the statement of claim in the proceeding. The plaintiffs claim a declaration as to the proper construction of a share sale contract and, in the alternative, that it be rectified. The strike out application is in the nature of a demurrer; the defendant says that even if all the factual matters alleged by the plaintiffs are true, the claim could not succeed.

[2] It was accepted by the parties that to succeed on this application the defendant had to show that the claims the plaintiffs make are so clearly untenable that they could not possibly succeed – in accordance with *General Steel Industries Inc v Commissioner for Railways (NSW)*.[1] Ultimately my decision is a result of the application of this test. If I were determining this matter after a trial, and I had nothing more than the material I have on this application I would give judgment for the defendant. While I think the plaintiffs make arguable points, my view is that they are overwhelmed by the defendant's arguments. However, there has been no trial and the usual interlocutory steps such as disclosure have not taken place. There may be documents in the defendant's possession that assist the plaintiffs. It may be that the process of hearing the witnesses and attending to the nuances in their evidence brings a trial judge to the opposite view of the merits from the one I take. Where the plaintiffs advance points which are arguable it is their right to have the matter run to a trial. The position would be no different if the defendant's application had been for summary judgment.[2]

[3] I will now give my reasons for the view I take of the merits of the matter which will hopefully elucidate the reasons for the determination I have come to.

Construction

[4] I will deal first with the construction point.

[5] The defendant purchased the shares in a company called InsSync Pty Ltd by written agreement dated 20 November 2012. InsSync held all the shares in SRS Underwriting

---

1 (1964) 112 CLR 125, 129-130.
2 *Rich v CGU Insurance Ltd; Silbermann v CGU Insurance Ltd* (2005) 214 ALR 370.

Agency Pty Ltd. At a commercial level the defendant was purchasing the business of SRS, pleaded to be the business of an insurance underwriting agent.

[6] The share sale contract provided that an amount of about $37 million was to be paid for the shares initially, and that another amount, called the Earn-Out Amount, was to be paid, as part of the purchase price, after three years. The parties' dispute is about the calculation of this Earn-Out Amount.

[7] The parties were sophisticated commercial parties buying and selling a valuable asset. Lawyers were directly involved on both sides throughout the negotiations. Negotiations lasted eight months and involved many different people from both sides at various times and on various occasions – see paragraphs 6, 7 and 22 of the amended statement of claim, and the particulars to paragraph 8(d). The contract appears to have been carefully drafted. It uses language with precision and the parts of the contract which touch on this dispute involve some sophisticated accounting and mathematical concepts. These matters tend against a conclusion that errors occurred in drafting, or that the contract should be interpreted as meaning something other than what the words used mean.

[8] The underwriting business derived income from what are called general commissions – paragraph 3(a) of the amended statement of claim – and from profit commissions – paragraph 3(b). Profit commissions are payments made when (after about three years, and up to about seven years, after the insurance is written) the insured has not made a claim on the policy – paragraph 5 of the amended statement of claim. On the other hand, general commissions are paid on the basis of insurance written and not affected by whether or not the insured makes a claim – paragraph 4. General commissions are the primary contributor to the income of SRS's business – paragraph 4(c). The right to receive profit commissions for policies which existed at the time of the sale "was a valuable right worth millions of dollars" – paragraph 8(a). It did not depend upon the performance of the business after the sale. Although the amount of the profit commissions was uncertain, the work which would produce them had already been undertaken by the vendors – paragraph 8(b). By contrast, the earnings of the business after the sale did depend upon the continued good performance of the business and could not be guaranteed – paragraph 8(d). At paragraph 8 of the amended statement of claim it is alleged that the plaintiffs and the defendant were aware of these matters during negotiations, and I accept that for the purpose of this application.

[9] It was accepted on this application by the defendant, and it seems correct to me, that the information detailed at paragraph [8] above, which is really in the nature of information about the asset being purchased – the profit stream – is the kind of background information which can be taken into account in interpreting a contract in the absence of ambiguity.[3]

[10] The contractual method for calculation of the Earn-Out Amount involves considering the general and profit commissions received by the business between completion of the

---

[3] *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd & Anor* (2015) 256 CLR 104, [46]-[52], and in particular [49]; *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337; *Electricity Generation Corporation v Woodside Energy Ltd & Ors* (2014) 251 CLR 640, [35].

sale and a date three years later. I think it permissible in interpreting the provisions of the contract to work on the basis that the commercial purpose of including the Earn-Out Amount as part of the purchase price was to make the purchase price, to some extent, reflect what income the business received during the three years after its transfer to the defendant. That seems to me in accordance with principles of interpretation requiring an attempt to achieve the commercial objects of the contract.[4] I think the plaintiffs' strongest point on this application is that while the contract contemplated that only one amount would be paid as the Earn-Out Amount, that amount was to be calculated in a way that had separate regard to the two streams of income – profit commissions and other income (mostly general commissions). The plaintiffs argue that it is hard to see why this would be if it did not reflect the commercial purpose of ensuring that the vendors received the benefit of profit commissions which resulted from their running of the business before sale, regardless of how well or poorly the business performed after sale. This is true on the factual basis that I use to determine this application: ie., that all the facts alleged in the amended statement of claim are true. However, even the facts pleaded there contain some difficulties, and the contradiction which I remark upon at footnote 11 below may be part of a factual answer to this point. This is something I cannot determine on this application.

[11] Turning to the words of the contract, the purchase price for the shares is defined as:

> "4.1 Amount
>
> The Purchase Price for the Shares is:
>
> (a) the Initial Purchase Price …; plus
>
> (b) the Earn-Out Amount (if any)."

[12] Clause 4.2 makes provision for payment of the Initial Purchase Price, and cl 4.3 makes provision for adjustments to it. Then at cl 4.4 is:

> "4.4 Payment of the Earn-Out Amount
>
> The Purchaser must pay to each Vendor the Earn-Out Amount (if any) … on the Earn-Out Payment Date."

[13] The Earn-Out Amount was defined in the contract as meaning:

> "Earn-Out Amount means an amount equal to:
>
> (a) the Earn-Out EBITDA Amount; plus
>
> (b) the Earn-Out Profit Commissions Amount;
>
> provided such amount can be no greater than the Maximum Earn-Out Amount."

[14] The Maximum Earn-Out Amount was defined to be $8 million.

---

4 *Woodside,* above, [35].

[15] The Earn-Out EBITDA Amount and the Earn-Out Profit Commissions Amount are both defined in the contract by introductory words, "means an amount calculated as follows:". Both definitions are in the form of algebraic equations based on the receipts of the business in the 2013-2015 calendar years. These definitions are in Annexure A to this judgment. The Earn-Out EBITDA Amount is based on income other than profit commissions, ie., largely general commissions. It therefore will be affected by how well the business performed after sale. The Earn-Out Profit Commissions Amount is based on the amount of profit commissions received in the relevant period. It therefore will reflect the "quality" of the business written before sale, and not be affected by the performance of the business after sale.

[16] The parties are agreed on these facts: when the time came for payment of the Earn-Out Amount, the Earn-Out Profit Commissions Amount was $3.62 million. However, the Earn-Out EBITDA Amount was a negative figure of over $17 million.

[17] The defendant's argument was based on the text of the contract. First, the definition of Earn-Out Amount. Having regard to the words "an amount equal to" and the word "plus" and the fact that the definition imposed an upper limit on what the Earn-Out Amount might be but not a lower limit, it was said that the definition of Earn-Out Amount should be construed as a mathematical equation so that a zero figure, or negative amount, might be produced as the Earn-Out Amount. In the circumstances which have transpired here, it was contended that there was no Earn-Out Amount payable, for, if added together mathematically, the negative figure of Earn-Out EBITDA Amount overtopped the Earn-Out Profit Commissions Amount.

[18] The defendant's argument continued that this was supported by the fact that the definition of Purchase Price at cl 4.1(b) used the words "the Earn-Out Amount (if any)", showing that it was within the contemplation of the parties that there might not be an Earn-Out Amount. Clause 4.4 used the same words, "(if any)".

[19] The defendant further relied upon the fact that the definition of Earn-Out Profit Commissions Amount contained, within its terms, upper and lower limits of the profit commissions earned in each calendar year – see the definition at point B. Including the lower limit meant that the Earn-Out Profit Commissions Amount could never be a negative amount. In contrast, the Earn-Out EBITDA Amount contained no such ceiling or floor, and could therefore mathematically be a negative amount.

[20] The plaintiffs' prayer for relief, so far as the construction point is concerned, was for a declaration that on the proper construction of the share sale agreement:

> "(a) the 'Earn-Out EBITDA Amount' and the 'Earn-Out Profit Commissions' cannot be less than zero; and
>
> (b) further and in the alternative, the 'Earn-Out Amount' is made up of two separate payments, being the Earn-Out EBITDA Amount and the Earn-Out Profit Commissions Amount which cannot be set off against each other"

[21] It seems to me that the plaintiffs' construction at [20](a) above is untenable if regard is had solely to the definitions of the amounts in the contract. They are sophisticated mathematical definitions. There is no minimum built into the definition of Earn-Out EBITDA Amount; there is a minimum built into the definition of Earn-Out Profit Commissions Amount. It seems to me, having regard to these contrasting definitions, that the omission of a floor in the definition of Earn-Out EBITDA Amount must have been deliberate. Further, the floor which is included in the Earn-Out Profit Commissions Amount has the effect that the minimum that figure can be is zero. Again I would regard this as a deliberate choice: the point of including the floor chosen, was to prevent the Earn-Out Profit Commissions Amount being a negative number. In circumstances where the parties regarded the Earn-Out Profit Commissions Amount as a valuable right worth millions of dollars, and regarded the Earn-Out EBITDA Amount as something which could not be guaranteed and which was dependent on the performance of the business after sale, the omission of a floor in the definition of Earn-Out EBITDA Amount gains significance. The parties chose not to define the Earn-Out EBITDA Amount in a way which would prevent it being a negative number, even though it was the amount which was the most unpredictable of the two amounts, and even though they believed the Earn-Out Profit Commissions Amount was valuable and thus likely to be a positive amount. It is difficult to see that the parties did not contemplate, and allow for, the possibility that the Earn-Out EBITDA Amount might be a negative amount.

[22] The plaintiffs' case on this point depends upon an argument that the words of the contract should be interpreted in light of evidence of extrinsic events during the course of negotiations for the contract. I deal with this below at paragraphs [36]ff.

[23] The plaintiffs' alternative construction at [20](b) above raises a more difficult point. The definition of Earn-Out Amount contains the word "plus" joining sub-clauses (a) and (b). This is an unusual word to have used. It is capable of having a mathematical meaning as well as the ordinary English meaning of "by the addition of"; "increased by"; "something in addition" or "more (by a certain amount)."[5] The defendant relies on it as one indication that what is to be performed in calculating the purchase price is a mathematical exercise. The same can be said of the words "an amount equal to" which are also unusual and have a more mathematical connotation than ordinary English.

[24] In my view the text gives a strong indication that what is meant is one amount comprising the amounts of sub-clauses (a) and (b). The definition does not use the words, "amounts equal to".

[25] There is further textual support for an approach which involves treating the definition of Earn-Out Amount as one to be calculated mathematically. There are the algebraic nature of the definitions of Earn-Out EBITDA Amount and Earn-Out Profit Commissions Amount.

---

[5] Compact Macquarie Dictionary.

[26] There is significant reference to accounting procedures and terminology throughout the contract.[6] The mechanism to trigger the Earn-Out Payment is the exchange of the Earn-Out Statement. This depends upon the directors of the company purchased approving the full year accounts to 31 December 2015. The Earn-Out Statement is based on those audited accounts. That is, an accounting exercise was contemplated by the parties as the factual substrate to the calculation.

[27] Notwithstanding the emphasis on accounting principles, the contract also uses precise English to express the parties' intentions: the drafter was not captive to mathematical or accounting language. At cll 13.1 and 14 the expression "each of" is used and at cl 11.3(a) perfectly plain language is used to give rights over two distinct sums of money. Similar use of language in cl 4.1 would have achieved the construction for which the plaintiffs contend. Instead, it appears by comparison with the language used in the whole of the contract, a deliberate choice was made to use language with an algebraic connotation.

[28] Very much in support of the defendant's construction is Schedule 12, also contained in Annexure A to this judgment. It is a pro-forma Earn-Out Statement. It is part of the contract and I think it correct to have regard to it in interpreting cl 4.1. In *Barangaroo Delivery Authority v Lend Lease (Millers Point) Pty Ltd*,[7] the New South Wales Court of Appeal had regard to a worked example which was part of the contract even though it was labelled, "for information purposes only" – [41], [51]-[58]. The same Court also had regard to a worked example in *Lindsay-Owen v Winton Partners Funds Management Pty Ltd.*[8]

[29] Schedule 12 records that it is "for illustrative purposes only", much like the worked example in *Barangaroo.* However, here that notation continues, "to demonstrate the mechanism for calculating the earn-out". It is that mechanism for calculation which is the very point in dispute between the parties. So, while, as in *Barangaroo,* the figures in Schedule 12 are hypothetical,[9] Schedule 12 is not of reduced weight on the point in issue in this application; it deals with that very point.

[30] Schedule 12 describes the exercise it records as a calculation – see the first sentence. It shows calculation of the Earn-Out Amount as an algebraic exercise. Particularly as to the point in issue between the parties, it shows the exercise described at cl 4.1 of the contract as "(F) + (K)" and records in parenthesis next to this "(Always subject to a maximum of AUD8 million)". It seems to me strongly to support the interpretation that cl 4.1 requires a mathematical calculation and that there is a maximum, but no minimum, amount.

---

6 Definitions of Accounting Standards, Accounts, Agreed CGT Amount, Completion Accounts, Earnings, EBITDA, EBITDA Principles, Management Accounts, Net Working Capital Amount, cll 7.1, 7.2, 7.8, 18, Schedule 3, clauses 3 and 4.

7 [2014] NSWCA 279.

8 [2017] NSWCA 78, [9], [73]-[74].

9 It seems to me the plaintiffs' argument that Schedule 12 supports their case because it uses a positive amount of Earn-Out EBITDA is plainly wrong having regard to the notation that the schedule is for illustrative purposes.

[31] The point made at [21] above in relation to the argument recorded at [20](a) is relevant to that recorded at [20](b) too. Again, it is quite strongly against the plaintiffs' case on construction. The parties contemplated that there would likely be a positive Earn-Out Profit Commissions Amount because the right to the profit commissions was a valuable one worth millions of dollars. They stipulated a maximum in the definition of this amount. In that context they chose to use the words "(if any)" at cll 4.1 and 4.4. If positive amounts of Earn-Out Commissions were contemplated as likely, the words, "(if any)" allowed for a situation where the Earn-Out EBITDA Amount was negative, and set off against the profit commissions.

[32] So far as the text of the contract is concerned, the plaintiffs say that (i) the word "plus" in cl 4.1 should be given the meaning of "as well as" – see [23] above, and (ii) the word "amount" should be interpreted to mean something which exists, "a positive quantifiable figure" it was put in submissions, rather than a mathematical concept which might be negative. Such a construction would give effect to the commercial purpose identified in [10] above – it would mean that the vendors would get the Earn-Out Profit Commissions Amount which was attributable to the quality of the insurance business they wrote, irrespective of how the business had performed when the defendant ran it.

[33] As to those arguments, I think that recorded at [32](i) cannot withstand the overwhelmingly mathematical language I have described at [17], [18], [19], [21], [25], [29] and [30], above. That recorded at [32](ii) seems unlikely in circumstances where the definition of Earn-Out Profit Commissions Amount is deliberately worded so that it can yield zero, a quantifiable, but not positive figure, and the definition of Earn-Out EBITDA can yield a negative amount. It also does not fit well with the use of "(if any)" in cll 4.1 and 4.4, for those qualifying words would not be necessary if the argument were right. In fact, the words "(if any)" in cl 4.1 show that the Earn-Out Amount is only to be added to ("plus") the Initial Purchase Price if it is a positive amount – the addition is not to be performed if the Earn-Out Amount is a negative figure. This supports the idea that "amount" is used to mean any mathematical amount, not to mean a real, extant amount. Lastly, if the plaintiffs' interpretation were correct, it is odd that cl 4.1 does not put the Earn-Out Profit Commissions Amount at 4.1(a), and the Earn-Out EBITDA Amount at 4.1(b), having regard to the expectation that there would likely be an Earn-Out Profit Commissions Amount, and doubt whether there would be an Earn-Out EBITDA Amount. I do accept that none of those reasons accounts for why the Earn-Out Profit Commissions Amount and the Earn-Out EBITDA Amounts are treated separately in calculating the Earn-Out Amount.

[34] The plaintiffs seek to have recourse to the negotiations towards the share sale agreement to support their construction case. From the pleading it can be seen that negotiations took place over eight months and were in two stages. After five months the parties entered into what was called a non-binding term sheet (10 August 2012) – paragraph 17 of the amended statement of claim. They entered into the share sale agreement three months and 10 days after that – paragraph 24.

[35] In *Mount Bruce*[10] the High Court confirmed that before resort can be had to extrinsic evidence (other than the type of evidence described at [9] above) to interpret a contract,

---

[10] Above, [10].

there needs to be ambiguity in the meaning of the words to be construed. In my view, having regard to the language of cl 4.1 and the definition of Earn-Out Amount, in the context of the whole contract as discussed above, there is no ambiguity in this contract. However, having regard to the nature of the relief sought, I go on to look at the evidence which the plaintiffs contend would resolve what they say is an ambiguity in their favour.

[36] At paragraphs 9, 10, 11 and 12 of the amended statement of claim the plaintiffs plead:

(a) the parties' entry into negotiations;

(b) the fact that at some point, relatively early in the negotiations, some representatives on behalf of the plaintiffs said they expected the sale price to be based on the business's earnings;

(c) the fact that at some such stage some people on behalf of the plaintiffs said because the business was strong they expected the price to be based on seven times (or more) the earnings;

(d) that at some stage the defendant was told the EBITDA was high and so was the price; and the defendant said it was capable of paying a high price, and

(e) that someone on behalf of the defendant sent an email on 20 June 2012 which said that <u>because profit commissions were more difficult to predict</u>, that this part of the company's income stream should be treated as a bonus deal, separately to the calculation of sale price based on general commissions.[11]

[37] Even when there is ambiguity in a contract, it is not permissible to look at "evidence of the parties' statements and actions reflecting their actual intentions and expectations".[12] It is not permissible to look at negotiations in order to see what the parties' intentions or expectations were.[13] Nor to see what the words in the contract mean.[14] What the plaintiffs contend ought be gathered from the negotiations set out above is evidence of the parties' subjective intentions and expectations. The defendant referred me to a passage from *Prenn v Simmonds*:

> "The reason for not admitting [evidence from negotiations] is not a technical one or even mainly one of convenience. … It is simply that such evidence is unhelpful. By the nature of things, where negotiations are difficult, the parties' positions, with each passing letter, are changing and until the final

---

[11] The underlined part of this pleaded case in [36](e) above, contradicts what is pleaded at paragraph 8 of the amended statement of claim, ie., that it was the EBITDA amount which was uncertain in the future and the Profit Commissions which were known to have a present value of millions of dollars. I suspect this just illustrates the dangers of looking at statements made by various people, in various contexts, at various times during negotiations, especially when there were so many people involved over such a period of time.

[12] *Mount Bruce,* above, [50].

[13] *Codelfa Construction,* above, p 352.

[14] *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101, [42].

> agreement, although converging, still divergent. It is only the final document which records a consensus."[15]

[38] In my view the facts pleaded at paragraphs 9-12 of the amended statement of claim are largely irrelevant. So far as it is alleged at paragraph 12 that the defendant said it expected the profit commissions would yield a bonus deal rather than being part of the main consideration, I cannot see that is admissible in interpreting the contract.

[39] Likewise, I cannot see that the information pleaded at paragraph 13 of the amended statement of claim is admissible in interpreting the contract. It is an email offer which fixes a price by reference to three components: present EBITDA; future EBITDA up to a maximum, and future profit commissions up to a maximum. The offer is expressed in far more simple terms than the share sale agreement ultimately was, and indeed far more simple terms than any final contract was likely to be. It was not agreed between the parties. It is not helpful to understanding the terms of the contract which were.

[40] Similarly, the email exchange pleaded at paragraphs 15 and 16 of the pleading is inadmissible and unhelpful in interpreting the written contract. It simply is an expression by the plaintiffs of their opinion of the worth of the business which was being sold by reference to its income stream. The meaningfulness of this negotiating tactic may perhaps be judged by the response, which was that the defendant took that view "on board". Whether or not the exchange was meaningful then, it is not meaningful in interpreting the words of the contract now.

[41] For clarity, I find the matters at paragraphs 9-16 of the amended statement of claim are not admissible in interpreting this contract because of the rule stated at [37], above and because they are irrelevant. I cannot see that I should assume these matters will be admitted at trial because I am dealing with an application to strike out. Admissibility of these statements is a matter of law which can be determined now as well as at trial. If I am wrong about that, they do not influence my interpretation of the contract.

[42] Paragraph 17 of the amended statement of claim pleads the 10 August 2012 term sheet which was agreed between the plaintiffs and the defendant. It reads:

> "17. On about 10 August 2012, the plaintiffs and [the defendant] signed a non-binding Term Sheet … providing as consideration for a purchase of the Business an amount being a minimum amount of $35,800,000 and a maximum amount of $45,000,000 made up of 'the sum of':
>
> (a) an initial payment due on settlement of $35,800,000;
>
> (b) deferred consideration of up to $9,200,000 made up of 'the sum of' the following:
>
> (i) a 7.25 multiple of the average annual EBITDA <u>growth</u> (excluding Profit Commissions) in 2013, 2014 and 2015; and

---

[15] *Prenn v Simmonds* [1971] 1 WLR 1381, 1384; and see *Chartbrook,* above, at [30]-[41].

(ii) a 7.25 multiple of the average Profit Commissions in 2013, 2014 and 2015 (subject to an annual cap of $1,000,000 and a floor of $500,000).” (my underlining)

[43] The plaintiffs said that the non-binding term sheet was in a different position to other negotiations. It was said that the parties had agreed on what was contained in it and that therefore the making of that agreement was part of the surrounding circumstances.

[44] It has always been accepted that a court may have regard to an antecedent contract between the same parties in interpreting a contract.[16] Remarks have been made that the usefulness of such an exercise may be limited where the contract to be interpreted supersedes the earlier contract.[17]

[45] In *Nemeth v Australian Litigation Funders Pty Ltd & Ors*,[18] Sackar J paid significant regard to a non-binding heads of agreement in interpreting a later contract. The subject matter of the earlier and later agreements were related, but the contract was not one which superseded the earlier heads of agreement; it was between different parties and regulated different rights to those dealt with in the heads of agreement document.

[46] In *Australasian Medical Insurance,* the factual finding was that an antecedent agreement had been reached between the parties to an insurance contract as to the scope of the indemnity – [69]. The parties had agreed upon what they meant by a particular phrase – [70]. In this way the case was similar to cases where the parties have agreed upon the meaning of a term and then used that term in a subsequent written contract without defining it.[19]

[47] The term sheet here is an agreement meant to be superseded by a formal agreement. In fact it was not superseded for three months and 10 days, and it is very simple compared to the ultimate contract.

[48] However, I accept that it is part of the background matrix between the parties because it is something agreed between them. It differs from mere negotiation, and I can have regard to it in interpreting the contract ultimately made. It is difficult to see how useful it could be in those circumstances. It records only what the parties had agreed at one stage of the negotiation. There is nothing to show that this intention persisted unchanged at the date of the contract. Further, it does not show that the parties had agreed on any particular approach to or definition of the Earn-Out Amount which was to persist in governing their negotiations and ultimate contract.

[49] It was said for the plaintiffs that the word “growth”, which I have underlined in the extract from the term sheet at [42] above, showed that the parties only contemplated that

---

16 *Ladbroke Group plc v Bristol City Council* [1988] 1 EGLR 126, cited in *Australasian Medical Insurance Ltd v CGU Insurance Ltd* (2010) 271 ALR 142, [61] ff.

17 *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co* [2001] 2 Ll Rep 161, cited in *Australasian Medical Insurance Ltd,* above, [66].

18 [2013] NSWSC 529, [38], [68] and [70].

19 *Partenreederei M/S Karen Oltmann v Scarsdale Shipping Co Ltd* [1976] 2 Ll Rep 708, cited in *Australasian Medical Insurance,* above, [58].

the EBITDA figure would be positive. I do not agree. The term sheet set a minimum contractual price: $35,800,000. It follows from the word "minimum" that the parties contemplated circumstances where no further amount was payable by way of deferred consideration; only the minimum would be paid. Further, it is clear from paragraph 17(b)(ii) of the extract at [42] above, that the parties contemplated that at least half a million dollars would be regarded as earned in profit commissions in each of the years 2013, 2014 and 2015. Thus, the only circumstances in which the minimum amount of $35,800,000 would be paid, was if the EBITDA figure was negative and the two figures were set off against each other, a treatment quite consonant with the phrase, "the sum of". This analysis strongly supports the defendant's case.

[50] The word "growth" is also pleaded to have been used in the communication at paragraph 13 of the amended statement of claim, see [39] above. That is, the component relating to future EBITDA was pleaded to be one based on "future EBITDA growth of up to $5,930,000." This was also relied upon in support of the submission that it was only an increase in EBITDA that the parties contemplated as the basis for the Earn-Out EBITDA Amount.

[51] The contractual formula which defines Earn-Out EBITDA Amount (see Annexure A) will only yield a positive figure if the average EBITDA in the three years after sale is more than the 2012 EBITDA. Any positive figure which did result from an application of the formula will be a multiple of such an increase. In that sense any positive figure would be based on EBITDA "growth". That is, the Earn-Out EBITDA Amount was not just a percentage of the business income.

[52] These days it is common enough to speak of "negative growth". If an Earn-Out EBITDA Amount, as defined, was only ever contemplated to be generated if there was an increase in EBITDA after sale, it would have been easy enough to say so. Or to provide a floor, as was done in the definition of Earn-Out Profit Commissions Amount. At the time of contract the EBITDA in 2013-2015 was uncertain; it could not be guaranteed.[20] The EBITDA in 2012 had been high.[21] The business was changing hands. It was not unreasonable to contemplate that the EBITDA might fall, rather than grow, in the coming years. If it did, the value of the business would be negatively affected. It is not unreasonable that this would be reflected in the purchase price.

[53] In short, the word "growth" in the email at paragraph 13 is contained in an inadmissible document. The word "growth" in the term sheet is not definitive of any position. The plaintiffs' argument about its meaning in the term sheet is contradicted by the other language of the term sheet ("minimum"). The word "growth" was not chosen for use in the ultimate contract, the provisions of which are plainly inconsistent with the implications the plaintiffs seek to draw from the word in the term sheet. I do not think the use of the word "growth" in the term sheet advances the plaintiffs' case.

[54] At paragraph 18 of the amended statement of claim it is pleaded that throughout the negotiations neither party ever discussed the separate components of the deferred consideration as being less than zero, or being set off against each other. Further, it is

---

[20] See [8] above.

[21] See [36](c) and (d) above and paragraphs 10 and 11(b) of the amended statement of claim.

said that during the negotiations the parties never discussed a floor for the Earn-Out EBITDA Amount.

[55] In my view a court could not take what is pleaded at paragraph 18 into account in construing the share sale agreement. The plaintiffs are clearly inviting the Court to have regard to the negotiation process which is impermissible to divine their intentions. There may be many reasons why these things were not discussed. In negotiations it is often the case that both parties have an interest in speaking only of optimistic scenarios. The fact of the matter is that such scenarios were within their contemplation. The choice not to put a floor in the definition of Earn-Out EBITDA Amount, and the provision for a minimum payment in the term sheet shows that.

[56] The facts pleaded at paragraphs 20, 21, 22 and 23 of the amended statement of claim show that at one point in October 2012, in the negotiations towards the contract, the parties discussed the idea that the Earn-Out EBITDA Amount and the Earn-Out Profit Commissions Amount would be payable at different times. I accept that having these amounts paid at different times would make it most unlikely that one of those figures could be set off against the other.

[57] However, for the reasons expressed at [37] above, I cannot see that it is permissible to have regard to these negotiations in interpreting the share sale agreement. Further, I cannot see that the evidence is relevant, or that if I had regard to it, it would assist my interpretation of the contract. This discussion arose as a mooted solution to a specific problem: the parties could not agree whether the Earn-Out Amount should be paid at the end of a financial year or the end of a calendar year. There is no evidence that the parties ever thought through what a payment at two different times would mean for any potential set-off. That part of the negotiation seems to have been caught up in an issue about the cost of having an extra set of accounts prepared at the end of a calendar year, and what solution could be found to that problem. Ultimately this issue was resolved and the parties came to an agreement which meant that the solutions being proposed to what was essentially an accounting issue became irrelevant. Looking at these pleaded facts in context provides a good example of why Courts do not, and should not, look at all the ins and outs of negotiations in interpreting contracts.

[58] As I expressed at the outset of these reasons, I have a distinct preference for the defendant's construction case. However, I cannot say the plaintiffs' case could never succeed.

Rectification

[59] I turn to the plaintiffs' rectification case. The plaintiffs pleaded that the definition of Earn-Out Amount ought to be rectified so that it read as if the words "(if greater than zero)" were inserted after the words "the Earn-Out EBITDA Amount" in (a) of the definition. It was pleaded that there was a common intention of the parties to the share sale agreement that the Earn-Out EBITDA Amount and the Earn-Out Profit Commissions Amount would be amounts of zero or above – paragraph 41(a)(i) of the amended statement of claim. So really the plaintiffs' rectification claim should be that

the words "(if greater than zero)" should be in (a) and (b) of the definition of Earn-Out Amount.

[60] Further it was pleaded that there was a common intention that the Earn-Out Amount was to be made up of "two potential separate payments" which could not be set off against each other – paragraph 41(a)(ii) of the amended statement of claim.

[61] The common intention was said to be demonstrated from the facts and circumstances which I have already discussed, together with the fact that on 12 August 2013 (10 months after the contract date) at a meeting between a representative of the plaintiffs and some representatives of the defendant, the representative of the plaintiffs made statements consistent with the two Earn-Out Amounts not being capable of being set off against each other, and the representatives of the defendant did not contradict that.

[62] The plaintiffs' case that the parties believed the Earn-Out Profit Commissions Amount was a valuable right worth millions of dollars; the words "(if any)" in cll 4.1 and 4.4 of the contract; the parties' knowledge that the Earn-Out EBITDA Amount could not be guaranteed; the deliberate choice of the parties to put a zero floor in the definition of Earn-Out Profit Commissions Amount, but not the Earn-Out EBITDA Amount, and the specification of $35.8 million as a minimum payment in the term sheet, where there was a floor well above zero for the Earn-Out Profit Commissions Amount, go strongly against there being a common intention as alleged at paragraph 41(a) of the amended statement of claim. In fact, if there was a common intention as alleged, it is remarkable that the contract consistently documents, at several places, and in some detail, the opposite intention.

[63] Further, the facts pleaded at paragraphs 9-12 and 15-17 of the amended statement of claim are not capable of proving the common intention alleged by the plaintiffs at all, or as at the alleged date of contract.

[64] It was said that insofar as the plaintiffs relied upon things not being said in negotiations (paragraph 18 of the amended statement of claim), silence could not be supportive of a common intention. I would not accept that as a general principle; something might be so far from the parties' contemplation that it might be said, colloquially, "that was never even discussed". However, here, as I have explained, whether or not matters were discussed, they have found their way into the contract.

[65] The silence of the defendant's representatives in the face of the statements pleaded at paragraph 41 under the heading "particulars" seems weak evidence of a common intention. Apart from this, the only real indication of the common intention alleged by the plaintiffs seems to me to be the fact that the contract does not simply require a figure based on the business's overall income to be paid as the Earn-Out Amount, but treats profit commissions separately in calculating that amount. It seems to me that the rectification case pleaded is weak, but not so weak that I would strike it out. In making that decision I bear in mind that it is more likely that the rectification case (as opposed to the construction case) will gain strength from disclosure and a hearing at trial.

[66] The application is dismissed. I will hear the parties as to costs.

ANNEXURE A

Earn-Out EBITDA Amount means an amount calculated as follows:

A = (B/3 minus C) x 7.25

Where:

A = the Earn-Out EBITDA Amount

B = the aggregate amount of EBITDA (excluding Profit Commissions but including the Transaction Related Rebate) in respect of the SRS Business for each financial year during the Earn-Out Period as shown in the Earn-Out Statement and agreed by the parties, deemed to be agreed by the parties or determined by the Independent Accountant (as the case may be) under clause 8.

C = the EBITDA (excluding Profit Commissions) in respect of the SRS Business for the 2012 financial year being $4,603,448.

Earn-Out Profit Commissions Amount means an amount calculated as follows:

A = (B/3 - $500,000) x 7.25

Where:

A = the Earn-Out Profit Commissions Amount

B = the aggregate amount of the Profit Commissions for each calendar year during the Earn-Out Period as shown in the Earn-Out Statement and agreed by the parties, deemed to be agreed by the parties or determined by the Independent Accountant (as the case may be) under clause 8, provided the Profit Commissions in each calendar year comprised in the Earn Out Period must, for the purposes of calculating the Earn-Out Amount, have a value of at least $500,000 in any such year and must not be given a value in excess of $1,000,000 irrespective of the actual value of the Profit Commissions in each such year.

For the avoidance of doubt if the actual Profit Commissions for any calendar year comprised in the Earn Out Period is equal to or greater than $500,000 and less than or equal to $1,000,000, the actual Profit Commissions amount will be used.

Schedule 12 – Pro forma Earn-Out statement

The amounts included in the calculation below is for illustrative purposes only to demonstrate the mechanism for calculating the earn-out					
All amounts are presented in AUD					
1) Earn-Out EBITDA Amount					
Annual EBITDA (Jan to Dec)	4,750,000	5,150,000	5,650,000		*(A) – Reported EBITDA (excluding PC but including Transactional Related Rebate) – illustrative*
Average EBITDA 2013-2015				5,183,333	*(B) = Average of annual EBITDA for 2013 to 2015 (A)*
Base EBITDA				4,603,448	*(C) – EBITDA excluding Profit commission but including Transactional Related Rebates*
Difference between average EBITDA and Base EBITDA				579,885	*(D) = (B) – (C)*
Multiple				7.25	*(E) – as stated in SPA*
Earn-Out EBITDA Amount				**4,204,169**	*(F) = (D) x (E)*
2) Earn-Out Profit Commissions Amount					
Profit commissions (Jan - Dec)	800,000	1,200,000	400,000		*Illustrative amounts*
Profit commissions – cap	1,000,000	1,000,000	1,000,000		*As stated in SPA*
Profit commissions – floor	500,000	500,000	500,000		*As stated in SPA*
Profit commission used in calculating average profit commission	800,000	1,000,000	500,000		*Annual profit commission for the year, subject to cap and floor*
Average profit commission				766,667	*(G) – Average of annual profit commission for 2013 to 2015*
Upfront profit commission amount paid in initial consideration				500,000	*(H) – as stated in SPA*
Profit commission for calculation of earn-out profit commission amount				266,667	*(I) = (G) – (H)*
Multiple				7.25	*(J) – Multiple as stated in SPA*
Earn-Out Profit Commission Amount				**1,933,333**	*(K) = (I) x (J)*
Total Earn-Out payable (Always subject to a maximum of AUD8 million)				**6,137,502**	*(F) + (K)*