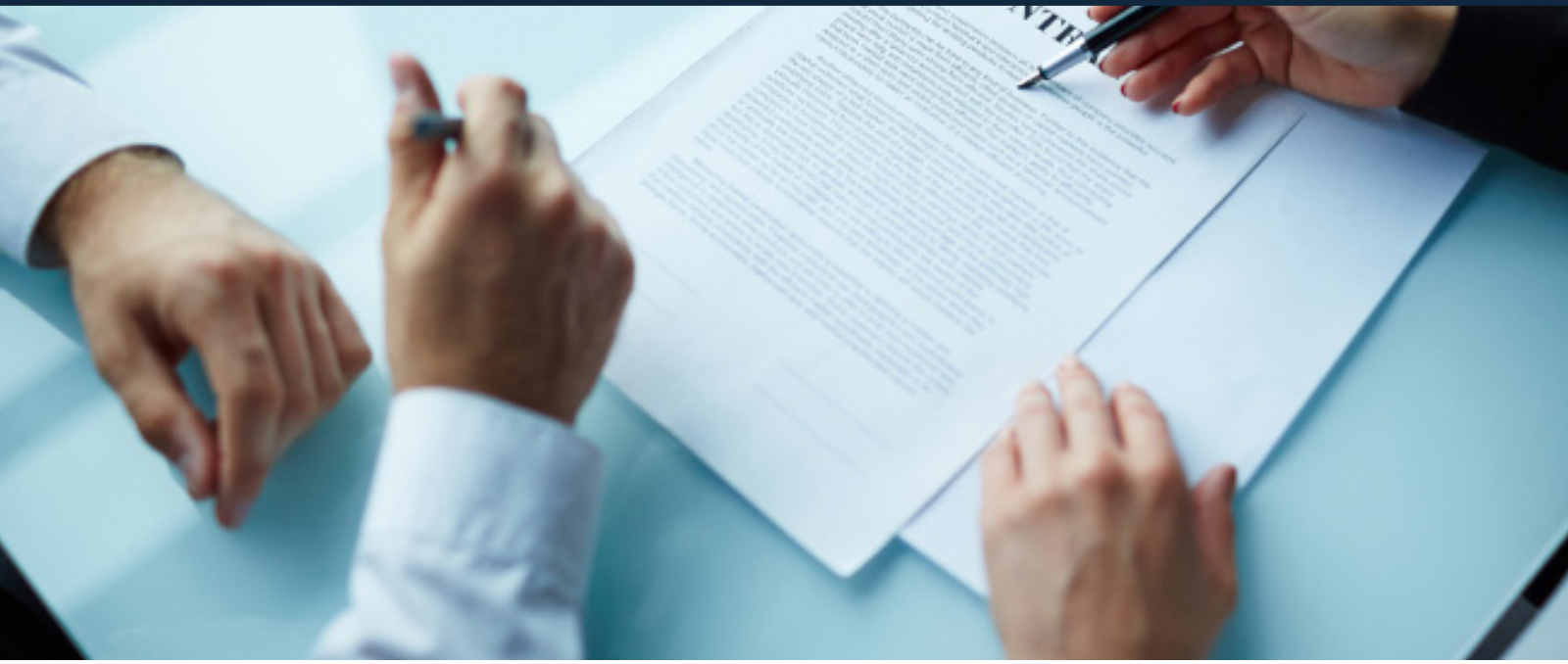
BROADLEY REES HOGAN



MORE THAN A MATTER OF SEMANTICS

Never make a promise you can't keep

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The recent decision of *Semantic Software Asia Pacific Ltd v Ebbsfleet Pty Ltd* [2018] NSWCA 12 (**Semantic Case**) serves as a warning to directors and companies of the risk in making needlessly daring promises in contractual agreements.

Background

In 2012 and 2013 Semantic Software Asia Pacific Ltd (**Semantic**), a software development company, raised money from investors to fund the research and development of new software. During this period, Ebbsfleet Pty Ltd and McGee Pty Ltd, as trustees of a self-managed super fund (together referred to as **Ebbsfleet**) entered into 10 separate share issue agreements with Semantic for the subscription of 6.5 million shares for a total value of $1,625,000 (**Share Agreements**).

The investments were preceded by extensive communications between Ebbsfleet and Semantic's sole director Mark Bradley (**Bradley**) as well as an "Investor Pack" provided by Semantic. The documents within the Investor Pack made a number of representations to prospective investors as to the potential returns an investment may yield. The promises ranged from a 'guarantee' that shares would triple within two years and went so far as to claim that shares would increase tenfold "within three years or sooner".[1]

1 *Ebbsfleet Pty Ltd as trustee for Ebbsfleet Superannuation Fund v Semantic Software Asia Pacific Ltd (No 3)* [2017] NSWSC 78 [23]

Pursuant to the statements made in the Investor Pack, Bradley, personally and on behalf of Semantic, again assured Ebbsfleet that the shares would triple in value within two years of issue.

The Problematic Promise

Clause 46 of the Share Agreements stated that:

> *The Director of the Company, Mark William Bradley, a Party to this Agreement as Guarantor in respect of this clause, warrants that Investor's Issue Shares* **shall triple in value within two years** *from the date of this Agreement and should Issues [sic] Shares not so triple in value,* **Mark William Bradley must transfer additional shares** *from his personal and/or beneficial shareholdings sufficient to effect said tripling in the value of Investor's Issue Shares.*
>
> ...
>
> *Mark William Bradley further warrants that he* **must retain at least 10,000,000 shares** *in his beneficial ownership to satisfy this Guarantee...*
>
> *(emphasis added)*

This clause ultimately encompassed three promises to Ebbsfleet, these being that:

1. The shares would triple in value within three years;

2. In the event the shares do not triple in value within this period, Bradley must personally provide adequate shares to sufficiently effect the tripling that was promised; and

3. Bradley must personally hold 10,000,000 shares in Semantic so as to be able to fulfil the second promise.

Ultimately the shares did not "triple in value". Rather, they crashed to such a low that throughout proceedings, the court deemed them to be "essentially worthless".[2] Furthermore, Bradley sold all of his shares following the execution of the Share Agreements.

The First Court Appearance

Proceedings commenced in the Supreme Court of NSW in 2017 on two grounds.[3] Firstly, Ebbsfleet claimed that Bradley and Semantic were in breach of the Share Agreements by breaching the warranty given as to the value of the shares.

The second cause of action was based in misleading and deceptive conduct. Ebbsfleet alleged that the representations as to the future value were made without reasonable basis and that the statements were accordingly misleading for the purposes of the Australian Consumer Law.[4]

The Supreme Court in the first instance found in favour of Ebbsfleet on both grounds and against both Semantic and Bradley.

As Bradley no longer owned any shares in Semantic, the breach could not be remedied through a 'share transfer' as stipulated in clause 46. The court held, however, that the wording in clause 46 did not make a transfer of shares the exclusive remedy available to Ebbsfleet.[5]

In respect of the breach of contract, Semantic and Bradley were ordered to pay damages so as to place Ebbsfleet in the position as if the contract had been performed and the warranty been made good – an ultimate return of $4,875,000.

For the misleading and deceptive conduct, Bradley was ordered to pay Ebbsfleet an amount equivalent to the value of the lost investment ($1,625,000). The court noted "[a]s the shares are worthless, or practically worthless, [Ebbsfleet] have lost virtually all of that investment".[6]

The effect was that both Bradley and Semantic would be required to pay to Ebbsfleet an approximate total of $6,500,000 for the contractual breach and misleading and deceptive conduct claim.

The Appeal

The decision of the Supreme Court was appealed by Semantic and Bradley.[7] Semantic argued that the clause 46 warranty was made solely Bradley and not by Semantic.

2 Ibid [128].
3 *Ebbsfleet Pty Ltd as trustee for Ebbsfleet Superannuation Fund v Semantic Software Asia Pacific Ltd (No 3)* [2017] NSWSC 78.
4 *Competition and Consumer Act 2010* (Cth) Sch 2 s 18.
5 Ibid [58].
6 Ibid [128].
7 *Semantic Software Asia Pacific Ltd v Ebbsfleet Pty Ltd* [2018] NSWCA 12.

Semantic further argued that Stevenson J erred when he held that Semantic was also joined in the making of all warranties in the relevant schedule of the Agreement, due to a separate clause that stated:

> 6.4 "*[Semantic] warrants to [Ebbsfleet] that:*
>
> ...
>
> *The Warranties are true and accurate in all respects*"

Stevenson J held that the failure to meet the clause 46 warranty therefore resulted in a breach by both Bradley and Semantic.

The Court of Appeal agreed with Semantic and upheld the view that the clause 6.4 warranty simply constituted a promise and affirmation that Bradley had given the warranty in clause 46. Their Honours stated that clause 6.4 only bound Semantic to those warranties which Semantic itself made and did not extend to any contractual promise made by Bradley.[8] It was held that the operation of clause 6.4 did not have the effect of joining Semantic into the warranty under clause 46 as that had expressly stated to be given by Bradley alone.[9]

Whilst the Court of Appeal overturned the primary judge in respect of the contractual promises purportedly made by Semantic, it upheld Stevenson J's decision in respect of clause 46 and the warranties binding Bradley.[10] It affirmed the finding that Bradley alone had warranted the share value and that Bradley alone was liable to Ebbsfleet for the breach.[11] In doing so the Court of Appeal also affirmed that relief was not limited to the transfer of shares.[12]

In respect of the misleading conduct, the Court of Appeal overturned the original judgement, finding there to have been insufficient reliance by Ebbsfleet on the representations.[13]

Accordingly, the damages were reduced by over $1,500,000, with Bradley alone required to pay damages of approximately $4,950,000.

The Outcome

The decision serves as a salient reminder to never make a promise you can't keep. Parties to a contract must take the utmost care in the promises they make and avoid making unnecessarily bold warranties or statements, particularly as they relate to future performance.

The promises you make are more than just a matter of semantics.

For more information regarding contract law issues, contract drafting or negotiations, please contact Gina Bozinovski.

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8 Ibid [163].
9 Ibid [152].
10 Ibid [147].
11 Ibid [168].
12 Ibid [154].
13 Ibid [186].