



Warranties and indemnities

Andrew Lockhart-Mirams asks if you know what you are signing.

What is a warranty?

A warranty is a contractual statement which takes the form of an assurance from one party to another regarding a matter of circumstances. Simply put, a warranty can be seen as a promise from one party to another in relation to a set of facts.

Warranties are often seen in sale and purchase agreements (SPAs) and are given by the seller to the buyer, typically relating to the condition of the business being sold and any existing liabilities.

But, warranties are also found in non-transactional contracts, for example in the standard GDS contract. In this example, a warranty may take the form of an assurance from the contractor to NHS England, stating that: "[...]

all information in writing provided to the PCT(NHSE) in seeking to become a party to this contract was, when given, true and accurate in all material respects [...]"

Warranties can be given by both parties to the contract and therefore may be given by the contractor or NHS England.

What is an indemnity?

Indemnities and warranties are often confused with one another and can be seen to have similarities. However, an indemnity is a promise one party gives, to meet a specific legal liability of another. As stated above, a warranty is a statement affirming a matter of circumstance.

An indemnity may, for example, provide that party A will indemnify party B against costs, expenses, damages and losses suffered arising out of any claim made by an employee of party A.

A comparable warranty may state something along the lines of: "Party A warrants that there are no current or potential disputes with any of the employees of party A."

It is possible to indemnify against loss suffered as a result of a breach of warranty.

Warranties specifically found in a transaction

Warranties serve two main purposes within a transaction:

- 1) To provide the buyer with a remedy (a claim for breach of warranty) if the statements made about the target business later prove to be incorrect and the value of the business is thereby reduced. Warranties therefore provide a form of retrospective price adjustment.
- 2) To encourage the seller to disclose known problems to the buyer. As the seller's liability under the warranties is invariably limited to the extent that proper disclosure is made against them, the effect of the warranties should be to flush out potential problems.

Examples of warranties

The warranties will often reflect the information provided by the seller as part of the due diligence exercise (the fact finding exercise carried out by the buyer and his professional advisors about the seller's business). Where concerns are raised when carrying out due diligence, specific warranties should be included in the SPA addressing these (or, if more appropriate, indemnities should be requested against the liabilities). All transactions will also have a number of



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general warranties.

Warranties may, for example, cover or provide that:

- All information provided by the seller or his advisors as part of the due diligence process is correct (as far as the seller is aware).
- The seller has not done, or is aware of, anything that could give rise to a potential employment claim from an employee of the practice.
- The seller is not aware of any act or failure to act that may give rise to the practice being reported to the GDC, CQC or NHS England.
- Equipment is in a state of reasonable repair and condition (less any fair wear and tear).
- No environmental laws have been breached.

Warranties will also be provided against the state of any premises or property, however these may be found under separate property documentation.

Warranties in the SPA

The seller's solicitor will often attempt to limit the effect of warranties in the SPA, or remove them.

Disclosures

If a warranty is disclosed, this can protect the seller from a breach of warranty claim.

A disclosure will outline why a warranty is not true and cannot be given. Once a warranty is disclosed against, the buyer will be aware the warranty cannot be given and therefore cannot claim for a breach against that warranty.

As a seller, it is therefore vitally important to review the warranties you are giving and to ensure you disclose against the ones you are not able to give. It is important to note the buyer will consider the disclosures made and consider whether it is commercially viable to continue with the transaction. If acting as a buyer, do consider in depth the disclosures made and ask for more information where required.

Once disclosures have been made, the buyer is in a position to make an informed decision about how to proceed and could, for example, seek a specific indemnity from the seller against any liability arising from that specific disclosed issue.

Disclosures will be recorded in a document called the 'disclosure letter', addressed from the seller to the buyer. It is standard practice for the buyer to sign the letter accepting the disclosures and indicating they are aware of them.

Share purchases or sales

Where a buyer is acquiring shares in a company, additional warranties and indemnities will be required. This is because unlike in an asset purchase, all liability remains with the company being sold. As the buyer acquires the company (or part of it) they also acquire all attached liabilities. In an asset purchase, liability will remain with the seller as only the assets are transferred.

Legal and administrative disclosures

In certain cases an experienced dental lawyer may split out due diligence enquiries into legal enquiries and administrative enquiries. Administrative enquiries may include investigations as to:

- Whether the autoclave or compressor has been correctly maintained and has a valid and in date safety inspection certificate.
- How the patient records are kept and how they will be transferred to the computers of the new buyer (if relevant).
- If patients are referred to other surgeries and on what basis.

This may save time and reduce the costs as the solicitor involved will be able to concentrate on the legal matters and production of purchase documentation.

Ultimately, the buyer will want to request warranties in respect of the above, and will likely require confirmation that the information provided is true and accurate in all material respects.

If a warranty is breached

In the event a warranty is breached, in the context of an SPA, this gives rise to a claim for breach of warranty by the buyer against the seller. It may also be possible to terminate a contract, but not to rescind it. Termination will only be possible depending on the breach and the terms of the contract.

As above, in the event a warranty is breached in a non-transactional ➡

Contract, the recipient party of the warranty may sue for breach of warranty and therefore be able to recover damages for any loss suffered.

Individual contracts will outline procedures to be followed in the event a claim for breach of warranty is to be brought. Typically, a breach of warranty is actionable within six years of the date of agreement if a contract is used, and 12 years if a deed is used. Contracts or deeds may however contain other agreed terms, for example: "No claim under the warranties shall be deemed to have been made unless notice of such claim was made in writing to the seller by or on behalf of the buyer, specifying in reasonable detail the nature of the breach and the amount claimed before the expiry of 18 months from the completion date."

Often, the seller is also permitted the opportunity to attempt to resolve the breach within a given time.

A maximum cap to the value of a claim may also be negotiated into a contract, for example: "The aggregate maximum liability of the seller in respect of all and any claims under the warranties shall in no event exceed the purchase price (or a specific figure may be given for example £50k."

Indemnity and warranty insurance

Where there are concerns that a party may not be able to financially meet the value of a claim against an indemnity or warranty, it may be beneficial to arrange warranty and indemnity insurance. This should be discussed with an insurance broker.

If such insurance is arranged, in the context of a sale of a practice,

the seller's solicitors should ensure the SPA contains terms requiring the buyer to make any claim, under the warranties or any indemnities, against the insurance policy first.

Are warranties representations?

A representation is a statement which relates to a matter of fact or present intention, made during contractual negotiations, which the parties do not ordinarily intend will become a contractual term, but which may induce another party to enter into a contract.

Typically, a breach of representation may entitle the person receiving the representation to a remedy for misrepresentation (under the Misrepresentation Act 1967) or breach of contract. In some circumstances it may also be possible to void and rescind an agreed contract (rescission is not possible for a breach of warranty).

In the case of *Idemitsu Kosan Co Ltd v Sumitomo Co Corp* [2016] EWHC 1909, the High Court considered whether contractual warranties given by the seller in a share purchase agreement were capable of giving rise to action for misrepresentation.

The claim was brought by the buyer on the basis that matters warranted by the seller were untrue as of the date the SPA was created. It was argued that these warranties were also, by their nature, representations and should give rise to a claim for misrepresentation. Though the SPA indicated they were warranties, it was argued that this did not mean they could not also form representation.

Ultimately, the court decided against this argument on the basis

that a warranty is provided within a contract, and that contract provides that a party only gives that warranty; finalisation and execution of that contract does not make any form of statement or representation to the other party that would allow for a claim of misrepresentation.

Furthermore, the court decided that the claim was defeated by an 'entire agreement' clause which stated that the buyer had agreed and acknowledged that it had not relied on or been induced to enter into the SPA by any representations or warranties other than the warranties listed in the SPA.

However, the court did accept that in principle, depending on the facts of an individual matter, it would be possible that specific language used communicating a negotiating position or draft contract could amount to a pre-contractual representation capable of founding action for misrepresentation.

Conclusion

It is extremely important to understand any warranties you are giving and to appreciate the extent to which you may be held liable in the event they are untrue.

If you are the recipient of warranty from another party, do not rely on it when deciding whether to contract with that party. Consider whether you require any specific additional warranties, particularly if you have concerns regarding any form of liability.

If a warranty is breached, ensure all contractual steps are adhered to, either if you intend to make a claim or if a claim is made against you.