

Corporate

FOLLOW THE CONTRACTUAL PROCEDURES

Importance of Complete Compliance

An English Court of Appeal decision – *Trealt plc v Barrett and Others* – given in February 2015, highlights the importance of ensuring that contractual provisions as to procedural matters are fully complied with. The Court of Appeal decision upheld an earlier High Court decision in the same matter.

Commercial contracts have provisions dealing with the essence of the contract, the sale of the shares, the supply of the product, the price to be paid (and how it might be adjusted) etc. and also provisions dealing with procedural matters such as service of notice.

This case illustrates that failure to follow agreed procedural steps may have significant commercial implications for the parties and that doing “substantially the same thing” may not be enough to protect contractual rights.

The key facts

- Trealt plc (**T**) had agreed in April 2008 to purchase the shares of two companies from a number of selling shareholders (collectively **B**) under a Share Purchase Agreement (**SPA**).
- The purchase price was to be paid subsequent to the transaction completing and was to be based upon audited accounts of the target companies for two relevant years, being 31.12.2010 and 31.12.2011. 31 December was the date to which the target companies made up their accounts each year.
- The SPA provided that the earn-out consideration would be the average of the aggregate pre-tax profit or loss of the target companies as shown in the audited accounts for those two years, subject to certain adjustments as set out in the SPA.
- T had a period of five months from 31.12.2011 in which to serve an earn-out notice specifying its view of the amount of earn-out consideration payable.
- The contract provided that if a valid earn-out notice was not served, the parties were deemed to be in dispute as to the amount of the earn-out and the matter would be referred to an expert for a final and binding determination.
- At the time of entering into the SPA the parties knew that T prepared its audited accounts to 30 September in each year. While the SPA protected the interests of the Sellers in relation to the earn-out by various provisions as to the manner of preparing the accounts to be used to calculate the earn-out, it provided that the Purchaser was not precluded from changing the accounts reference date for the target companies. T did so change the audit reference date to 30 September.

When the time came to serve an earn-out notice, T calculated its assessment of the amount of earn-out payable by reference to two sets of audited accounts made up to 30.09.2010 and 30.09.2011 respectively, which T adjusted by reference to management accounts so as to arrive at figures for the twelve calendar months ending on 31.12.2010 and 31.12.2011.

The findings

It was held by the High Court at first instance that as T’s earn-out notice was not based on audited accounts made up to 31 December in each of the two years, a valid earn-out notice had not been served within the contractually required time.

On appeal by T, the Court of Appeal upheld the High Court judgment.

The High Court case also considered whether the purported earn-out notice had been validly served.

The SPA provided that the notice could be served by sending it by pre-paid first class post, however serving the notice by email would not constitute good service for the purpose of the SPA. It

was accepted between the parties that an email serving the earn-out notice was sent by T and was received by B so that there was no dispute that B did as a matter of fact know of T's calculation. While the evidence of the parties differed as to whether the earn-out notice was also served by pre-paid first class post, having heard the evidence, the High Court ruled that it had been so served. Had the High Court not so ruled the consequence would have been that B could have taken the view that no earn-out notice was properly served and that the earn-out was thus to be determined by the expert. It would not have been enough that B undoubtedly had received T's calculation of the earn-out (and could have disputed it) if it did not receive it in the manner specified in the contract.

Conclusion

In dealing with post contract matters it is critical that parties review and adhere to the procedures agreed in the contract to avoid the risk of adverse and unexpected consequences.

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