New South Wales Supreme Court

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Club Hotels Operations Pty Limited v CHG Australia Pty Limited [2005] NSWSC 998 (7 October 2005)

Last Updated: 12 October 2005

NEW SOUTH WALES SUPREME COURT

CITATION: Club Hotels Operations Pty Limited v CHG Australia Pty Limited [2005] NSWSC 998

CURRENT JURISDICTION: Equity Division
Commercial List

FILE NUMBER(S): 50091/05

HEARING DATE{S): 05/09/05, 06/09/05, 08/09/05, 12/09/05-15/09/05, 19/09/05-21/09/05

JUDGMENT DATE: 07/10/2005

PARTIES:
Club Hotels Operations Pty Limited (First Plaintiff)
Club Hotels Group Pty Limited (Second Plaintiff)
CHG Australia Pty Limited (Defendant)
Stokeston Projects Pty Limited (Third Cross Defendant)

JUDGMENT OF: Einstein J

LOWER COURT JURISDICTION: Not Applicable

LOWER COURT FILE NUMBER(S): Not Applicable

LOWER COURT JUDICIAL OFFICER: Not Applicable

COUNSEL:
Mr L Foster SC, Mr A Ogborne (Plaintiffs) (Third Cross Defendant)
Mr J Stevenson SC, Mr N Kidd (Defendant)

SOLICITORS:
Bruce Stewart Dimarco (Plaintiffs) (Third Cross Defendant)
Corrs Chambers Westgarth (Defendant)

CATCHWORDS:
Contract
Purchase of hotels

Contractual warranty that information attached as annexure was true and correct, complete and accurate and not misleading in any respect for period specified
Proper construction of warranties
Interpretation of words "sales" and "gross profit percentage"
Principles of construction
Suggested inconsistency as between (1) United Kingdom and High Court of Australia decisions and (2) two particular High Court decisions, as to width of admissible background which would have been reasonably available to the parties
Constructive knowledge principle
Finding that subject information was being warranted as being accurate as information contained in particular document
Whether contractual warranties were breached
Finding that warranty was that information was accurate as a record of the key performance indicators produced within the system operated by vendors
Causation
Post hoc ergo procter hoc
Purchaser claims that purchase price was determined by a formula comprised of one variable and one constant [variable being EBITDA for the hotels, constant being an earnings multiplier]
Purchaser claims as damages the difference between the value of the hotels as warranted and their true value to the purchaser
Test said to include element of subjectivity
Principles applicable as to quantum of damage
Novation
Sale contracts identifying purchaser as Macquarie Bank as promoter of defendant
Defendant incorporated after date of sale contracts
Corporation unable by adoption or ratification to obtain benefit of a contract purporting to have been made on its behalf before it came into existence
Whether purchaser succeeded to novated rights and obligations
Proper construction of interrelated contractual documents

ACTS CITED:
Corporations Act 2001 (Cth)
Local Government Act 1993 (NSW)
Trade Practices Act 1974 (Cth)

DECISION:
Cross-claims fail. Short minutes of order to be brought in.

JUDGMENT:

IN THE SUPREME COURT
OF NEW SOUTH WALES
EQUITY DIVISION
COMMERCIAL LIST

Einstein J

Friday 7 October 2005

50091/05 Club Hotels Operations Pty Limited & Anor v CHG Australia Pty Limited

JUDGMENT

The proceedings

1 The proceedings are concerned with the rights of the respective parties concerning the purchase of four hotels situate at Campbelltown, Mt Annan, Leumeah and Wattle Grove in south-western Sydney. The sale contracts relating to the hotel businesses included a number of promises given by the vendors including a "promise, representation and warranty that the information attached as Annexure K (Weekly KPI Summaries) is *true and correct, complete and accurate and not misleading in any respect for the period as specified in Annexure K*". The matters litigated concern whether or not the contractual warranties were breached.

2 Some significant threshold issues require determination including the entitlement of the plaintiffs to sue in circumstances in which they were not the purchasers as at the time of exchange of contracts. Another significant issue concerns whether even if the plaintiffs had such an entitlement, the damages claim is based upon a misconceived approach to principle. And even if the damages claim falls within accepted principle, there is a causation issue.

The purchaser

3 The original purchaser was described in each of the sale contracts as "Macquarie Bank Limited as promoter of the defendant, CHG Australia Pty Ltd [described in the sale contracts by its former name, "Leisure and Entertainment Acquisitions Pty Ltd"] a company to be incorporated".

Joint-venture arrangement

4 The evidence disclosed [transcript 231] that the transaction was in essence at its commencement, a joint-venture arrangement, initially between Macquarie Bank and a Westpac equity investment vehicle, 'Quadrant'. The investment was to be fully funded by an external lender ultimately being National Australia Bank.

5 Each of the sale contracts was for material purposes in identical form although the particular clauses sometimes have different numbers. As a matter of convenience only this judgment examines the provisions with respect to the transaction relating to the Wattle Grove Hotel.

6 Likewise as a matter of convenience only, this judgment adopts the present name of companies where changes of name have taken place after entry into the sale contracts.

Group - the vendor

7 For overview purposes it suffices to describe CHG as having on 1 March 2004 purchased four hotels from Group.

[To be more precise there were six contracts entered into. This was because Group was the vendor of the hotel businesses conducted at each of the four hotels and of the land at Campbelltown and Mt Annan, whereas the third cross defendant Stokeston Projects Pty Ltd ["Stokeston"] was the vendor of the land at Leumeah and Wattle Grove. Hence there were two contracts relating to Leumeah and Wattle Grove, one dealing with the sale of the business and one dealing with the sale of the land.]

8 Group and Stokeston gave certain warranties in the sale contracts relating to the hotel businesses and land.

9 Completion of the contracts took place on 5 April 2004 at 11.30am.

The guarantor

10 The first plaintiff, Club Hotels Operations Pty Limited (“Operations”) agreed to guarantee and indemnify CHG against any loss arising out of or in connection with any promise, representation or warranty made or regarded as made in connection with the sale contracts being or becoming false, misleading or incorrect.

11 Operations granted to CHG certain mortgages and charges ["the securities"] securing its obligations under that guarantee and indemnity.

[It is convenient to refer to Operations, Group and Stokeston together as "Operations/Group" or as “Group”]

CHG's claims

12 CHG claims:

(i) to be entitled to enforce the mortgages because it says that:

(a) the warranties given in the sale contracts were breached;

(b) misrepresentations were made in connection with the sales

(ii) declarations and money orders arising out of those breaches and misrepresentations.

13 Ultimately the TPA causes of action were only pressed in relation to the costs of security expenses.

Operations' claims

14 Operations seeks relief in the form of permanent injunctions to restrain a CHG from enforcing the securities.

The novation provisions

15 The novation provision is to be found in the sale contracts [clause 57.1]. It reads inter alia as follows:

“If Macquarie as promoter of CHG, a company to be incorporated is the purchaser at the date of contract, then it may, in its absolute discretion and at any time prior to completion, by notice in writing to the vendor or require the vendor to novate this contract...”

16 The parties are at issue in relation to whether or not the rights arising out of any breach of the promises, representations and warranties made by the second plaintiff, Club Hotels Group Pty Limited (“Group”) in the sale contracts were expressly retained by Macquarie and not novated to CHG under clause 2 (c) of the novation deeds entered on 5 April 2004. At the time of the sale contracts Group was known as Stokeston Hotels Pty Ltd.

The alleged warranties and representations

17 On an overview basis it is convenient to refer to two only of the claims made by CHG:

· sales and GP percentage figures

· costs of security expenses

18 In what follows, I proceed to set out the nature of the claims for present determination by this Court as outlined in CHG's outline submissions.

"The First Claim – Sales and GP% figures

(i) In the contracts relating to the hotel businesses, Group gave a "promise, representation and warranty that the information attached as Annexure K (Weekly KPI Summaries) is *true and correct, complete and accurate and not misleading in any respect for the period as specified in Annexure K*". [see clause 47.2 of the Purchase Contracts relating to Campbelltown Club Hotel and Mount Annan Club Hotel, and clause 45.2 of the Purchase Contracts relating to Leumeah Club Hotel and Wattle Grove Club Hotel] (the *Warranty*)].

(ii) Annexure K (the Weekly KPI Summaries) included figures said to be "Sales" for, inter alia, the Main Bar, Bottle Shop and Bistro and "GP%" for the Main Bar and Bottle Shop for each of the hotels for each week in the calendar year 2003.

(iii) That warranty was breached (and was false, misleading or incorrect for the purpose of the Guarantee) in two respects.

Sales

(i) First, the "Sales" figures for the Main Bar, Bottle Shop and Bistro for each of the hotels included amounts for the notional sale price of items for which no cash or other consideration was received or receivable. They included the notional sale price of items of stock that were in fact not sold at that price, but were sold at a reduced price or given away.

(ii) CHG contends that the ordinary meaning of the terms "sales" is the increase in an entity's assets arising from the exchange of goods, property or services for an agreed sum of money or credit.

(iii) The quantum of the "notional" prices that has been included in "Sales" in the Weekly KPI Summaries for the Main Bar, Bottle Shop and Bistro has been calculated ($280,625).

(iv) The result is that the information in the Weekly KPI Summaries is not "true and correct, complete and accurate and not misleading in any respect". Accordingly, the promise, representation and warranty in the Contracts has been breached, and is false, misleading or incorrect.

GP%

(i) Second, the GP% figure for the Main Bar and Bottle Shop recorded in the Weekly KPI Summaries were overstated and inaccurate. The true GP% figures for the Main Bar and Bottle Shop are recorded in Group's accounts. They are lower than those warranted in the Weekly KPI Summaries. The annual average overstatement is 2.25% and 1.39% respectively, as itemised in the report of GCA Gower dated 10 June 2005.

(ii) The result is that the information in the Weekly KPI Summaries is not "true and correct, complete and accurate and not misleading in any respect". Accordingly, the promise, representation and warranty in the Contracts has been breached, and is false, misleading or incorrect.

(iii) The cause of the overstatement in the GP% does not matter. All that matters is that the GP% figures are overstated.

(iv) However, one probable explanation for at least part of the overstatement is that the Weekly KPI Summaries did not take into account stock adjustments in calculating GP%, whereas Group's accounts did.

The Second Claim – Costs of Security Contract

(i) The Vendors disclosed to CHG prior to the Contracts the existence of a weekly security expense of $3,700 per week. In fact, the true security expense was $9,110 per week.

(ii) In the contracts relating to the hotel businesses, Group gave a "promise, representation and warranty" that the Vendor has disclosed to CHG the particulars of each contract material to the property and the business [clause 56.8 of the Purchase Contracts relating to Campbelltown Club Hotel and Mount Annan Club Hotel, and clause 53.8, 48.9 and 47.9 respectively of the Purchase Contracts relating to Leumeah Club Hotel and Wattle Grove Club Hotel] (the *Ninth Warranty*).

(iii) The disclosure of a weekly security expense of $3,700, when the actual weekly expense was $9,110, constituted a breach of that warranty.

(iv) It also was:

- conduct engaged in by Group in trade or commerce that was misleading or deceptive, or likely to mislead or deceive, in contravention of section 52 Trade Practices Act 1974; and

- a representation made or regarded as made by Group in connection with the Purchase Contracts that was or became false, misleading or incorrect (for the purpose of the Guarantee.

Reference Out

19 During the hearing a number of other claims dealing with sundry particular allegations of loss and damage by reason of breaches of warranties pleaded in nominate paragraphs of the statement of claim and amended cross-claim became the subject of an order for reference out pursuant to Division 3 of Part 20 of the Uniform Civil Procedure Rules 2005. These constituted a largely cut down version of the cross claimants originally pursued suite of claims concerning alleged fire safety defects, and one matter concerning a claim that the Campbelltown Hotel was used as "a place of public entertainment" without a licence from Council, in contravention of Section 68 *Local Government Act 1993*.

20 Shortly before the reference was due to commence, the parties settled these claims [cf Consent Orders 5 October 2005].

Overview of the issues

21 It will be apparent that the issues range across a number of areas of detail:

· In terms of the proper construction of warranties and the claimed damages, the central focus is on the communications which took place between the parties prior to the entry into of the contract;

· In terms of the alleged breaches of warranty a close examination of particular financial/business records fall for examination, generally concerning the above described focus on sales, GP percentage figures and costs of security expenses.

EBITDA

22 A deal of the evidence was concerned with CHG's claim that during the negotiations for the purchase it had been made clear by Macquarie Bank that the yield which it was prepared to accept was not less than a 14% return. The case as opened was that one could see from the negotiations anterior to the purchase that Macquarie Bank had made clear that it would not pay more than a capitalisation rate of 14% on the 'EBITDA' [earnings before interest, tax, depreciation and amortisation]. In fact the evidence showed that following a final negotiation, the hotels were purchased on the basis of a 13.65% yield on EBITDA (or 7.326 multiple) rather than the 14% yield

(or 7.1428 multiple) originally sought.

23 CHG does not seek a curial determination as to what the 'true' EBITDA was. The proposition was that:

(i) had Ernst & Young [which had been retained by the purchaser to carry out a financial due diligence on the hotels], known the "true" position, they would have derived a lower EBITDA than was in fact derived;

(ii) the true measure of damages to which CHG is entitled in law is to be discerned by a calculation of the true value of the hotels "to it".

24 The extensive evidence before the Court in relation to the EBITDA was accepted by both parties as relevant to the issues. It became reasonably plain that CHG sought to contend that the proper construction of the contractual warranty that [the information attached to the sales contracts as annexure K being the (Weekly KPI Summaries) was true, correct, complete, accurate and not misleading], was informed by the anterior negotiations. In short it was appropriate to construe the contractual warranties by reference to the matrix of fact *known to* all parties during the negotiations [as the judgment makes clear the parties were at issue as to the ambit of the italicized word].

The case put by CHG

25 CHG put its case as follows:

Sales

i. Its primary case was that there was no ambiguity in the use of the word “sales” as used in the weekly KPI figures. “Sales” meant transaction whereby money or money’s worth was received [and the term ‘sales’ did not include promotional and discount meals for which no payment was received from the customer].

ii. Its secondary case was that if the term “sales” was ambiguous then the context made clear that the parties had used the term with the meaning set out in i. In this regard the Court was entitled to take into account the surrounding circumstances in which the contracts were made to resolve the ambiguity: *Codelfa Construction Pty Ltd v State Rail Authority* (NSW) (1982) 149 CLR 337 at 350 per Mason J.

GP per cent

iii. Its case was that the GP per cent in relation to the Main Bar and Bottle Shop was overstated because appropriate stock adjustments during the calendar year 2003 (including for errors, pilferage and wastage), were not recorded in Jetz [an internal point of sales data base business system which operated such that no sales could be processed within any of the hotels unless entered into an electronic till].

26 Mr Stevenson submitted that:

i. Notwithstanding the particular manner in which the vendors for *internal* purposes had set about creating the KPI figures, the relevant warranty had used the word “information”.

ii. The warranty had been that “the information attached as [weekly KPI summaries] was true and correct, complete and accurate and not misleading...”.

iii. As a *matter of fact* that was a promise that the figures for sales and GP percentage were in fact the correct figures.

iv. On examination the figures were seen as a matter of fact, to be incorrect.

Two questions which arise

27 At least two questions arise for consideration:

i. What does the warranty properly construed in context mean?

ii. Does any knowledge which the purchaser or their agents had [or could have had had they troubled to inspect the documents made available to them] in relation to the weekly and daily trading sheets and the attachments to them, affect the entitlement of the purchaser to rely upon the strict words of the warranty?

The case which was not pursued

28 During final address Mr Stevenson [transcript 645-646, 655] made clear that CHG did not pursue a case seeking to use the anterior negotiations in an attempt to establish that:

· a proper understanding of the warranty seen in context demonstrated that as a matter of the logic involved in the particular calculations, the warranty was no more and no less than a warranty as to the true EBITDA and/or that;

· that the parties had intended by the reference to the weekly KPI Summaries, that the Operations/Group warranty was a warranty as to the true EBITDA being 14% of the purchase price.

The Accountants

Ferrier Hodgson

29 Ferrier Hodgson, who had been the accountants for Group, provided abridged financial information to the Macquarie Bank. That abridged financial information ["the Ferrier's report"] had been prepared for the purpose of the sale process in December 2003.

Ernst & Young retainer and report

30 The retainer by Macquarie Bank of Ernst & Young [PX 3/741] and the consequential Ernst & Young 'limited scope' Financial Due Diligence report of 27th February 2004 [PX 770 et seq] are particularly important documents in terms of the evidence. The final letter of retainer was dated 9 February 2004 but represented the result of very many drafts.

31 Mr Murdoch was the then partner of Ernst & Young responsible for this client/project in terms of the provision of a “limited scope financial due diligence” concerning the proposed hotel purchase.

32 Mr McMorron was a senior consultant part of the Ernst and Young team headed by Mr Murdoch. His role within the team was as an on the ground project manager meaning that he had day-to-day supervision and responsibility for the work program under the overall supervision of Mr Murdoch.

33 The approach taken by Ernst & Young was carefully outlined in paragraphs 1.2 and 1.3 of the Due Diligence report in the following terms:

“**1.2 Our Approach**

Our approach has been in two key steps.

Firstly we have compared the abridged financial information prepared by Ferrier Hodgson for the year ended 31 December 2003 to various supporting documentation provided by the Vendor. At a summary level the Ferrier Hodgson information is also referred to as "Presented EBITDA". This first step attempts, within the constraints of the due diligence process, to establish and "actual" 2003 result for the Club Hotels Group. At a summary level the derivation of an "actual" 2003 result is referred to as "Adjusted EBITDA".

Secondly, we have normalised Adjusted EBITDA in an attempt to better reflect a maintainable position of the Club Hotels Group. The normalisations have been identified, discussed and agreed with MBI Management and are based on information provided by Vendor Management. As a summary level the results of this work is referred to as "Normalised EBITDA".

We understand that the Ferrier Hodgson abridged financial information was prepared for the purposes of the sale process in December 2003. The Ferrier Hodgson abridged financial information does not represent the Club Hotels Group complete profit and loss statement but an estimate of results built up from an average week per hotel. The information does not include balance sheets or cash flow statements.

We have compared revenue, gross margin (excluding bistro) and gross salaries and wages) included in the Ferrier Hodgson abridged financial information to week-by-week KPI Reports (represented to be "actual" results for 2003) and where available certain underlying business systems and supporting information (internal and external). We have also carried out procedures on the key growth and profit drivers underlying EBITDA being revenue and gross margin, including Data Monitoring Service ("DMS") gaming tax invoices, a limited review of bank statements, as well as undertaking further analysis and comparisons with the Jetz POS system (an internal business system covering bar and bottle shop). These comparisons and others identified a number of differences that have been included as adjustments to EBITDA and are discussed in Section 2 below.

It appears likely that the way in which the Ferrier Hodgson abridged financial information was prepared (eg before the end of the year, for the purposes of sale, with the inclusion of certain normalisations) has led to the differences identified when comparing the information to the various supporting documentation provided by Vendor Management. The nature and extent of these differences were discussed in detail with Ben Smith who while agreeing with them considers certain other factors need to be taken into account to fairly reflect the maintenance position of the Club Hotels Group.

Several normalisation adjustments have been prepared to remove the effect of abnormal or non-recurring events, to reflect improvements in the business that MBI Management consider to be ongoing, or to adjust for other matters considered relevant. Further explanations of significant identified adjustments by MBI Management and the results of our limited review of these normalisations are provided in Section 3 below. The normalisations should be considered judgmental.

The above analysis has been supplemented by discussions with and enquiries of Ben Smith, the Vendor's of the Club Hotel Group, Jason Buffier, Club Hotel Group General Manager and Greg Cruger, the Club Hotel Group Financial Controller and various members of the Consortium's Management Buy In team ("MBI Management"), in particular, Mr Steve Bartlett.

1.3 Limitations in information Provided

We note that the Club Hotels Group is not subject to independent audit and is a "cash" business.

The Vendor has been very obliging and provided selected information during the due diligence process which we consider of a reasonable standard. Nevertheless, the due diligence procedures have been limited and we have not had full and free access to the books and records of Club Hotels Group as, we understand, activities outside the scope of this transaction are included in those books and

records.

A summary of the selected information provided by the Vendor, if any, compared 'to the abridged financial information provided by Ferrier Hodgson (gross profit and expenses) is set out below...

We understand that MBI Management has assessed the sundry revenue and other expense numbers where we did not receive any documentation (ie, shaded red and have provided relevant adjustments, if any, to the Consortium. This means that there is approximately $48K per week (ie, $2.5m per annum), or approximately 10%, of gross margin and overhead that were not subject to the due diligence procedures.

[Pages 777-778 of the PX 3]

34 The key findings in paragraph 1.4 included inter alia:

"1.4 Key Findings

The Table below summarises the key results form our limited due diligence on the Club Hotels Group for the year ended 31 December 2003.

Comment	EBITDA	% of Revenue	Ref
Presented EBITDA	$10,475K	37.5%	Ferrier Hodgson
Adjusted EBITDA	$9,398K	34.3%	Section 2
Normalised EBITDA	$9,965K	35.7%	Section 3

Adjustments to Presented EBITDA are detailed in Section 2 of this report and related predominantly to differences between underlying business systems (eg Jetz, Wage Easy etc) and the information provided by Ferrier Hodgson (ie, Presented EBITDA). As noted above Presented EBITDA represents a mix of estimated and normalised numbers.

We have set out normalisation adjustments to provide further information on what may be a more appropriate maintainable EBITDA amount. The key normalisations reflect an improvement in business performance (specifically net gaming revenue) occurring during 2HFY03, the theoretical gaming return of 11% and an adjustment to remove the effect of the incident at the Campbelltown Hotel in September 2003.

Due to the input from MBI Management in determining these normalisations, their significance and the assumptions involved we recommend the normalisations are discussed in detail with MBI Management."
[Paragraph 1.4 to be found in PX 3 at 778]

The evidence

35 As both parties adduced extensive evidence of what had been said in conversations and meetings leading up to the entry into of the purchase contracts it is necessary to summarise some, but not all, of that evidence.

36 It is easy to become confused as to what is the purpose of the extensive evidence adduced by the respective parties as to these conversations and meetings. To my mind that evidence goes to discerning that which constituted the background facts "known" to both parties consistently with the principles later set out in the judgment. One is looking for the background knowledge which would reasonably have been available to the parties *in the situation in which they were at the time of*

contracting. This is because the interpretation of a written contract involves the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of contracting.

37 It has to be acknowledged that several of the persons who gave evidence had difficulties in recalling for certain what it was that had been said in a particular meeting or in a particular conversation on a particular date. Notwithstanding those difficulties evidence was given of the substance of the communication, especially in cross-examination.

38 The findings as to what occurred do not suggest that any particular witness whose recollection is not accepted as correct, did not genuinely believe at the time when the evidence was given that the version of facts was as given. It is a common finding in the Courts that over time witnesses tend sometimes to persuade themselves of a particular version of events [as for example that something had been said] which version of events is ultimately rejected by the Court. That form of rejection of evidence follows a careful examination of *all* the evidence before the Court, including contemporaneous written materials weighed on the balance of probabilities. This is what occurred in the present proceedings. No witness is found to have deliberately misled the Court.

39 Both senior counsel ultimately acknowledged in final address, that there were very few situations in respect of which critical challenges to the acceptance of particular evidence could be pinpointed. What one really has is versions of fact given on the one hand by the witnesses for CHG and given on the other hand by the witnesses for Group. Not every witness called by a particular party gave consistent evidence to that given by other witnesses called by that party. But the general picture involved a very substantial measure of agreement between witnesses called by CHG as between themselves and witnesses called by Group as between themselves.

40 The most convenient way forward would appear to be:

Step one
· To first, identify certain but not all of the witnesses who gave evidence and to initially introduced the witnesses and to outline some only of the evidence which they gave on nominate issues;

Step two
· then to proceed in chronological order to chronicle the wider evidentiary matrix, albeit that this may overlap what has already been covered in step 1. Findings as to reliability of certain evidence are given in this step;

Step three
· following that exercise to give more precise findings as to a number of particular matters.

Mr Bartlett

41 Mr Bartlett had been the Chief Executive Officer of CHG . Whilst involved in the acquisition of particular hotels in Adelaide, the funding for which was eventually provided by the Macquarie Bank, he received information that the hotels the subject of these proceedings may be available for sale.

No communicated warranty of accuracy of gross profits

42 Mr Bartlett accepted that Mr Smith could not and did not say to him that Mr Smith was willing to warrant that the gross profit in the weekly KPI summaries and the Ferrier accounts were accurate [transcript 196.10]. This evidence is accepted as reliable.

Understanding of Group position re Ferrier's Accounts

43 Mr Bartlett conceded that he had understood that the Club Group were not prepared to stand behind anything in the draft Ferrier Hodgson accounts under the heading of "expenses" this being a matter which the purchaser would have to work out for itself [transcript 174.5 set out in more detail below].

Mr Murdoch

Strictly limited retainer of Ernst and Young

44 It is patently clear from Mr Murdoch's evidence and the documents that were created at that time that Ernst & Young was not engaged to perform a full audit of the four hotels. The reason why their due diligence was limited in nature importantly included the fact that they were not given full access to the books and records of the hotels.

45 The result of the due diligence was that Ernst & Young concluded that the "normalised EBITDA" [that is, the EBITDA which had been calculated in the Ferriers' report adjusted by Ernst & Young's due diligence activities] was $9,965,000 per annum. It was this "normalised EBITDA" which was used by Macquarie in determining how much it would be willing to pay for the hotels.

46 In normalising the EBITDA, Ernst & Young took as their starting position the Ferriers' report. They then compared this report against the Weekly KPI Summaries, then the Jetz System Reports.

Evidence of Mr McMorron

47 Mr James McMorron was a senior consultant with Ernst & Young at the time when the due diligence of the four hotels was being carried out. He attended on site at the hotels and can be accurately described as the senior Ernst & Young person who so attended. Importantly, he was the primary conduit between the hotels and Mr Murdoch.

Ferrier report of doubtful validity

48 His evidence, by way of his statement, was that, at the commencement of the due diligence, he was provided with the Ferriers Report. In his evidence he states that he treated this Report as being of doubtful reliability, however, he used it as the starting point from which he would conduct the limited due diligence.

KPI, Jetz and Ferrier's report

49 Mr McMorron's evidence was that sometime during the course of the due diligence project, he received weekly KPI summaries in respect of each hotel for the calendar year 2003.. His evidence is that he was told by Mr Smith or Mr Cruger that that the Jetz system contained the most accurate record of sales for the hotels. This is despite Mr McMorron not having been trained/shown how to use the Jetz system by the hotel managers; although he was provided with print-out reports from the Jetz system.

50 Accordingly, on Mr McMorron's evidence, he was provided with three documents, the Ferriers Report, the Weekly KPI Summaries and a Jetz Report with which he was to conduct the limited due diligence exercise. Only limited access was given to the Jetz system, and Mr McMorron's evidence was that it was represented to him that, outside of the general ledger, the KPI summaries gave the most accurate picture of the hotel business.

Promotional " Give-aways"

51 With regard to the issue concerning whether or not promotional give-aways were included in sales, Mr McMorron's evidence is that it was not a part of the scope of work which Ernst & Young was

engaged to perform to determine this issue one way or the other.

Stock Adjustments

52 With regard to the issue concerning whether or not stock adjustments were included in the gross profit percentages, Mr McMorron's evidence is that he had requested information on the gross profit percentage of the hotels from Mr Cruger, and that in light of previous discussions regarding the treatment of stock adjustments in the JETZ system, he had assumed that the gross profit percentage took account of such adjustments. In other words, Mr McMorron's evidence is that he was not told one way or the other as to whether or not the gross profit percentage included stock adjustments, although he assumed it to be the case in light of the previous discussion he had participated in.

Mr Russell

53 Mr David Russell was an associate director in Macquarie Bank at the time that the transaction, the subject of these proceedings, was being negotiated and completed. He worked in the investment banking division which was, for want of a better description, the division of the bank which was responsible for discovering new investment opportunities for the bank and performing the requisite work such that the bank could take advantage of those opportunities.

Lack of responsibility for drafting clauses in contracts

54 Mr Russell's evidence disclosed that, on the Macquarie Bank side, no single person was responsible for approving its investment in the hotels; nor was any single person responsible for the drafting of the ultimate contract for sale entered into between it and the plaintiffs.

55 His evidence included:

"Q. ... were you personally involved with the lawyers in relation to working out exactly what the terms in the purchase or sale contracts would be?
...
A. I was involved in the negotiation with respect to the contracts.

Q. Insofar as the necessity, such as it was, to protect the purchaser by appropriate clauses in the contract, were you shown the clauses, did you discuss these matters with legal advisers or was it up to someone else to do that?
A. Some of the clauses I would have been shown but not all of them. I didn't read the documents in their entirety at all. There wasn't the time.

Q. So who from the perspective of Macquarie Bank, if anyone, was the person with the responsibility of liaising with whomever was drawing the sale contracts to go through line by line and crossing Ts and dotting Is as it were?
A. To the best of my recollection, there was nobody that went through - we relied on Freehills is essentially the response. So there was nobody, to the best of my recollection, from Macquarie that went through each clause making sure with Freehills that we were happy with the wording in every clause of the contract. So given the time we had to rely on Freehills. We did, however, at some point, and I can't remember exactly when, have a couple of our people, our internal legal people, talk to Freehills and they would have been involved in reviewing, I am sure, some aspects of the contracts, but it wasn't their responsibility to sit down with Freehills and go through and make sure that the wording was appropriate. We really did rely on Freehills to represent the purchaser's interests in that sense...

Q. Well, are you saying that Quadrant then would have gone along to Freehills, for example, to discuss the detail of the contracts?
A. No. They were, like I was for example, they attended a meeting regarding the key commercial

issues but because of the time constraints we really did have to rely on Freehills to get a lot of the technical wording drafting correct.
[transcript 306-308]

56 In regard to obtaining approval for the investment, it appears that many people from different positions in Macquarie Bank were required to give their approval to the deal before it could proceed. Each was responsible for a different aspect of the project. This process by which Macquarie Bank would come to a position whereby it would either approve or reject an investment proposal was what Mr Russell described as happening generally, the current circumstance involving no significant departure from this template.

57 His evidence with respect to the decision-making process included:

"A. To the best of my recollection with this particular investment we would be required, because the investment initially involved the bank itself as opposed to a managed fund by the bank taking exposure, we were required to go through a number of internal divisions, including what we call R and D credit, R and D compliance, and accounting division, called FOD, tax, so on and so forth, and each of those divisions are responsible for looking at the impact of the transaction on the bank.
In addition to that we would also, with respect to this transaction, we were also required to go to the executive committee. Executive committee is Alan Moss, Alan Moss's committee. He is the managing director of Macquarie. Once it had gone to the executive committee Alan Moss also wanted to speak to a couple of the members on the board of Macquarie Bank about this investment because of the nature of the investment and the assets involved.

Q. Was the real decision maker, if I can call it that, in relation to the investment Mr Moss having consulted the board members that you mentioned, after receiving all of the upward moving reports from people below?
A. When you say the real decision maker, what do you mean?

Q. Well, I'm looking to ascertain who it was that made the decision on behalf of Macquarie Bank to make this investment in the way that it was made?
A. Various groups and divisions, including the executive committee, have various roles of sign off. In terms of the decision to make the investment, the investment is proposed by the transaction team, which Mr Facioni lead, so he was responsible for putting the investment proposal up to the various groups within Macquarie and, for want of better words, championing the investment, so it would be inaccurate to say that Alan Moss is responsible for the investment. He is responsible for - he sits on the - his responsibilities extend to sitting on the investment - the executive committee and the executive committee's responsibilities relate to certain aspects of the transaction.

Q. Would this be fair that obviously it had to go through the transaction group that Mr Facioni headed up, and if it didn't get through that it wasn't going anywhere, is that right?
A. That's fair, that's a fair statement.

Q. But the fact it went through there wasn't the final tick on the investment?
A. Correct.

Q. It had to go up the line?
A. There had to be other people approve the investment, given their particular responsibilities.

Q. Including Mr Moss, the executive committee and his, as it were, informal discussion with two members of the board?
A. Including the executive committee, which Mr Moss sits on, so you are saying Mr Moss and the executive committee. It's the executive committee.

Q. All right. Of course there were other groups within Macquarie that fed reports in which fell to

consideration by the executive committee, weren't there?
A. The executive committee, normally what they will do is that they will sign off on the aspect of the transaction that they are responsible for and that sign off, if the various divisions that I have mentioned before, for example, credit, compliance, tax, FOD et cetera, if they have not given their sign off at the time that the sign off of the executive committee is sought, then the executive committee sign off is made subject to those divisions giving their sign off."
[transcript 230-231]

Knowledge that Ferrier's sheets could not be relied on as places for representations and warranties

58 Mr Russell also gave evidence as follows:

"Q. All right, and you were, when you sent this e-mail [PX P11], I suggest, well aware that you needed to get some warranties about the revenue in the light of the fact that Mr Campbell had told you on the 9th firstly that accounts or the sheets from Ferrier Hodgson were not the actuals, I suggest, and secondly that you had to - that the vendors would warrant the revenues?
..

Q. You were following up on the subject matter of the 9 February e-mail with a view to working out just what it was you can get by way of warranty?
A. Correct, this is what we were requesting in respect of reps and warranties.

Q. Knowing, I suggest, that the sheets in the Ferrier Hodgson had sent on the 9th could not be relied upon by you?
A. As the basis for the reps and warranties?

Q. Yes?
A. I wasn't expecting that both sheet would form the rep and warranty document in the legal agreements
[transcript 316-317]

Evidence given by Mr Ben Smith

59 Mr Smith was a director of each of the plaintiffs throughout 2003. He oversaw the general operations, the general manager and the financial controller who looked after the matter on a day-to-day aspect. They reported to him on a regular basis. He had received on a weekly basis the weekly trading sheet issued by the Jetz system. He was aware in effect from time to time from looking at the KPI's and the weekly trading sheets, of the operational performance of each of the hotels to which he pay close attention [transcript 484]. He was aware that the weekly KPI summary reflected accurately the figures that were produced on the weekly trading sheet [transcript 485].

Explanations given to CHG

60 The type of difficulty which arises for the Court where such a very close focus is placed upon communications becomes apparent when for example, Mr Smith was asked in chief, to explain what he did to make certain that the CHG representatives to whom he was speaking understood what he was saying. His answer included:

"I explained things thoroughly. I suppose I read their body language [as] to whether they were accepting and understanding... what I was saying and if there was any question they didn't understand or raised an issue that wasn't clear we would go over it again and they appeared to me to have a comprehensive understanding of what we were talking about."

Experience with 'yield' parameter

61 Mr Smith had been involved in buying and selling hotels over a period of approximately 15 years [transcript 486]. It had been his experience when negotiating such purchases or sales that he and the persons with whom he had dealt tended to speak in terms of a yield that a hotel was said to give [transcript 487]. His experience had been that when persons would buy and sell hotels they tended to speak in terms of a percentage *yield* rather than in terms of a *multiple* [transcript 487].

62 His evidence included:

Idea of a yield

"Q. And just see if I understand this. The idea of a yield is to take the earnings of the hotel and divide it by the price?
A. Yes.

Q. Multiplied by a hundred?
A. Yes.

Q. To give a percentage yield?
A. Yes.

Q. And that is the yield that the purchaser expects to get from his or her investment in a hotel?
A. Yes.

Q. And it is right, isn't it, you understand this, that the idea of a multiple is really just the converse of that, that is you take the price and divide it by the earnings?
A. Yes.

Q. And you get the multiple?
A. Yes.

Q. The one idea, that is the yield, is a function of the other idea, that is the multiple?
A. Yes.

Discussion with Mr Bartlett

Q. So am I right in thinking that the very point you are making in paragraph 3(b) is that in the conversation that you are referring to, which is one with Mr Bartlett, the discussion was in terms of yield not multiple?
A. That's correct, yes...

Q. You don't dispute though, do you, that in the course of that conversation there was a discussion between you and Mr Bartlett concerning the possible purchase of a hotel by an interest associated with Mr Bartlett?
A. We had that discussion, yes...

Q. Do you accept that in the course of that conversation Mr Bartlett said something to you about either the yield that those for whom he was speaking were looking for or the multiple they were prepared to pay?
A. He did make mention of the yield.

Q. So your point is that you and he or he spoke of yield not multiple?
A. Yes.

Q. And what he said to you was, wasn't it, that he was speaking relevantly to achieve a yield of 14 per

cent?
A. Words to that effect.

Q. And you said, didn't you, that yield - when I say you, I mean the suite of companies for whom you were speaking - were prepared to consider selling the hotels to those for whom Mr Bartlett was speaking on that basis, that is a 14 per cent yield?
A. No, I did not.

Q. You deny that?
A. I didn't say that we were prepared to sell them at 14 per cent yield, no.

Q. What is your recollection about what you did say, if anything, about the plaintiffs' attitude to a sale at that yield rate?
A. I said I felt it was probably a little off the mark, that we were interested in selling, we were interested in talking but--

Q. You said you were interested in selling?
A. We were interested, yes, and would be interested to talk to them but on our terms and conditions. That is generally what we said.

Q. Well, is this right, that Mr Bartlett said to you something like this, that "Macquarie Bank is aware of your hotels", did he say something about that?
A. Yes.

Q. Did he say something to the effect of "Macquarie Bank would like to talk to you about buying the hotels"?
A. Words to that effect, yes.

Q. And they were looking at a 14 per cent return?
A. That was their objective.

Q. So he said to you that is what they are looking to achieve?
A. Yes...

EBITDA discussion?

Q. What I am putting to you is this: That you said to Mr Bartlett that you would be prepared to, that is the plaintiff would be prepared, to sell the hotels to Macquarie on the basis of Macquarie achieving a 14 per cent return on EBITDA?
A. No, I didn't say that...

HIS HONOUR: Q. Can I just ask you, when you said a moment ago in answer to a previous question, "No, I didn't say that", are you quite certain of that?
A. I am, yes. My understanding is that the question I was asked was did I say that I was prepared to sell the hotels to Macquarie Bank at a 14 per cent yield and I said no, I did not say that.

Q. Mr Stevenson was putting to you a question which used EBITDA in the question?
A. I did not use the word EBITDA either, no...

STEVENSON: Q. Could I ask you this directly so we clear it up. What do you say about this proposition: Was EBITDA mentioned at all with the conversation you had with Mr Bartlett at the end of January 2004?
A. I don't believe it was, no.

Q. It may have been?

A. I couldn't say he didn't mention the word but there was no discussion of EBITDA during the conversation.

Q. So do you say that so far as this 14 per cent figure was referred to, it was referred to in the context of an expression 14 per cent yield?
A. The 14 per cent yield, yes.

Q. You understood that the 14 per cent yield was one referable to earnings?
A. To do with earnings, yes....

Common usage of EBITDA concept?

Q. And you know that when one is looking at assessing earnings of a business which generates its income primarily in cash, the notion of EBITDA is the one most commonly used to assess what the earnings are?
A. Hotels are slightly different to a traditional business on the way they have traditionally been sold on earnings. So EBITDA in the banking sense is not what a hotel broker would truly present to an incoming buyer.

Q. Well, what is the difference between EBITDA and what you and I are talking about as what is usually held?
A. The hotel broker, when they prepare accounts, if they were to prepare accounts for the sale of a hotel, would set the business on a single holding over operated basis to compare like with like and that's how they would be prepared.

Q. On a stand-alone basis do you mean?
A. Yes.

Q. So is the point you are making that the earnings figure would normally be prepared for each hotel as if it was a stand-alone hotel, not for a group of four hotels?
A. And operated by an individual as opposed to necessarily a company or their operating structure involvement.

Q. So as opposed to being under one management?
A. Yes.

Q. ...Do you understand that when one is looking at assessing the earnings of a hotel, whether they be on a stand-alone basis or as part of a group, the accounting concept that is usually had regard to is usually EBITDA, that is earnings before interest, tax, depreciation and amortisation?
A. With the exception of what they usually call the industry add-backs. That is a common expression used to try and get a more realistic picture." [transcript 487-491]

Level of due diligence required

63 Mr Smith's further evidence was that he was not aware to what level or extent Macquarie Bank required due diligence, that is to say whether they required it to be performed in a thorough or brief manner. In particular his evidence was:

"I presumed that they would do their normal legal process that is done in the purchase of a business like this, their usual legal checks, the usual solicitors and contracts. It says they need a bank valuation. Now, Macquarie are a bank and I wasn't sure whether that was an internal bank or whether they were a decision for certainly finance. That hadn't been discussed. Macquarie have a large number of, you know, private equity cash funds that don't require borrowing. They didn't just say they were going to put into that or they were going to put on their own books. [transcript 499]

Q. And you do agree, don't you, that Mr Russell said words to the effect that Macquarie Bank would like to pay a price based on the 14 per cent yield?
A. Yes, that was the ambition of the fund.

Q. Can I suggest to you that what he said was that Macquarie Bank would not pay a price which was more than a 14 per cent amortisation rate?
A. No, he didn't say that.

HIS HONOUR: Q. How certain are you of that?
A. I am reasonably certain of that. It was a price that we wouldn't have sold the hotels at and my understanding was they were buying a - trying to buy a large group of hotels of which they were trying to achieve an average price of 14 per cent on." [transcript 501]

Denial of EBITDA sale basis

64 Mr Smith denied that the sale could have proceeded upon the basis that the Ernst & Young due diligence had to achieve a 14 per cent capitalisation of 2003 EBITDA:

"Q. Did Mr Russell say that Macquarie Bank was looking for 14 per cent return on its investment?
A. He indicated to me that they were trying to acquire a large portfolio of hotels of which this was the first group and that they were able to achieve across the group an average yield of 14 per cent.

Q. Well, I am asking you a slightly more precise question. Did he say to you that Macquarie Bank was looking for a 14 per cent return on its investment in these hotels?
A. That was their stated desire, yes.

Q. So they were saying more, weren't they, than - sorry - Mr Russell said more than that Macquarie Bank would like to pay a price based on the 14 per cent return? I will finish the proposition. You said that that's what they were looking to do.
A. I couldn't tell you exact words. They're splitting hairs between "looking to" and "liking to", but the understanding I got really in the meeting was that their desire was over a large portfolio to achieve 14 per cent yield.

Q. What I am suggesting to you is that Russell went further and made clear that Macquarie Bank would not want to pay more than an amount cap rated on a 14 per cent yield?
A. No, he did not.

Q. So you are quite clear, you say, about that?
A. I am, yes.

Q. What I suggest to you is that Mr Russell went further and mentioned that he understood that the 2003 EBITDA for the hotels was 10.43 million?
A. I don't recall that figure specifically being cited at that meeting.

Q. You do recall, don't you, that that particular figure was referred to later in the month by the Macquarie Bank?
A. There were a variety of fairly similar figures that were referred to on a number of occasions to do with profit and, as I said, to say that that one specifically was referred to by who on what day, I really couldn't tell you.

Q. I think you just said that you can't recall the figure of $10.43 million being mentioned at the 5 February 2004 meeting?
A. That's correct.

Q. You don't deny it, do you?

A. I really don't know if that figure specifically was mentioned. The meeting was a very broad bush negotiation. We weren't digging into detail, because no-one had detail there to discuss. So I think Mr Russell may have mentioned it. I don't know where he would have got the figure from or what he drew his conclusion to mention it but--

Q. He may have mentioned it?
A. He well could have, well could have.

Q. And can I suggest that further what Mr Russell said at that meeting was that if it turned out that, in Macquarie's view, the 2003 EBITDA was less than a figure of 10.43 million, then from Macquarie's point of view the price they were prepared to pay would have to be adjusted. He said that, didn't he?
A. We didn't discuss adjusting the price.

Q. And he said to you, didn't he, that if a 14 per cent capitalisation of 2003 EBITDA was satisfactory to you, then Macquarie would proceed with doing due diligence?
A. No, he didn't.

Q. And can I suggest to you that you understood that and that that's the basis upon which, as you understood it, the Ernst & Young due diligence did proceed?
A. It couldn't have proceeded on that basis.

HIS HONOUR: Q. Is that because your evidence is that that was not said?
A. No, it couldn't have proceeded on that basis because we were very clear at that first meeting and I was clear with Mr Bartlett when I met him in Canberra that we wouldn't be handing across detailed profit and loss accounts. So there was no way that they could work out accurately the DA of the business over 2003. They would have to make their own assessment of what their likely operating profit of the hotel would be and make their own decision based on that."
[transcript 502-503]

65 Later in his cross-examination he accepted that the desire of Macquarie Bank was to achieve a process of confirmatory due diligence which would test its non-binding indicative offer in the endeavour to confirm that the EBITDA was 10.43 [transcript 510]. However although Mr Smith understood that this was the desire of Macquarie Bank he was quite clear that there was no agreed precondition:

"Q. ... What Mr Russell was making clear to you at this 5 February meeting was that Macquarie Bank would be looking to pay $74.5 million, assuming that the EBITDA of 10.43 that he had in mind was one with which, or Macquarie Bank rather, would be satisfied?
A. ... it wasn't a precondition that he made of us when we were at the meeting, no."
[transcript 506]

Warranties to be given

66 Mr Smith had given evidence in his affidavit of 1 April 2005 of recalling a conversation with Mr Russell and Mr Facioni in which he had said that the only financials Club would warrant were the wages and the takings. He had not been able to recall exactly in which conversation the weekly KPI Schedule document came to be agreed upon as the only document to be included as an annexure into the sale contract. Under cross-examination [transcript 512.7] it was put to him that ultimately he did agree to give the warranties which are to be seen in the contract.

67 The entirety of the evidence given by witnesses accepted as reliable supports the inference that the bald earlier communication that the only financials Club would warrant were the wages and the takings was overtaken by the references to the KPI Schedule and the acceptance that the material warranty was that to be found in the sales contracts.

Evidence of Mr Cruger

68 Mr Cruger was the Group Financial Controller for the Sahben Group of companies which included Club Hotels Operations Pty Ltd and Club Hotels Group Pty Ltd which he collectively referred to as "Club Hotels". He had been the Group financial controller for Club Hotels since June 1998.

Systems/requests for information

69 During the course of the due diligence he received numerous requests for information from the due diligence team normally through Mr McMorron seeking the provision of particular reports or documents or information. He had actually personally been primarily responsible for designing and implementing the financial management systems and business records for Club Hotels. He gave very detailed evidence of those systems which included:

· detail of the process of recording financial data;

· detail of the manner in which the sales aspect of the business involved all sales being operated through the tills which were linked to a computer server within each hotel known as the Jetz server [a software package which operated such that no sales could be processed within any of the hotels unless entered into an electronic till, that is to say no sale could be processed unless recorded in the Jetz data base];

· a detailed description of the functions performed by the respective duty managers leading to the building up of the daily trading sheets;

· a detailed description of those daily trading sheets and of each item within the sheets;

· a detailed description of the phrases and figures to be found on the cash summary reports;

· a description of the data files which were the source of information contained in the weekly KPI figures.

The Ernst and Young testing

70 In his first statement he gave evidence that in February 2004 Ernst and Young performed sample testing of the daily and weekly trading sheets choosing the week ending 26 October 2000 for Wattle Grove and Leumeah and the week ending 24 August 2003 for Campbelltown and Mt Annan.

Trading sheets

71 He recalled providing to Mr McMorron the weekly trading sheets and related trading sheets and petty cash reports for those periods.

GP percent

72 He also gave evidence concerning the "GP percent" figures recorded in the daily trading sheets. He had understood 'GP percent' as meaning the gross profit percent, a term which he used to describe the gross profit of each sale by taking into account the price paid by Club Hotels for the item and the price the item was sold for to the customer. He had always known the phrase as referring to the gross margin per cent for each item sold. He also gave detailed evidence concerning the stock take process.

KPI figures

73 He also gave detailed evidence as to the KPI figures which were annexed to each of the sale contracts for the four hotels to compare them with the corresponding data in the Jetz system.

Provision of documents to Mr McMorron

74 In paragraph 4 (b) of his statement of 24 August 2005 he had given the following evidence:

"I provided the weekly and the daily trading sheets, petty cash vouchers, petty cash summaries and bank statements for the weeks requested by Mr McMorron. Exhibited to me and marked 'GC1' are copies of the weekly and the daily trading sheets, petty cash vouchers, petty cash summaries, bank statements and associated documents for the week ending to November 2003 which I provided to Mr McMorron.

75 Under cross-examination it eventuated that at the time he signed his statement he had not had the two volume exhibit GC1 in front of him at all. Nor had he himself put together the documents which now appear in those volumes. Nor had he looked through those volumes since that time. Nor was he even aware at the time he gave evidence, unless he would look through the documents, whether the two folders were or were not a complete set of the documents which he gave to Mr McMorron.

76 Whilst none of this appeared to augur well for the reliability of his evidence, the matter was satisfactorily clarified in re-examination when he identified three bundles of original material representing daily trading sheets to which were attached the particular vouchers which had been kept under his own supervision. His evidence was that when he provided materials to Mr McMorron for the weeks requested, he had handed over the original daily trading sheets. In the case of the weekly and petty cash summaries and bank statements he had opened up the relevant files on his computer and printed the documents off for Mr McMorron. Before he signed the statement he had sent in to Bruce and Stuart, all of the daily trading sheets and supporting vouchers as bundles. Although he did not have the folders at the time he signed the statement and gave evidence that he could not presently recall precisely for which weeks he had given to Mr McMorron the daily trading sheets and the supporting vouchers, he had no doubt at all that he had provided the daily trading sheets and the supporting vouchers to Mr McMorron for certain weeks. This evidence is accepted.

77 In those circumstances his evidence is regarded as reliable, the crucial parameter being what he had actually provided to Mr McMorron. The finding is that he had provided to Mr McMorron the weekly trading sheets and related daily trading sheets and petty cash reports for the weeks ending 26 October 2003 for Wattle Grove and Leumeah and the week ending 24 August 2003 for Campbelltown and Mt Annan. The end result is that the Court finds on the evidence, that it is more likely than not that Mr McMorron was provided with such documents.

Proceeding to endeavour to thumbnail sketch evidence given by witnesses against a general chronological background

78 The following chronicle of the evidence given [which includes sundry segments of witnesses written statements] always requires to be monitored in the light of the cross-examination: some of the witnesses evidence given in the written statements did not stand up to cross-examination. Where possible the judgment endeavours to identify these occurrences.

6 January 2004

Evidence of Mr Bartlett

79 Mr Bartlett gave evidence that on 6 January 2004 he met with Mr Ben Smith. On his evidence the conversation was as follows:

Mr Bartlett: "I am interested in purchasing your hotels at 7 times earnings."

Mr Smith: "I think that they are worth more than that."

Mr Bartlett: "On what basis?"

Mr Smith: "Their performance. Plus we have a number of keen parties. At a price of 7 times earnings we would not be interested in selling the hotels."

Mr Bartlett: "Okay. Well there's no point in proceeding any further at this stage. However, we should stay in touch."

Mr Smith: "Okay".

Evidence of Mr Smith

80 Mr Smith gave evidence that during a discussion with Mr Bartlett, he said:

"The price is $75 million and we're not prepared to supply accounts. We will give you full access to the Jetz point of sale system in or taking is and wage information. You will have a number of Hotel experts like myself and they will be able to put together a theoretical profit and loss for the hotels under your management".

81 Mr Smith's evidence is accepted as reliable on this issue.

Late January 2004

82 Mr Bartlett gave evidence that he had had a conversation with Mr Smith in which he had said that Macquarie Bank wished to talk to Mr Smith about the purchase being made with their funding and that the material amount was still “7 times earnings but that Macquarie may be prepared to negotiate”.

83 Mr Smith in his statement denied having had the telephone conversation and denied at any time having heard Mr Bartlett use the phrase "seven times earnings" or any similar phrase.

84 Mr Smith's evidence is accepted as reliable on this issue.

9 February 2004

85 On this date Mr Campbell, a director of Ferrier Hodgson, sent an e-mail to Mr Russell of Macquarie bank attaching draft accounts for the four hotels for the 12 months up to 31 December 2003. [PX 3/735]. The e-mail stated that the draft accounts had not been subject to audit and were provided for information purposes only, a matter noticed by Mr Bartlett when he read the e-mail [transcript 173]. In the same e-mail Mr Campbell made the point that the company was prepared to warrant its revenues and margins but that the purchaser would need to satisfy itself as to expense levels.

86 Under cross-examination already adverted to, Mr Bartlett conceded that he had understood when he received the e-mail that the Club Group were not prepared to stand behind anything in those accounts under the heading of "expenses" and that this was a matter which the purchaser would have to work out for itself [transcript 174.5]. His evidence included:

“Q. You no doubt felt as at 9 February when you read this e-mail that between you and Mr Hicks you could work out fairly well for your purposes what the expenses were likely to be in these hotels, isn't that right?
A. Yes.

Q. Based upon yours and his experience?

A. Yes.

Q. And in particular knowing how it would be that you and he would run them?
A. Yes.

Q. Because after all, expense levels are very heavily dictated by the way in which the hotels are run, aren't they?
A. They are.

Q. And you were told in this e-mail, I suggest, of course that the accounts attached exclude head office overheads, directors' drawings and depreciation with certain expenses allocated on a single holding basis?
A. That's right.

Q. Would you accept that after you read that e-mail, that it was up to you and Mr Hicks, and indeed anyone else in the Macquarie camp, to work out for the purposes of any financial assessment of these hotels just what the expenses would be under the new management?
A. Yes."
[transcript 174-175]

10 and 11 February 2004

87 Extensive evidence was given in relation to conversations said to have taken place at a meeting at Leumeah in relation to the due diligence process to be undertaken by Ernst & Young.

Evidence adduced by the plaintiff

88 The evidence adduced by the plaintiff included the following:

Mr Smith's evidence

"Mr Smith did not review line items of the Ferriers accounts with Mr McMorron or anyone else.

In relation to discussions regarding expenses, Mr Smith said words to the effect of:

"I would have to ask Ferrier's how they came up with that figure. These are not our accounts. For all of these expenses you will really need to ask Bartlett or Hicks or Blewitt how they intend to manage the hotels."
[Statement of Ben Smith dated 19 August 2005 – para 15 (b)]

In relation to discussions regarding Ferriers accounts, Mr Smith said words to the effect of:

"You have to understand that the Ferriers accounts were not prepared for this transaction. They were prepared last year in relation to the ALH transaction which never went ahead. ALH requested some figures to show what each hotel might earn by way of revenue and incurred by way of expenses if it was run as a freestanding operation. Graeme Campbell from Ferriers prepared these accounts in association with Gerry Quinlan to show how each hotel might operate if run as a stand-alone pub. They came up with typical expenses for those sorts of hotels based on their knowledge of the industry. The expenses have no relationship to the actual Club Hotel expenses."
[Statement of Ben Smith dated 19 August 2005 – para 15(b) and 15(c).]
[This evidence is accepted as reliable]

Discussion between either Mr McMorron and Mr Cruger or Mr Smith.

Mr Smith said words to the effect of:

"All of our sales for the main bars, bottle shops and bistros go through the Jetz system and are recorded in Jetz ... ... you can get all the information you need about the sales from Jetz."
[This evidence is accepted as reliable]
[Statement of Ben Smith dated 19 August 2005 – para 16.]

Mr Cruger's evidence
[The whole of what follows as Mr Cruger's evidence is accepted as reliable]
Mr Cruger said to Mr McMorron words to the effect of:

"All of our sales in the main bars, bottle shops and bistros are recorded on the Jetz system."
[Statement of Gregory Cruger dated 24 August 2005 – para 2(b).]

Conversation as between Mr McMorron and Gregory Cruger to the effect of the following:

Mr *McMorron: We want to see some sample weekly and daily trading sheets so that we can reconcile them against the weekly KPI summaries."*
Mr *Cruger: Which weeks to you want? The trading sheets for the first half of the year have been moved to storage off site. It you want them from the first half of the year, I can get them for you, but if you want them for the second half of the year then I have them at my fingertips."*
[Statement of Gregory Cruger dated 24 August 2005 – para 4(a).]

Details of discussion between Mr McMorron and Mr Cruger regarding Jetz system. Mr Cruger said words to the effect of:

"The sales figures and GP percentage figures in the weekly trading sheets are put into the weekly KPI summaries at the end of the week. Each week the figures for that week are added to the document so that it builds up over the year. The week KPI summaries we have given to you contain the weekly figures for the whole year. You can check any of the weekly figures in the week of the KPI summaries back against the weekly trading sheets and then the weekly trading sheets back against the daily trading sheets."
Statement of Gregory Cruger dated 24 August 2005 – para 8(a).

Mr Cruger did not say anything to Mr McMorron to the effect that food is recorded in the Jetz system, the food is recorded in any summary report obtained from the Jetz system or the weekly figures in the weekly KPI summaries where adjusted to take account of the monthly stock adjustments.
[Statement of Gregory Cruger dated 24 August 2005 – para 8(b).]

Discussions between Mr Cruger and Mr McMorron during the due diligence process

Mr McMorron: *Can you tell me how the Jetz system deals with sales?"*
Mr Cruger: "*Sure. All of the sales in the hotels are rung up through electronic tills which are linked to the Jetz system. Everything has to go through the tills. The staff do not have high level access to the Jetz system so they cannot go back and subsequently change any entries. This means that every sale, whether cash or otherwise, is recorded in the Jetz system. At the end of each shift, the manager counts the cash in the tills and checks this against the sales recorded in the Jetz system. This information gets entered into a daily trading sheet. The hotel management can access the Jetz Manager module and check the sales figures for any day."...*

Mr McMorron: *"I would like to know more about how the daily and weekly trading sheets are prepared"*
Mr Cruger: *"At the end of each shift, the manager takes the cash draw from each till into the manager's office and counts the cash taken by the till during the shift. The manager records the cash count in the daily trading sheet. It will be easier if I show you on one of the daily trading sheets."...*

Mr Cruger: *The manager enters the cash count figures for each till into the "Cash Count" column. Each of the tills has a separate row. The "AM" is the morning shift and "PM" is the evening shift. This daily trading sheet is a sheet I designed in Excel. The manager enters the figures directly into the sheet on the computer. The manager then looks up the "JETZ Theoretical" sales figures in the first column from the Jetz system and enters them in the daily trading sheet. These are the figures recorded in the Jetz system for all of the sales in the hotels. The manager then totals up any petty cash vouchers and enters the total in the "Petty Cash" column.*

Mr McMorron: *"What is covered by Petty Cash?"*
Mr Cruger: *"For the bars it might be some item needed by the staff; for the bistro it might include meal vouchers. The manager prepared a daily petty cash summary as part of the same Excel workbook listing all of the petty cash items and attaching all of the vouchers. This petty cash summary stays with the daily trading sheet. Here it is here, with the vouchers attached.*

Mr Cruger: "*For the bottleshop tills, the manager also gets the EFTPOS and credit card payments from the Jetz system and enters them in the "Cards" column. The computer then calculates the total of the receipts and displays it in the "Actual" column and works out any difference between this and the figures recorded in the Jetz system and displays it in the "Var +/-" column. The manager also enters the gaming machine and TAB figures. The spreadsheet then adds up the sales and cash adjustments and the manager enters the final amount that is put into the Armaguard safe in the "Less cash to Armaguard" cell. This means that the daily trading sheet gives us a cradle to grave record of all the sales from the tills right through to the amount that gets banked. At the end of each day, the manager obtains the gross margin percentage figure for bar and bottle shop sales from the Jetz system and puts it into the daily trading sheet in the "GP%" column."*

Mr McMorron: *"Does the manager also make up the weekly trading sheets?"*
Mr Cruger: "*The weekly trading sheets are actually part of the same Excel spreadsheet as the daily trading sheets. The weekly trading sheet was automatically generated by Excel from the information puts into each daily trading sheet. The manager would print out each daily trading sheet and the petty cash summary and attach the individual petty cash vouchers and EFTPOS and credit card receipts to the daily trading sheet. At the end of the week, the manager put together each of the daily sheets and these would be collected or sent to head office. On each Monday morning, the managers would also email the completed weekly workbook file in to head office."* [Statement of Gregory Cruger dated 24 August 2005 – para 9]

89 Mr Smith also gave evidence which is accepted as reliable that the conversation which he had had with Mr Murdoch during the meeting of 11 February 2004 included:

"Mr Murdoch: We would like to see the books and records of the hotels."

Mr Smith: It has already been agreed that we will not be handing over our accounts. The companies run a number of other business so the company accounts are not a true reflection of the accounts of these hotels. On the revenue side you can anything you want from Jetz and the weekly KPI summaries. We will also get you information on wages, the gaming machine records and TAB records. We will not be giving you other information on expenses. Macquarie has its own experts to work out what its expenses will be depending on how it manages the hotels.
Statement of Ben Smith dated 19 August 2005 – para 23."

Mr Buffier's evidence

90 Mr Buffier was the General Manager for Club Hotels Group Pty Ltd for the whole of 2003, his responsibilities including the supervision of the trading activities of the Club Hotels Group hotels. He gave evidence of participating in a meeting of Tuesday 10 February 2004 at which he meant a number of representatives of the purchaser as including Mr Russell, Mr Hicks and others. His continuing evidence which is accepted as reliable included:

"8. On either the Wednesday, Thursday or Friday of the same week referred to above, I observed that there were several people who appeared to be coming and going from the offices in Leumeah and through the Star Bar. I now only clearly remember one of those persons being James McMorron. I recall that he was an accountant by background and worked at Ernst & Young. I recall that on one of the days being either 11, 12 or 13 February 2004 that Mr McMorron came to my desk and said words to the following effect:

"Jason, can you show me how the JETZ system calculates the GP% figure noted in the KPI schedule?"

I said in response words to the following effect:

"I will show you."

9. I then turned to my computer and Mr McMorron moved next to me to look at my computer screen.

10. I then continued with words to the following effect:

"I will just enter into the JETZ manager, and see here, I click on the Product and Stock Control icon. Let's now choose one of the hotels [I now cannot recall which hotel I chose] and click on one bottle shop product group. You see here that it lists all the product groups. Let's choose one [I now do not recall which specific product group I chose]. You see that it lists the columns including "normal sale price" which includes GST, the "current cost" which excludes GST, and the "normal GP%" on that item.

Let's pick one specific stock item. [I then picked one]. See how it lists the prices and the GP%. Let's now check this on my calculator."

11. At this point I got out my calculator and punched in the sale price in dollar figures as listed on the screen in front of us (which included gst), then I subtracted the current cost figure which was listed on the screen for that item after I had multiplied it by 1.1 so as to add the GST. That produced a number on my calculator. I then said words to the following effect:

"See, that is the gross margin including gst in dollar terms on the sale of that item at that price."

12. On the calculator I then divided that number by the sale price figure which appeared on the computer screen and that gave a figure on my calculator which, when multiplied by 100, matched the GP% figure shown on the screen for that product.

13. I then said words to the following effect:

"See, the percent figure here matches the GP% figure in JETZ for this item."

Mr McMorron then said words to the following effect:

"Yes, I see that."

I then said words to the following effect:

"The GP% figure listed on the trading sheets and the KPI are just an aggregation of the gross margin on all the products sold during any given week. So to answer your question, that is where it comes from."

Mr McMorron then returned to the Star Bar."

[Affidavit of Mr Buffier of the 21 October 2004]

Evidence adduced by the defendants

91 Evidence adduced by the defendants included the following:

Evidence of Mr McMorron

"Discussion between Mr McMorron and Ben Smith regarding line items within the Ferriers accounts. Mr Smith said words to the effect of:

"I will have to speak to Ferriers about why they did that".
OR words to the effect of:
"I will discuss with Ferriers where that expense item came from".
[Statement of James McMorron dated 16 June 2005 – para 8.]

[Despite these words, Mr McMorron gave evidence that he had never received any such information This evidence is rejected as unreliable.]

Discussion between Mr McMorron and Mr Smith or Mr Cruger. Mr McMorron recalls hearing words to the following effect:

"The Jetz system has the most accurate figures for sales for the main bars, bottle shops and bistros and for the gross margins for the main bars and bottles shops".
[Statement of James McMorron dated 16 June 2005 – para 15.]

Discussions between James McMorron and Club Hotels Group staff including Mr Smith, Mr Cruger and Mr Buffier. Mr McMorron cannot recall any discussions during which he was told that the monthly stocktake adjustments were not incorporated into the weekly KPI summaries. [Statement of James McMorron dated 16 June 2005 – para 39.]

92 Further evidence adduced by the defendants as to these conversations or part of them included the following:

Evidence of Mr Murdoch

"Conversation as between Mr Murdoch and either Gregory Cruger, Jason Buffier or Ben Smith to the effect of:

"Mr Murdoch: I have been provided only with these accounts [referring to the Ferrier's accounts]. Who prepared them?"
Him: Graeme Campbell at Ferriers prepared them on the basis of the information I have provided to him."
Mr Murdoch: What information?"
Him: Graeme Campbell's knowledge of the hotels, his discussions with myself and staff, plus the weekly KPI information available at the time he prepared the accounts. The KPI information provides information on revenue, gross margin and wages and is used by us to manage the business."
Mr Murdoch: Can we see the KPI's?"
[Statement of Geoffrey Murdoch dated 24 June 2005 – para 14.]

Further conversation between Mr Smith and Mr Murdoch:

Mr Murdoch: I would like to compare the Ferrier's P&L [by which I meant the Ferrier's accounts] as against the books and records of the hotels."
Mr Smith: I can't let you do that. The books and records of the hotels contain various private

expenses that are not relevant to the hotels. All I will let you have is the weekly KPI information and other selected information, including information from the point of sales system ..."
Statement of Geoffrey Murdoch dated 24 June 2005 – para
16.

Conflict of evidence as to whether the KPI document was represented to comprise "actual cash numbers"

93 Mr Murdoch gave evidence that words to the following effect were said to him on several occasions during the due diligence exercise, by each of Messrs Smith, Cruger and Buffier of words to the effect:

"The Weekly KPI Summaries of what we use to run the business and are based on actual information. They are of the actual cash numbers."

94 Each of Messrs Smith, Cruger and Buffier gave evidence that these words had not been said. However:

· Mr Smith did recall telling Mr Murdoch that the Weekly KPI Summaries accurately recorded the sales run-up through the Jets system.

· Mr Cruger recalled saying to Mr Murdoch and other members of the Ernst and Young team on a number of occasions words to the effect that:

"The figures in the Weekly KPI Summaries come from the weekly trading sheets which, in turn, from the Jetz system"

"all of our sales are recorded in the Jetz system"

· Mr Buffier recalled saying words to the effect: "the weekly KPI summaries of one of the tools I use to do my job" [his evidence was that he had said this because the weekly KPI summaries were the documents that summarised the weekly trading results and allowed him to review and discuss trading trends and year over year comparison with the individual Hotel Managers]

95 Under cross-examination Mr Murdoch accepted that he was unable to point to any specific occasion when he was told words to the effect that the KPI Summaries were "the actual cash numbers". However he believed all three of the above described persons had said these words to him.

96 Whilst the factual finding is a difficult one and although I accept that Mr Murdoch honestly believes that what he was told was as above described, the balance of probabilities suggests that those words were not used. That is the finding.

11 to 20 February 2004

97 In his statement Mr Bartlett gave evidence that between approximately 11 and 20 February 2004 he had a conversation with Mr Smith at Leumeah to the following effect:

Mr Bartlett: "The gross profit looks good, but I would like to see the actual accounts."

Mr Smith: "You can't see the accounts. But I'm willing to warrant that the gross profit in [the Weekly KPI Summaries] and [the Ferriers Accounts] are accurate."

Mr Bartlett: "57% gross profit on bistro seems high." [I was referring to the 57.36% profit margin recorded in the Ferriers Accounts]."

Mr Smith: "It's not that high. We are very conscious of our menu pricing and portioning and as a result are able to generate that profit margin."

Mr Bartlett: "Okay. Well I also still have trouble understanding how the bottle shop and main bar margins are so good. The bottle shop and main bar revenues recorded in the [Ferriers Accounts] is approximately equal to, or in some cases slightly higher than, the GP% recorded in the [Weekly KPI Summaries]. Do they include all the stock adjustments?"

Mr Smith: "The [GP%] recorded in the [Weekly KPI Summaries] is the [GP%] after taking into account all stock adjustments including for errors, pilferage and wastage."

98 Under cross-examination already adverted to, he accepted that Mr Smith could not and did not say to him that Mr Smith was willing to warrant that the gross profit in the weekly KPI summaries and the Ferrier accounts were accurate [transcript 196.10].

Ignoring what was said by Club personnel

99 Also under cross-examination his evidence included:

“Q. And you've got yourself over the page saying "57 per cent gross profit on the bistro seems high", and you refer to that figure in the Ferrier's accounts, and you had him commenting on that. Do you see that?
A. Yes.

Q. Now, you were concerned at the time, that is around about mid-February, that the assertion that there was 57 per cent gross profit in the bistro might be wrong, weren't you?
A. Yes.

Q. You thought it was too high?
A. Yes.

Q. Based on your experience?
A. Yep.

Q. And ultimately you resolved that as far as your camp was concerned by instructing Ernst & Young to assume 50 per cent gross profit in the bistro, didn't you?
A. Yes.

Q. And so you ignored, as it were, what you were being told by the Smith side of things?
A. Yes.

Q. Whatever it was in relation to that matter?
A. Yes. “
[transcript 196]

13 February 04

100 Mr Campbell gave evidence of having attended a meeting on 13 February 2004 at the offices of Macquarie Bank at which were present representatives of Quadrant Capital together with Mr Russell and Mr Facioni of Macquarie Bank and Mr Smith. At this meeting he was handed a document headed “Project Sandringham Non Binding Deal Terms Sheet” [PX 3/728] which included the following:

“This term sheet is not an offer capable of acceptance

Non-binding

Indicative Offer: The Purchasers are pleased to reconfirm the acquisition price of $74.5m cash based on confirmation of CY03 EBITDA of $10.43m and the Conditions

Conditions The conditions to the Indicative Offer:

· Confirmatory due diligence
· Final credit approvals including Macquarie internal approvals
· Resolution of Issues Identified
· Exclusivity

Issues Identified ...

· Warranties

Process to completion

Complete Acquisition Agreement 16-27 February
Complete Confirmatory due diligence 16-27 February
Refresh Property Valuation 23February-5 March
Final Approvals 1 – 5 March
Binding Commitment 1 – 5 March
Settlement ?"

19 February 2004

101 Evidence was given of conversations between Mr Smith, Mr Murdoch and Mr McMorron at Leumeah on this date.

Evidence of Mr Smith

102 Mr Smith whose evidence on this conversation is accepted as reliable, gave evidence of conversation to the following effect:

"Mr Murdoch: "We have only come up with a profit of $10 million not $10.2 as Macquarie Bank are aiming for, to pay your price. Can I run through some things with you? Lets start with the KPI summary ...We have done a check on the KPI figures on a week by week basis for the entire period and there are a number of minor variations from those recorded in Jetz. They appear to be either typos or rounding issues and only relate to a couple of thousand dollars and do not effect the overall outcome."

Mr Smith: Other than that are you satisfied with the information that you obtained from Jetz and the accuracy?"
[I interpolate to note that Mr Murdoch gave contradictor evidence to the effect that in relation to the comparison between the Weekly KPI Summaries and the Ferriers Accounts there were large discrepancies. This did not surprise him because of the concerns which he had held in relation to the Ferrier Accounts which had been created for the purposes of soliciting bids from prospective purchasers were unaudited; excluded certain expenses and were annualised based on an average week of information]

Mr McMorron: "Yes it is a very good system and I have had a chance to look through it thoroughly. It is very good for monitoring sales and margins...
[I interpolate to note that Mr Murdoch could not recall these words having been said [20 (d)].
Mr McMorron's evidence was that these words were not said but that instead he had said:
"This system appears at fit for purpose on the basis of what we've seen to date. It seems to handle sales and margins in a reasonable fashion"[33]]

Mr McMorron: ”We do not agree with your wages figures on the KPIs. They are understated by about 15%”

Mr Smith “Does your figure include holidays and superannuation?”

Mr McMorron: “Yes.”

Mr Smith: We account for leave and super separately. The KPI’s are primarily used as a management tool so that we can compare wages from week to week and to takings.”

Mr McMorron: I will need to confirm it but it appears to work out very close to the amount of super and holiday pay. It looks like we are in agreement....”.

Mr Smith: Most of our promotions are paid for directly by our suppliers. We have about $50 for things like badge draws and pick the joker where applicable but one of the significant amounts is for food promotions. We find this is a very cost effective way of bringing in customers. Items like the 2 for 1 steak nights are expensed as a promotion. On nights when we have good food promotions we often find that our gaming take significantly increases. Wattle Grove on a Monday night is a great example. We have a separate area on the trading sheet for F&B promotions....Is there anything else that you require?”

Mr Murdoch: No both you and Greg have been very helpful James and Sally will finish things off tomorrow and we should have a final report for Macquarie Bank on Monday. If there are any questions I have over the weekend I will call you on your mobile.”
[Affidavit of Ben Smith sworn 1 April 2005 – paras 18 – 21]

Evidence of Mr Murdoch

103 Mr Murdoch gave evidence that the following events took place:

“The essence of the conversation was that Mr Murdoch and Mr McMorron had compared the Ferriers accounts with the weekly KPI summaries and other information provided the Club Group and come up with the Disparities. Mr Murdoch & Mr McMorron took Mr Smith through the “Disparities” at the meeting on 19 February.

Mr Murdoch, Mr Smith and Mr McMorron went through the nature and extent of the Disparities and led to the “adjustments” column summaries on page 6 of the due diligence report. Mr Smith agreed with the adjustments.
[Statement of Geoffrey Murdoch dated 24 June 2005 – para 20(d).]”

26 or 27 February 2004

104 Mr Bartlett gave evidence of having been present at a meeting at about this time at which a number of persons were present at the offices of Bruce and Stuart including Mr Ben Smith and Mr Paul Smith and representatives of Macquarie Bank and others. His recollection was that he had certainly been present at such a meeting. His evidence included:

“Q. You see, I want to put to you that the, if I may be so rude as to call it, chiselling of the price took place at a time when you weren't there?
A. It may have, but at this meeting the conversation about multiples of earnings was certainly had in my recollection because I remember Ben specifically saying, "I don't care how you work your price out. Our price is X and that's that".

Q. I see. I just want to get this clear. Ben said you think at the Bruce and Stuart meeting of the 23rd,

"I don't care how you work your price out. Our price is X and that's that"?
A. Yes.

Q. That's not in your statement?
A. No.

Q. But you do remember that?
A. Yes.

Q. Mr Smith wasn't interested in multiples or EBITDA or anything else, he was just interested in the price as far as you were concerned, is that right?
A. Yes.

Q. And you don't yourself know whether what ever was said about price and multiples by Macquarie Bank personnel was genuinely their position, do you?
A. I never know what they were thinking.

Q. No, and you weren't privy to what it was that went on inside Macquarie Bank that led them to first of all offer the original price and secondly to seek to have it reduced?
A. I could never know exactly what went on, no.

Q. Because you weren't part of that process of deliberation, were you?
A. I had some robust discussions with them on the calculations of their earnings multiple and they explained to me how they had come up with that earnings multiple. That was the limit of my involvement with them on that."
[transcript 203-204]

Standing back from all the facts

105 It is apparent that the proceedings insofar as a vital issue is concerned are about the proper construction of the sale contracts.

106 The principles which inform that exercise cannot be exhaustively stated although a great deal of assistance may be gained from the authorities. As the following examination of the authorities makes clear the present exercise involves the Court discerning:

· what was *the situation* of the parties at the time of contracting;

· what were the circumstances with reference to which the words were used.

Construction of commercial documents

107 As the Court is dealing with commercial documents, the contracts should be construed so as to be given a commercial, reasonable and rational operation (*Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd* (1968) 118 CLR 429 at 437; *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 at 109; *Hide and Skin Trading v Oceanic Meat Traders Ltd* (1990) 20 NSWLR 310 at 313-4; *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 per Giles JA at [64]).

Contextual considerations

108 At the end of the day every contract requiring to be construed must be treated with a very special regard to the particular context in which that particular contract was entered into.

109 In *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289

the High Court observed at 292-293 that:

"in *Codelfa* (1982) 149 CLR 337, Mason J (with whose judgment Stephen J and Wilson J agreed), had referred to authorities [In particular, speeches of Lord Wilberforce in *Prenn v Simmonds* [1971] 1 WLR 1381 at 1383-1385; [1971] 3 All ER 237 at 239-241; *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 261; and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 995-997; [1976] 3 All ER 570 at 574-576] which indicated that, even in respect of agreements under seal, it is appropriate to have regard to more than internal linguistic considerations and to consider the circumstances with reference to which the words in question were used and, from those circumstances, to discern the objective which the parties had in view. In particular, an appreciation of the commercial purpose of a contract.

"presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating".
[*Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 995-996 ; [1976] 3 All ER 570 at 574]

Such statements exemplify the point made by Brennan J in his judgment in *Codelfa* at 401:

"The meaning of a written contract may be illuminated by evidence of facts to which the writing refers, for the symbols of language convey meaning according to the circumstances in which they are used."

110 In the result the Court is entitled to inquire beyond the language and to

"see what the circumstances were with reference to which the words were used, and the object appearing from those circumstances, which the person using them had in view":
[*Prenn v Simmonds* [1971] WLR 1381 at 1384 per Lord Wilberforce]

Principles as to admissibility of evidence to identify subject matter of an expression used in an agreement/Resolving ambiguities

111 Evidence of the surrounding circumstances in which a contract was made, including evidence of mutually known or notorious facts and evidence of the common commercial objectives or the genesis of a transaction is admissible to resolve an ambiguity in the language of the written document: *Prenn v Simmonds* [1971] 1 WLR 1381 at 1384 1385 per Lord Wilberforce*; Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 995 - 996 per Lord Wilberforce; *Codelfa Construction Pty Ltd v State Rail Authority* (NSW) (1982) 149 CLR 337 at 350 per Mason J, *Brambles Holdings Limited v Bathurst City Council* (2001) 53 NSWLR 153.

112 An ambiguity may be taken to arise when a word or words [as for example a descriptive term] in a document, read in context and with the knowledge of an ordinary, intelligent reader, raise two or more plausible meanings where the context of the words in the document is taken into account in light of the knowledge any ordinary intelligent reader of the document would bring to the reading of it: *Burns Philp Hardware Pty Ltd v Howard Chia Pty Ltd* (1987) 8 NSWLR 642 at 657 per Priestley JA. Thus stated, the test for ambiguity is an undemanding one: *Manufacturers' Mutual Insurance Ltd v Withers* (1988) 5 ANZ Ins Cas ¶60-853 at 75, 343 per McHugh JA.

113 As Mason J said in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337 at 352:

“The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous of susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the

surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious, knowledge of them will be presumed.

It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intended or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parole evidence rule is to exclude them, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification."
[emphasis added]

114 Spigelman CJ in *South Sydney Council v Royal Botanic Gardens* [1999] NSWCA 478 observed as follows:

"It is permissible to look at surrounding circumstances for purposes of interpretation of a contract "if the language is ambiguous or susceptible of more than one meaning". (*Codelfa* supra at 352 per Mason J). As this passage indicates, in this context the word "ambiguity" - ironically a word not without its own difficulties - does not refer only to a situation in which the words used have more than one meaning. A broader concept of ambiguity is involved: reference to surrounding circumstances is permissible whenever the intention of the parties is, for whatever reason, doubtful. (cf. with reference to a similar issue in the context of statutory interpretation: *Bowtell v Goldsborough Mort & Co Ltd* (1905) 3 CLR 444 at 456-477; *Minister for Immigration and Ethnic Affairs v Teoh* (1994-1995) 183 CLR 273 at 287-288; *Cross on Statutory Interpretation* (3rd ed 1995) pp 83-84 .." [emphasis added]

115 In *Peppers Hotel Management Pty Ltd v Hotel Capital Partners Ltd* [2004] NSWCA 114 McColl JA put the matter as follows at [66]

"[69] If the words used [in a written contract] are unambiguous the Court must give effect to them, notwithstanding that the result may appear capricious or unreasonable, and notwithstanding that it may be guessed or suspected that the parties intended something different. The Court has no power to remake or amend a contract for the purpose of avoiding a result which is considered to be inconvenient or unjust. On the other hand, if the language is open to two constructions, that will be preferred which will avoid consequences which appear to be capricious, unreasonable, inconvenient or unjust, 'even though the construction adopted is not the most obvious, or the most grammatically accurate': *Australian Broadcasting Commission v Australasian Performing Right Association Ltd* (1973) 129 CLR 99 at 109–110 per Gibbs J (as he then was). However, in construing written contracts it should be presumed that the parties did not intend their terms to operate unreasonably. The more unreasonable the result a party's construction would produce, the more unlikely it is that the parties would have intended it. If the parties did intend an unreasonable result, it is essential that that intention be made "abundantly clear": *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 251 per Lord Reid.

The meaning to be conveyed to a reasonable person

116 In *Maggbury Pty Limited v Hafele Australia Pty Limited* (2001) 76 ALJR 246 Gleeson CJ, Gummow and Hayne JJ at 248 [11], quoted with approval Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912-913, to the effect that interpretation of a written contract involves "the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of contracting".
[emphasis added]

117 In *Investors Compensation Scheme* at 912 - 913, it had been said that;

"the background knowledge which a reasonable person in the position of the parties will be regarded as having, for the purposes of the construction of contracts, includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man with the proviso that it should have been reasonably available to the parties"[emphasis added]

118 The High Court decision in *Royal Botanic Gardens and Domain Trust* (supra) was handed down two months after the decision in *Maggbury*. The majority judgment [Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ] includes the following passage (at [39]):

"[R]eference was made in argument to several decisions of the House of Lords, delivered since *Codelfa* but without reference to it. Particular reference was made to passages in the speeches of Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society* and of Lord Bingham of Cornhill and Lord Hoffmann in *Bank of Credit and Commerce International SA v Ali*, in which the principles of contractual construction are discussed. It is unnecessary to determine whether their Lordships there took a broader view of the admissible "background" than was taken in *Codelfa* or, if so, whether those views should be preferred to those of this Court. Until that determination is made by this Court, other Australian courts, if they discern any inconsistency with *Codelfa*, should continue to follow *Codelfa*..." [emphasis added]

119 An issue presently before this Court in these proceedings involves whether or not Lord Hoffmann's observations made in *Investors Compensation Scheme* which had apparently received affirmation in the majority judgment in *Maggbury* may be followed at first instance. The question involves whether or not this Court can discern any inconsistency between on one hand, the approach to the principles of contractual construction taken in the United Kingdom decisions referred to [in the passage cited from *Royal Botanic Gardens*], and on the other hand, the decision in *Codelfa*.

120 I have been unable to discern any such inconsistency insofar as concerns the proposition that the interpretation of a written contract involves the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to a reasonable person in the position of the parties in the situation in which they were at the time of contracting. That was the approach taken in the majority judgement in *Maggbury*.

121 The material background knowledge which informs the relevant interpretation involves the fact that particular documents had been provided by one party to the other for examination. This parameter was not the subject of the focus given by Mason J in *Codelfa*.

122 An important consideration concerns the fact that in the instant proceedings Group knew that the material documents had been sent across to Ernst and Young and are taken to have reasonably inferred that the documents would have been duly inspected.

123 None of the above is inconsistent with the decision in *Codelfa.*

124 Whilst it is unnecessary to approach the issue in terms of constructive knowledge principle, it seems to me to be arguable that in this field of discourse a failure to make inquiries in terms of a proper examination of documents provided by one party to another, [provision of those documents constituting facts known to both parties], may also be analysed in terms of denying to the party who fails to conduct the necessary examination, constructive knowledge of that which was discernible from those documents: cf *Consul Development Pty Ltd v DPC Estates Pty Ltd* [1975] 132 CLR 373 where Stephen J (at 412) recognized that, in certain classes of cases, negligence in making inquiries may constitute constructive notice.

Sophistication of parties

125 I approach the question of construction accepting as part of the background that the parties to the contract can readily be described as sophisticated and experienced, and in the case of Macquarie Bank, a party which was advised by both external and internal accountants.

The particular problem raised by the present issues

126 The issues litigated raise a problem commonly faced where there is an attempt to rely upon negotiations anterior to the execution of a signed contract as *clearly* showing that all parties to the eventual contract were at all material times of a particular common intent. The problem is that which was alluded to by Mason CJ in *Codelfa*. It concerns the Court being asked to find which were and which were not, as part of the anterior negotiations:

· statements and actions of the parties which were reflective of their mutually shared actual intentions to be *bound* in some particular way;

· statements and actions of the parties which did no more than reveal the terms of the contract which the parties *intended* or *hoped* to make [which were subsequently superseded by and merged in the contract itself].

127 In relation to the present proceedings disparate evidence was given by particular witnesses as to their beliefs and understanding and communications concerning:

· how the price to be paid by the purchaser for the hotels was to be calculated;

· how the price which the vendor may be or was prepared to receive, was to be calculated;

· what the KPI summaries were and/or how they were made up;

· what words used in the sales contracts meant;

· how the Jetz system had operated.

128 The question whether or not the KPI figures are not true or accurate falls to be determined by considering:

· what the KPI figures were;

· what the relevant witnesses said in evidence as to what was communicated between them at the time the contract was being negotiated;

· the terms of the KPI summaries;

· the evidence from the two accounting experts.

What was warranted?

The submissions of CHG as to the context in which the warranty falls to be construed

129 CHG submitted as follows:

"(i) Here, the context includes Mr Ben Smith's statement to Messrs Russell and Facioni that "the only financials we will warrant are the wages and the takings" and his further statement "why don't we use the weekly KPI summary which we have all been working from during the last two

weeks?" (Affidavit 1 April 2005 at paragraph 25).

(ii) It also includes statements made by members of the Plaintiff's "management" to Mr McMorran that the KPI document was "effectively the management accounts for the business" and the "operating document that they ran their business on" and that "they kept an eye on" (T375.45) and the statements made to Mr McMorron by members of the Plaintiff's "business and management" that "the KPI schedule was the closest we were going to get to getting real business information" (T399.20).
[My emphasis to highlight that not even this evidence would suggest a representation of the reach claimed in CHG's case]

(iii) A further part of the mutually known context was the refusal of the Plaintiff to make available to Ernst & Young the Plaintiff's general ledger and the statement made in the relevant clauses of the contracts that, other than the warranty sued on, the Plaintiff made "no other warranty about the turnover, profitability, present or future takings of the business".

(iv) Those mutually known facts, and the wording of the Warranty itself, make clear that what the Plaintiff was warranting was that, as a matter of fact, the "information" contained in the KPI summaries was "true and correct, complete and accurate and not misleading in any respect". The warranty was given "for the period specified" in the KPI document, that is to say for the calendar year 2003.

(v) Thus, whatever use the Plaintiff's management may have made of the KPI Summaries, and regardless of the provenance of the information in them and the manner in which they were created, the Plaintiff was promising that, as a matter of fact, the "sales" in the Main Bar, Bottle Shop and Bistro of each hotel for 2003, and the Gross Profit generated by the Main Bar and Bottle Shop for each hotel for 2003, were as is stated in the KPI Summaries."

No audit by Ernst & Young

130 I am satisfied from the whole of the evidence that whilst the Ernst & Young report noted that there were some risks in relying upon the KPI figures, it is clear that the report did not purport to perform any audit by which the reliability of those KPI figures were analysed in detail and necessary adjustments made. Macquarie Bank had given no instructions to perform such an audit, nor did Operation/Group believe that any such audit was to take place or had taken place.

131 The evidence clearly established that the Ernst and Young report used the KPI figures in coming to their own conclusions in regard to EBITDA.

132 It must be remembered that the contracts for sale certainly did not in terms, warrant the accuracy of the conclusions of either the Ferriers' report or the Ernst & Young report as to EBITDA. The evidence clearly establishes that the Ernst & Young Report used the KPI figures in coming to their own conclusions in regard to EBITDA.

Dealing with the matter

133 In what follows I accept as of substance and adopt the submissions advanced by Mr Foster SC leading counsel appearing for Group.

What were the KPI figures?

134 As will appear from what follows, the KPI figures were built up as a management document. They were not 'accounting' documents as would have been Profit and Loss accounts.

What was not warranted

135 Group did not warrant that the expressions "Sales" or "GP%" in the Weekly KPI Summaries had any particular meanings.

136 Group clearly did not expressly warrant that the "Sales" figures recorded in the Weekly KPI Summaries did not include promotional, staff and discount meals and beverages and other transactions for which no payment was received or receivable from the customer.

137 Group did not expressly warrant that the "GP%" figures recorded in the Weekly KPI Summaries did take into account stock adjustments made in the ordinary course of business. Group did not give any express warranty that any particular expression in the Weekly KPI Summaries had any particular meaning.

What was warranted

138 What Group did warrant was the accuracy of "the information attached as Annexure "K" (Weekly KPI Summaries)". It is significant that the annexure is expressly identified in the warranty as "Weekly KPI Summaries". This makes plain that the parties intentionally annexed that particular document and that the information was being warranted as being accurate as information contained *in that particular document*.

139 This construction is reinforced by the fact that the coversheet to annexure "K" in each of the contracts is headed "Weekly KPI Summaries". The document annexed is itself headed "Weekly KPI Summary".

The word “information”

140 In order to ascertain what is meant by the word "*information"* in the warranty, the form and terms of Annexure "K" require to be considered.

141 The annexure is described both in the text of the warranty and in the coversheet to the annexure as *Weekly KPI Summaries*. The expression "Weekly KPI Summary" is not a term of art; does not have an ordinary English meaning; and is peculiar to the business being sold. Evidence was admissible in order to establish what the document is - ie what a "Weekly KPI Summary" is.

142 Included within the body of admissible evidence going to determining the nature of the document, was evidence explaining how it was compiled. Many of the terms used in the document require explanation.

“Sales” and “GP%”

143 The two terms germane to the present case ("Sales" and "GP%") have different meanings depending on the context in which they are used.

144 Hence, regard must be had to the background knowledge which the parties had as to the Weekly KPI Summary to properly construe the warranty. The finding is that CHG knew at least the following matters about the Weekly KPI Summaries:

i. CHG understood that "KPI" stood for "Key Performance Indicators" and knew that the Weekly KPI Summaries recorded Key Performance Indicators which Group used to manage their businesses (T375.45, T399.20);

ii. CHG knew that the Weekly KPI Summary for each hotel was an historical financial record which had been built up week by week as a result of Group following a settled accounting process (Smith, 1 April 2005, para 8, 9, 11);

iii. CHG knew that, in respect of the "Sales" figures recorded in the Weekly KPI Summaries, those sales figures were entered into the KPI Weekly Summaries each week by Mr Buffier, the General Manager of Club Hotels Group Pty Limited, from corresponding sales figures appearing in weekly trading sheets prepared by the managers of the respective hotels, which sales figures were ultimately derived from and calculated by the Jetz point of sale system (Smith, 1 April 2005, para 8, 9, 11); and

iv. CHG knew that, in respect of the "GP%" figures recorded in the Weekly KPI Summaries, those figures were entered into the Weekly KPI Summaries each week by Mr Buffier from corresponding figures appearing in weekly trading sheets prepared by the managers of the respective hotels, which figures were ultimately derived from and calculated by the Jetz point of sale system (Smith, 1 Aril 2005, para 8, 9, 11).

145 The finding is that CHG knew that, in respect of the figures for "Sales" and "GP%", the Weekly KPI Summaries recorded Key Performance Indicators produced as a result of following a particular accounting process and as ultimately derived from and calculated by the Jetz system.

146 As the parties to the contracts both knew these background facts about the Weekly KPI Summaries, by warranting the accuracy of the information in the Weekly KPI Summaries, Group relevantly warranted that the information in the Weekly KPI Summaries accurately recorded the Key Performance Indicators produced week by week during 2003 *in accordance with its usual accounting processes*.

147 Group did not warrant that if some external accounting standard was applied to the information in the Weekly KPI Summaries, then that information was true and accurate. Rather, Group warranted that the information contained in the Weekly KPI Summaries was accurate as *a record of the Key Performance Indicators produced within the system operated by the Cross-Defendants*.

148 Group did not warrant that the true earnings of the business for 2003 or the EBITDA of the business for 2003 was any particular figure. Nor did they warrant that the GP% for the business was any particular figure.

149 Hence, by warranting that the information in the Weekly KPI Summary was true and correct, complete and accurate and not misleading, Group was relevantly warranting that the "Sales" and "GP%" figures - as Key Performance Indicators *recorded in accordance with the usual accounting processes and ultimately calculated by the Jetz system* - were true and correct, complete and accurate and not misleading.

Finding as to what was warranted

150 The defendant's proposition that it was appropriate to treat the word "sales" appearing in the KPI figures in the same way as one would have treated that word had the warranty been concerned with conventional profit and loss accounts, is rejected. [cf Gower cross examination [transcript 429.45]

151 Hence a proper understanding of the very precise manner in which the hotel business operations had been fed into the KPI figures would seem to have been essential if reliance was to be placed upon those figures.

152 The finding is that for the above reasons there has been no breach of the warranty.

Alternative Finding

153 The following section deals with the circumstance that my approach to the question as to how one should interpret the KPI Summaries is incorrect. In other words, what would be the result in the event that the correct approach is to read the KPI Summaries independently of what was specifically

said or communicated by each party to the other in the time leading up to the eventual signing of the contract.

Sales

154 Even if one is able to accept (without more) that both parties knew that the KPI document was a tool for internal management, there is no firm indication that the term sales or GP% should be interpreted in one way or another.

155 The experts agree that there is no prescribed meaning of the term "sale" in the Australian Accounting Standards. There are definitions of the terms "sales revenue" and "revenue from sales", although these terms were not used in the KPI summaries. That the Australian Accounting Standards do not prescribe a definition of the term "sales" suggests that there is no agreed industry usage of this term.

156 The experts, Ms Lindsay and Mr Gower approach the question from different bases. Ms Lindsay asked what a reasonable person (who is involved in preparing and using financial documents) would take the terms "sales" to mean; whereas Mr Gower asks what an accountant would take the term "sales" to mean.

157 In my view, the correct approach is to ask what a reasonable person (who is involved in preparing and using financial documents) would take the terms "sales" to mean. The parties to the contract can readily be described as sophisticated and experienced, and in the case of Macquarie Bank, a party which was advised by both external and internal accountants.

158 It is the recognition of what the KPI Summaries were intended to achieve (that is to be a tool by which the management of the hotels could run the business) by which the Court can determine what the term "sales" objectively means.

159 The KPI Summaries are divided into the different businesses of the hotels, relevantly, the Main Bar, Bottle Shop and Bistro. The issue regarding promotional give-aways affects these three areas of the business. The KPI Summaries list, for each area of the business, "Sales" and "Gross Profits percentage". It is agreed between the experts that the gross profit percentage is calculated by:

$$\frac{\text{"Sales" less" Cost of Sales"}}{\text{"Sales"}} \times 100$$

160 As described by Mr Gower in his evidence, there is no difference in absolute terms between the method which he proposes and the method which Ms Lindsay proposes. It is convenient to set out the methods which each proposes by way of an example showing a two-for-one promotion assuming that the retail price of a steak is $15, it was purchased by the business for $6 (that is the raw piece of meat):

· **Mr Gower's approach**
The customer pays $15 which is recorded as a sale. The business loses two steaks, recorded as a $12 cost of goods sold. The net effect is a $3 profit. [$15 sale *less* $12 cost of goods].

· **Ms Lindsay's approach**
The customer pays $15, but a sale of $30 is recorded being the retail value of two steaks. The cost of goods sold is $12, being the purchase price of the two steaks. A promotional expense of $15 is also recorded representing the fact that the retail price of one steak was not actually paid by the customer. The net effect is a $3 profit [$30 sale *less* $12 cost of goods sold less $15 promotion]

161 Clearly, as the example shows, the absolute difference is the same. However, the relative difference (that is, the gross profit margin) is not the same. Under the Gower approach, the gross

profit margin is 20% whereas under the Lindsay approach the gross profit margin 60%.

162 Ms Lindsay discloses in her report that the components of the gross profit margin percentage are largely dependent on the "source of the underlying data, the context in which the resultant GP% appears and the purpose of the document in which it appears." There is nothing in the KPI summaries to suggest that anything apart from sales and cost of goods sold was taken into account in determining the gross profit percentage margin. Significantly, there is no line item that describes the promotional expenses of the business. And Mr Gower's expert report at Annexure J appears to show that no other factor is taken into account in determining the gross profit margin percentage in the KPI summaries.

163 Seen in this light, it might be said that the GP% under the Gower model is representative of a different outcome than the Lindsay model. Under the Lindsay model, the GP% represents the gross margin at which the goods are marketed to the public. Under the Gower model, the GP% represents the gross margin that is actually achieved by the business. A bare reading of Annexure K does not disclose which of these two outcomes the GP% represents as it is not disclosed whether the Gower approach or the Lindsay approach is adopted when the "sales" figure was formulated. However, understanding the differences between the GP% in the two approaches sheds light on how an objective reading of the term "sales" was intended to be used.

164 In my view, based on the known purpose of the KPI summaries as a management tool, the Gower approach is preferred in accounting for promotional give-aways, and as such, these give-aways should not have been included in the "sales" figure.

165 This is largely because of the lack of disclosure in the KPI summary regarding "promotional expenses". As such, a reader of the KPI summary would not be made aware that the "sales" figure included monetary amounts which were not actually received. The fact that "promotional expenses" are not shown in the KPI summaries (nor were they warranted under the Sale Contracts) also leads to that conclusion that, if one adopts the Lindsay approach, the utility of the KPI summaries as a management tool is drastically diminished. Otherwise management would not know if the sales figure actually represented goods paid for, or goods given-away.

Gross Profit Percentage

166 Although both experts clearly agreed on how gross profit is calculated, they did not express an opinion as to what amounts should be included in the "costs" side of the formula. Ms Lindsay states that the only cost to be taken into account is the actual cost to the business of purchasing the product. Mr Gower states that the costs to be taken into account is the purchasing cost *plus* costs associated with stock losses.

167 In light of the above finding, on the alternate ground, that the objective reading of the term sales (divorced from what the parties may have communicated with one another) is that it does not include give-aways, the finding in regard to the gross profit percentage must necessarily be that which Ms Lindsay has put forward.

168 For the same reason that the term "sales" should not be read so as to include give-aways because there is no discrete disclosure in the KPI summary as to what the value of these give-aways are; so the gross-profit figure should not be read as including stock adjustments, where there is no otherwise indication that such stock adjustments have been included.

169 Moreover, the use of the term "gross" as opposed to using no qualifying term or the term "net", to my mind, strongly suggests that what is being shown is the surplus that is being realised by the business in the sale of the product, ignoring all other costs involved in the actual sale of the product. That is, the term "gross" suggests that only invoiced costs are taken into account. An otherwise reading of this phrase to include costs associated with stock losses would result in the reader of the KPI Summary being unaware of whether other costs (above the invoiced costs) were being taken into

account. What comes immediately to mind are the costs associated with the performing of stock-takes and other revaluations of stock which result, for example, from increases/decreases or the writing off of stock.

170 During the due diligence process, Mr Buffier took Mr McMorron through an actual example of calculating the GP% figure from the figures in the Jetz system and comparing it to the result calculated by the Jetz system. In the course of performing that calculation, Mr Buffier showed Mr McMorron that the Jetz system calculated GP% on each individual item by using the invoiced cost of that item as the cost of goods sold. Mr Buffier then explained that the *"GP% figure listed on the trading sheets and the KPI are just an aggregation of the gross margin on all the products sold during any given week. So to answer your question, that is where it comes from." (Buffier, 21 October 2004, para 13).*

171 That explanation made plain that the "GP%" figures in the Weekly KPI Summaries did not involve calculating cost of goods sold by reference to opening stock or any stock adjustments. Mr McMorron stated that "inasmuch as the [Buffier] affidavit refers to E&Y's work and my conversations with Jason Buffier, I would not disagree with its contents" (Ex D6, para 22).

172 Further, Mr Green explained and demonstrated the operation of the Jetz system to Mr McMorron and Mr Bartlett (Green, 1 November 2004, para 4-20), including the fact that ".. The system reports to you a GP percent figure for any period which you select. The system calculates on the sale of each item a gross profit margin by taking the sale price of the item, less the purchase cost for the item on the assumption that stock is sold on the "first in, first-out" basis." (Green, 1 November 2004, para 16). Mr McMorron confirms that he attended the meeting and says that his recollection of the meeting accords with Mr Green's (Ex D6, para 23).

173 Hence I accept that taking into account what was explained directly and expressly to the accountants acting for Macquarie Bank and to Mr Bartlett, a reasonable person in the position of Macquarie Bank would have understood that the “GP%” figures in the Weekly KPI Summaries did not take into account stock loss adjustments.

No consensus to a set formula issue

Mr Bartlett’s concessions

174 At one point during his cross-examination, the Chief Executive Officer of CHG, Mr Bartlett, gave evidence that he was told by Mr Ben Smith, a director of Club Hotels:

“I don’t care how you work your price out. Our price is X and that’s that”.
[transcript p.203 at line 39-43]

175 Mr Bartlett then went on to accept the propositions:

· that as far as Mr Bartlett was concerned Mr Smith was not interested in multiples or EBITDA but was just interested in the price [transcript 203.52];

· that Mr Bartlett did not himself know whether whatever was said about price and multiples by Macquarie Bank personnel was *genuinely* their position [his evidence was that he never knew what they were thinking] [transcript 204.5];

· that it would not have surprised Mr Bartlett if the negotiations by Macquarie Bank included its making observations about multiples and EBITDA simply in order to ‘chisel’ the price down [transcript 205.26].

Finding

176 In my view the evidence establishes that the price negotiations, at least in so far as the Group were concerned, did not purport to be conducted as an arrangement that a set formula was to be complied with. This shows that, at the very least, both parties were conducting their negotiations with different principles in mind. The parties did not reach any consensus tying the ultimate purchase price to a formula under which the earnings multiplier was static.

177 This finding rejects the foundational underpinning of CHG's case. The arms length nature of the negotiations, the limited access provided to CHG in terms of financial records, the nature of the limited due diligence conducted by Ernst and Young, the detail of the evidence accepted as reliable as to the anterior communications and the actual terms of the express warranty combine to mandate this finding which is reached on the balance of possibilities.

178 The evidence that the plaintiffs were aware, at the very least, of the method by which Macquarie Bank *said* it was determining what it would offer for the hotels, does not alter this finding.

Damages

179 Bearing in mind the above findings it is strictly unnecessary to deal with damages. I propose however to examine how CHG put its case and to briefly treat with what I regard as the misconceptions which underpin that case as presented.

CHG's case as presented

180 CHG's cross claim, in regard to the Annexure K and the KPI figures, is that by reason of the plaintiffs breach of warranty, it paid too much for the four hotels. The argument proceeds along the following line:

· first, the purchase price was determined by a certain formula [this formula being known by Group];

· the formula was comprised of one variable and one constant;

· the variable was the EBITDA for the four hotels;

· the constant was an earnings multiplier;

· the *EBITDA* was a variable because its value was determined by the actual financial performance of the hotels;

· the *earnings multiplier* was a constant because it was an arbitrary figure determined by the purchaser according to its own financial needs and did not vary according to the value of the EBITDA;

· because Group overstated the EBITDA, this flowed on, through the formula, such that the purchase price was also overstated;

· accordingly, the loss *to CHG* is the difference between the purchase price actually paid, and that which ought to have been paid under the formula.

181 In final address [transcript 750] Mr Stevenson put the following particular submissions:

· Damages are the difference between the value of the hotels as warranted and their true value to the Defendant. The test includes an element of subjectivity: the issue is as to the Defendant's loss.

· Prima facie, the value of the hotels as warranted is the purchase price of $73 million. That prima facie position should be accepted as the fact in this case.

· As to the value of the hotels to the Defendant:

(a) Macquarie, as promoter of the Defendant, made an indicative offer of $74.5 million for the hotels.
(b) That indicative offer was made on the assumption that the EBITDA for the hotels was $10.43 million and that it would achieve a 14% yield.
(c) The purpose of the Ernst & Young due diligence was to test the assumption as to EBITDA.
(d) On the basis that the KPI figures were true, Ernst & Young determined that the "normalised" EBITDA was $9.965 million.
(e) On the basis of Ernst & Young's determination, Macquarie assumed that the EBITA for the hotels was $9.956 million.
(f) On that basis Macquarie negotiated an "adjustment" of the price from the indicative offer of $74.5 million to $73 million.
(g) Macquarie thus purchased the hotels on the basis of a 13.65% yield on EBITDA (or 7.326 multiple) (rather than the 14% yield (or 7.1428 multiple) originally sought).
(h) If the Ernst & Young methodology for assessing EBITDA had been applied using the true KPI figures for sales and GP%, have a lower EBITDA would have been produced, as calculated by Gower.
(i) Macquarie would have sought a price adjustment on the basis of that lower EBITDA.
(j) The Defendant's loss should be assessed by applying the 13.65% yield in fact obtained in negotiation with the Plaintiff to the shortfall in the EBITDA. That involves calculating the damages on the same basis as the price was calculated.
(k) On that basis the Defendant's loss is $3.432million (Gower Scenario 1) or $2.6192 million (Gower Scenario 13).

The principles

182 The basic rule is that stated in *Hadley v Baxendale* (1854) 156 ER 145 at 151:

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."

183 Where a party sustains a loss by reason of a breach of contractual warranty, the inquiry is to ascertain how such party, so far as money can do it, may be placed in the same situation with respect to damages, as if the warranted position had been correct: *Robinson v Harman* (1848) 1 Exch 850 per Baron Parke at 855: applied by the High Court in *Wenham v Ella* (1972) 127 CLR 454 at 471; *The Commonwealth v Amman Aviation Pty Ltd* (1991) 174 CLR 64 at 80).

184 In *Livingstone v Raywards Coal Co* (1880) 5 App Cas Lord Blackburn at 39 said that damages for breach of contract should be:

"...that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation."

185 Clearly quantum of damage is a question of fact

186 In *Senate Electrical Wholesalers Ltd v Alcatel Submarine Networks Ltd* [1999] 2 Lloyd's Law Reports 422, a decision of the Court of Appeal relied upon by CHG, cited the above and other authorities and went on (at [31]), to accept the proposition that in order to obtain damages for breach of contract a plaintiff had to prove a loss, adding:

"...if he has suffered no loss, has sometimes happens, he can recover no more than nominal damages...."

187 The Court of Appeal then (at [32]) referred to the assessment of damages as being *subjective* in the sense that the loss is loss sustained by the *actual plaintiff,* not some hypothetical plaintiff.

188 The primary and well established measure of damages for breach of warranty are such sum as will put the plaintiff in the position in which it would have been if the warranty were correct: an immediate measure of damages being the difference between the price paid for that which is purchased and the true value of that which is purchased at the time: *EW Blanch Pty Ltd v Cooper* [2005] NSWCA 217 per Giles JA (at [118]).

189 Hence absent an appropriate factual matrix which demonstrates the propriety of moving away from the conventional measure of damages for breach of warranty, that measure of damages will be the difference (if any) between the value of the assets sold as warranted and their market or actual value in fact.

190 I accept that there could be a case where, for example, the value to a purchaser of the asset being purchased was dependent upon synergies associated with the purchaser's existing other business interests: cf *Eastgate v Lindsay Morden* [2001] Lloyd's Law Reports 511 (at [33]). In that sense the loss may be described as loss sustained by the actual plaintiff, not some hypothetical plaintiff. However notwithstanding the attempts by CHG to establish a case to this effect, no such case was made out.

CHG's case on damages would have failed

191 The short position is that CHG's case on damages would have failed by reason of the finding that the price negotiations were not conducted in terms of any consensus tying the ultimate purchase price to a formula under which the earnings multiplier was static. The finding rejecting the foundational underpinning of CHG's case has already been set out. At the very least, both parties were conducting their negotiations with different principles in mind. The finding is not affected by the evidence that the plaintiffs were aware, at the very least, of the method by which Macquarie Bank *said* it was determining what it would offer for the hotels.

192 However there are other answers to CHG's case on damages. In the circumstances these can be dealt with fairly shortly. In what follows the submissions of Group are generally accepted and adopted.

Causation

193 Principally, the alternate ground on which CHG fails concerns causation. The search is to determine whether or not the loss claimed resulted from the breach as found. This is because where there is found to be a breach of contract and a loss suffered, the latter is not necessarily caused by the earlier: cf the fallacy *post hoc ergo procter hoc* - "a thing which follows another is therefore caused by it".

194 On CHG's case, the loss which is claimed to have been suffered is directly referable, to the EBITDA figures which were presented in the Ernst & Young due diligence report. CHG's case, it should be remembered, is that the sale price which was agreed upon was the product of a mathematical calculation, the two integers being the EBITDA figure and an independent number representing the yield to be made on the investment.

195 The breach which it has put forward was the misstatement of the sales and GP% figures in the KPI summary document.

196 The causation issue looks at, first, whether the mis-statement in the KPI figures led to the EBITDA figures in the Ernst & Young due diligence report being incorrect; and if so, whether this incorrect EBITDA figure led to CHG paying too much for its investment as alleged.

197 Although Mr Murdoch and Mr McMorron of Ernst & Young gave evidence, it was never actually put to them whether the EBITDA conclusion, which they set out in their due diligence report, would have been different had they been aware of the true sales and gross profit percentage figures. However, the appropriate inference to be drawn from the due diligence report itself read in the light of the evidence accepted as reliable is, that a change in the KPI figures would more likely than not have led to a change in the Ernst & Young calculations and accordingly its EBITDA conclusion.

198 This inference is drawn for two reasons. First, evidence accepted as reliable was given to the effect that the KPI figures were more reliable that the Ferrier Hodgson report, and/or that the KPI documents represented the information from which the continued business was run. Secondly, the due diligence report itself states that the process by which Ernst & Young conducted its due diligence was to "compar(e) revenue, gross margin (excluding bistro) and gross salaries and wages) [sic] included in the Ferrier Hodgson abridged financial information to week-by-week KPI Reports (represented to be "actual" results for 2003) and where available certain underlying business systems and supporting information". These reasons strongly suggest that where the Ferrier Hodgson report and the KPI documents presented different results, Ernst & Young preferred the KPI documents.

199 The second step in treating with the causation issue is to discover whether a change in the EBITDA figure, as found by Ernst & Young, would on the balance of probabilities have resulted in a change to the purchase price ultimately agreed upon.

200 Several hurdles stand in the way of CHG establishing an answer to this question in its favour. First, although the purchase price negotiations took account of the past EBITDA of the hotels, it also took projected EBITDA into account (as demonstrated by the several Macquarie Bank internal reports). Moreover, it appears that whilst the EBITDA figures changed in the Macquarie Bank internal reports, the purchase price did not. That is, the purchase price was not a function of an independent yield multiplier. [See Ex P17 and 21]. Indeed, some of the multiples disclosed in the different proposition summaries disclose that the earnings multiplier would be greater than that which was ultimately adopted.

201 Macquarie Bank did not treat the EBITDA as a defining factor in negotiating the purchase price, although it did clearly treat the EBITDA as a measure of the appropriateness of its investment. What this evidence suggests is that the earnings multiple/yield was only used as *a measure* of the appropriateness of the purchase price.

202 Importantly, no objection was taken to the purchase price in any of the proposition summaries on the basis of the EBITDA. Moreover, the final earnings multiple [and the one which results when CHG's true EBITDA is used], falls within the range of earnings multiples disclosed in the numerous proposition summaries.

203 Further evidence, by way of an email, [Ex P18] strongly suggests that Macquarie Bank was using the Ernst & Young due diligence report (and importantly its EBITDA conclusion) to justify to external parties the price it was paying for the hotels. It would indeed be curious to find the purchaser being willing to drag the purchase price upwards: however this is explicable if reference is made to external third parties.

204 In addition to all of this, the result of the parties actual negotiations was a purchase price which represented a yield to Macquarie Bank which was less than the 14% yield.

205 These factors justify a finding that whilst the EBITDA played *some* role in the parties

determining what the purchase price would be, it was not *the only* factor which was taken into account. I reject CHG's submission that it was the only variable in a formula which determined the ultimate purchase price.

206 The causation issue resembles the question "which came first the chicken or the egg?" However the evidence suggests that the purchase price was determined, *and that only then* was the multiple determined [as opposed to the converse]. Of course if the multiple were a number that Macquarie Bank considered was too high, it would revisit the purchase price. However, what the proposition summaries show is that what Macquarie Bank had in mind was not any precise multiple figure, but rather *a range* in which the multiple could fall and still be seen as appropriate. The ultimate multiple fell within this range, and the multiple calculated by reference to the EBITDA propounded by CHG also falls within that range.

207 Accordingly, CHG fails to establish that it has suffered any loss which can be legally attributed to a misstatement in the KPI/EBITDA figures.

Actual Market Value

208 Finally it is pertinent to note that CHG's proposition can only have validity if the process of applying a multiple to the 2003 EBITDA figure is a legitimate way of determining the true value of these businesses, yet there was simply no evidence that this process is an appropriate way to determine their true value.

209 Even if it be accepted that the method has some validity, there is no evidence that 7.326 was an appropriate multiple to apply to the 2003 EBITDA so as to arrive at a true valuation of the business. Mr Gower expresses no opinion on the appropriateness of the multiple (Ex. D7 para 49).

210 No evidence was led as to what the actual market value of the hotels was.

Security expenses

211 There is no substance to CHG's case in this regard.

CHG's submissions

212 CHG's submissions in relation to this issue were as follows:

· "The Vendors disclosed to CHG prior to the Contracts the existence of a weekly security expense of $3,700 per week. In fact, the true security expense was $9,110 per week.

· In the contracts relating to the hotel businesses, Group gave a "promise, representation and warranty" that the Vendor has disclosed to CHG the particulars of each contract material to the property and the business [clause 56.8 of the Purchase Contracts relating to Campbelltown Club Hotel and Mount Annan Club Hotel, and clause 53.8, 48.9 and 47.9 respectively of the Purchase Contracts relating to Leumeah Club Hotel and Wattle Grove Club Hotel].

· The disclosure of a weekly security expense of $3,700, when the actual weekly expense was $9,110 (see Mr Gower's report of 10 June 2005 Ex D7 para 31) constituted a breach of that warranty."

Decision

213 The starting point in terms of this question is the actual words of the contract. The relevant term states:

"As at the date of this contract and on completion, the vendor promises, represents and warrants that

the purchaser has disclosed to the vendor the particulars of each contract material to the property and the business."

214 In Annexure E of the Mt Annan hotel and Campbelltown hotel contracts, and Annexure D of the Leumeah Hotel and Wattle Grove hotel contracts, the security contracts were disclosed the fee arrangement between those relevant hotels and the third-party security provider, "Australian Venue Security". This fee arrangement was that there would be payable a flat rate of $27 per guard per hour, there being no fixed term price set.

215 CHG's submission is not that there was some other security contract which bound the hotels, nor that this $27 fee rate was incorrect. Rather, its submission is that Group failed to disclose what the actual security expenses incurred were.

216 The clear words of the contract state that what is being guaranteed is that Group would disclose to CHG all the terms of the contracts which bound the hotels. Annexure D/E of the relevant contracts met this obligation in regard to security contracts. There are no terms in the contract that require Group to warrant the historical security expenses of the hotels. These figures do not form apart of the KPI schedules, nor does the assertion that such a guarantee exists find comfort in the pre-contractual discussions between the parties.

217 CHG's submissions regarding security expenses are rejected.

The novation issue

Relevant Contractual Provisions

218 Each of the Sale Contracts for the hotels was dated 1 March 2004. In each case, the purchaser was stated to be "Macquarie Bank Limited as promoter of Leisure and Entertainment Acquisitions Pty Limited a company to be incorporated". [CHG (formerly Leisure and Entertainment Acquisitions Pty Limited) was incorporated on 12 March 2004]

219 Pursuant to section 131 *Corporations Act*, a promoter of a company can enter into a contract on behalf of a company before it is registered and the contract will become binding on the company if the company becomes registered and ratifies the contract within a reasonable time. However a company cannot by adoption or ratification obtain the benefit of contract purporting to have been made on its behalf before the company came into existence: in order to do so a new contract must be made with it after its incorporation on the terms of the old one: *Natal Land and Colonisation Company Ltd v Pauline Colliery and Development Syndicates Ltd* [1904] AC 120 approving *Kelner v Baxter* (1866) LR2CP174, *North Sydney Investment and Tramway Company Ltd v Higgins* [1899] AC 263.

220 Each of the sale contracts contains a special condition relating to novation (see special condition headed "Deposit and Novation", being special condition 57 in some contracts and special condition 60 in other contracts).

221 Relevantly, the special condition 57 provides:

(a) Macquarie may at any time prior to completion require Group to novate the contract [clause 57.1 (c)];

(b) If Macquarie elects to novate the contract prior to completion, Macquarie shall prepare and deliver to Group for execution the deed of novation in substantially similar terms as the deed of novation annexed to the contract, and Group shall execute the deed and deliver the executed document to Macquarie [clause 57.2(a)];

(c) If Macquarie does novate the contract, "*each promise, representation, warranty, covenant and other benefit of the purchaser [Macquarie] under and in connection with this contract is deemed to be for the benefit of Macquarie Bank Limited as promoter of Leisure and Entertainment Acquisitions Pty Limited, a company to be incorporated and the entity to which this contract has been novated as purchaser*" [clause 57.2(c)].

222 The form of the novation deed annexed to the contracts is in relevantly identical terms to the six novation deeds (one for each sale contract) that were in fact executed immediately prior to completion.

223 The next special condition (special condition 58 in some of the contracts and special condition 61 in others of the contracts) specifies conditions precedent to the purchaser's obligation to complete the contract. The conditions precedent include Group delivering on completion to the purchaser the deed of novation in substantially similar terms as the deed annexed to the contract duly executed by the vendor, a guarantee deed in substantially similar terms as contained in an annexure to the contract, and specified mortgages and charges executed by Operations in favour of the purchaser.

224 The executed novation deeds are dated 5 April 2004. The novation deeds provide that on and from the Effective Time, which is defined to mean 9.00 a.m. on 5 April 2004, the sale contract is novated to Leisure and Entertainment Acquisitions Pty Limited (which subsequently changed its name to CHG). However, clause 2(c) of the novation deed provides that the Incoming Party "*does not obtain any right or assume any obligation or liability under the Contract or otherwise, which accrued or arose before the Effective Time or relates to any act or omission before the Effective Time*."

225 The parties to the novation deeds are Group (as the vendor) (or Stokeston in the case of two contracts), Macquarie and CHG (then known as Leisure and Entertainment Acquisitions Pty Limited).

226 Also on 5 April 2004, the deed of guarantee and charges and mortgages were executed and delivered by Operations in favour of CHG.

227 Also on 5 April 2004, at about 11.30am (after the Effective Time of the Novation Deeds), CHG completed the sale contracts by paying the purchase price to Group (and Stokeston) in return for Group (and Stokeston) delivering to CHG executed transfers of the hotels to CHG.

228 Of the contractual warranties currently relied upon, all but one are expressed in the sale contracts to be warranties made both at the date of the sale contract and at completion. The other warranty is silent as to the time at which it is made, with the result that the warranty is made at the date of the contract. That warranty, which is contained in special condition 47.2 (in some contracts) and special condition 45.2 (in other contracts), is the warranty that the sales and profit margin information contained in Annexure K to the contracts (being documents described as "Weekly KPI Summaries") is true and correct.

229 The terms of the guarantee and indemnity given by Operations to CHG need to be kept in mind. The "guaranteed monies" is defined as meaning all amounts which CHG pays, suffers or incurs or becomes liable for arising out of or in connection with any promise, representation or warranty made or regarded as made in connection with a sale contract being or becoming false, misleading or incorrect.

230 Further, under clause 11.11 of the guarantee, it is stated, inter alia, that CHG cannot make a demand on Operations under the deed;

(i) in respect of a breach by any vendor under any of the sale contracts of a promise, representation or warranty contained in clause 47.2 or clause 45.2 (as the case may be) of the sale contract (being the clause warranting the accuracy of the weekly KPI summaries) after the date that is 183 days after the

date of the deed; and

(ii) in respect of a breach of any other promise, representation and warranty contained in the sale contracts, after the date that is 365 days after the date of the deed.

Group's contention

231 Group alleges that the rights arising out of any breach of the promises, representations and warranties made by it in the sale contracts were expressly retained by Macquarie Bank and were not novated to CHG under clause 2 (c) of the novation deeds.

Dealing with the issue

232 I am in a position to deal with the issue fairly shortly.

233 The sale contracts specifically contemplated a novation in the terms that in fact took place, and specifically provided that in the event of such a novation, the warranties in the sale contracts are deemed to be for the benefit of Macquarie as promoter of CHG (not for the benefit of Macquarie in its own right).

234 While the novation deed is a separate document from the sale contracts and was executed at a later time than the sale contracts, it is nonetheless apparent that the deed of novation in a form including clause 2(c) was contemplated in the sale contracts as being *the form* of agreement that would be entered into prior to completion. Accordingly, it is a proper approach to construing the novation deed to have regard to the terms of the sale contract and in particular the terms in the sale contract relating to the novation: see, for example, *McVeigh v National Australia Bank* [2000] FCA 187.

235 Group's construction of clause 2(c) of the novation deeds produces the commercially absurd result that a condition precedent to the purchaser being required to complete the contract was that Operations deliver a guarantee to the purchaser containing guarantee obligations that (if Group is correct) cease to have any effect upon execution of the deeds of novation.

236 The subject warranty was a continuing warranty. It continued *up to completion*. It continued *thereafter*. For that reason it cannot be said that:

(a) CHG had no locus to pursue its claims for breach of warranty;

(b) The reason for the conclusion in a is that those claims are comprised of rights which:

(i) only accrued or arose before the Effective Time or

(ii) only related to acts or omissions before the Effective Time.

237 It is appropriate to note that Group:

· whilst contending that notwithstanding that the words used in clause 57.2 (c) of the sale contracts plainly represent an endeavour by the parties to produce a deeming provision [deeming each promise, representation, warranty, covenant and other benefit of the purchaser under and in connection with the contract to be for the benefit of Macquarie Bank as promoter of the company to be incorporated];

· also contended that the deeming provision was as a matter of law ineffective.

238 Group relied upon the principle that:

"[i]f the words in a written contract are unambiguous, the Court must give effect to them, notwithstanding that the result may appear capricious or unreasonable and notwithstanding it may be guessed or suspected that the parties intended something different."
[Per McColl JA in *Peppers Hotel Management Pty Ltd v Hotel Capital Partners Ltd* supra]

239 However there is always a particular context against which each document or set of documents requires to be construed. Very special regard does have to be paid to the particular context in which that particular contract was entered into.

240 Reference has already been made earlier in this judgment to the authorities which support the proposition that when the Court is dealing with commercial documents, the contracts should be construed so as to be given a commercial, reasonable and rational operation.

241 The present context concerning a group of interrelated contractual documents obliges the Court to inquire beyond the language and to

"see what the circumstances were with reference to which the words were used, and the object appearing from those circumstances, which the person using them had in view":
[*Prenn v Simmonds* [1971] WLR 1381 at 1384 per Lord Wilberforce]

Rejection of Group's foundational submission

242 That exercise results in the rejection of Group's foundational submission that the rights arising out of any breach of the subject warranties given by it in the sale contracts were expressly retained by Macquarie Bank and were *not* novated to CHG under clause 2 (c) of the novation deeds.

CHG's rights against Operations

243 In any event and even if the above approach be incorrect, there is an alternative analysis of substance which however would deal only with CHG's rights against Operations under the guarantee (which in turn is secured by the charge and mortgage). The analysis is as follows:

· even if the deed of novation has the meaning contended for by Group and Operations, the *deed of guarantee* is not dependent upon the warranties being novated to CHG, and so long as CHG paid money or suffered a loss "arising out of or in connection with" any warranty being or becoming false, those monies and/or losses fall within the definition of guaranteed monies in the guarantee.

· There is no requirement under the terms of the guarantee that the warranties in the sale contracts be made to CHG, only a requirement that CHG suffers a loss arising out of or in connection with a warranty being or becoming false.

· Given that CHG paid the purchase price which had been negotiated based upon the warranties set out in the contract, then CHG would, and warranties been false, have suffered a loss arising out of or in connection with that falsity.

· Further, clause 11.11 of the guarantee, which imposes time limits on CHG making a demand on Operations in respect of a breach by Group of the contractual warranties, similarly makes it plain that CHG is entitled to make a demand on Operations under the guarantee in respect of a breach by Group of the warranties in the sale contracts.

Conduct of hearing

244 At the commencement of the hearing leading counsel for both groups of parties agreed that in substance the cross claimant was conveniently to be regarded as the moving party to present its cross

claim case. No submissions were addressed to the Court by the defendant/cross claimant to the effect that in the event of the cross claim failing, the plaintiff was not entitled to the relief it sought.

Short minutes of order

245 The parties are to bring in short minutes of order on which occasion costs may be argued.

I certify that paragraphs 1 - 245
are a true copy of the reasons
for judgment herein of
the Hon. Justice Einstein
given on 7 October 2005

_____
Susan Piggott
Associate
7 October 2005

LAST UPDATED: 11/10/2005