

Principal Warranties

Accounts

A buyer will generally have agreed in principle to purchase the target company on the basis of audited accounts and financial statements. It is almost invariably warranted that the accounts give a "true and fair view" of the company. This is the formulation which auditors must sign off on under the Companies Act legislation. Sellers would not usually give a warranty beyond this.

A provision might be made in accounts, for example in relation to a possible liability which may be acceptable in accordance with accounting practice. Warranties are not generally expected to promise, in absolute terms, the accuracy of the provision. There are other items in accounts which are not appropriate to an absolute warranty because this is inconsistent with the manner in which accounting treatment works.

Warranties will typically deal with post audit management accounts covering the period since the latest financial accounts. The same level of warranties will not be appropriate as financial accounts. Management accounts by themselves have a different function and would not be audited.

Warranties would usually be required in relation to the business since the accounts date. It would be usual to confirm that there have been no new significant contracts, disposals or adverse changes. The seller would not be expected to warrant the future profits or position of the company.

Property

Treatment of property ownership varies from sale to sale. If there are one or relatively few properties, the buyer's solicitor may investigate title, in which event relatively few

warranties will be given. In effect, the warranties will be constituted by the answers to the standard property enquiries.

If there are a significant number of properties, then the seller's solicitor may provide a certificate of title dealing with properties with which he may be familiar. If this is the case, it will reduce the amount of property warranties required. Alternatively, if there is neither investigation of title nor a certificate of title, a significant number of property warranties will be given over a range of matters from title, planning, building control and compliance in respect of a whole range of issues which prospectively affect the value of property.

In addition to property assets, the buyer will want assurances in relation to other assets. For example, plant and equipment could be subject to hire purchase, conditional sale or lease agreements. A buyer will want assurance that there is title to the business assets. It may also require confirmation of the state of repair and conditions of the machinery concerned.

The need for environmental warranties will depend on the circumstances. Under English law environmental liability is potentially significant. There is a contaminated land regime under which owners of contaminated land can be made liable for the cost of clean up of past contamination. An indemnity may be given to deal with specific environmental issues or possible remediation requirements, where the land is particularly risky e.g. oil depot.

It is normally warranted that assets are properly insured in accordance with normal business practice, that there are no outstanding claims and there is no reason known why insurance would be avoided.

Intangible Property

Intellectual property has grown in importance. It will be particularly important in certain companies. Patents, trademarks and equivalent rights which are not registered can be a very valuable company asset. Warranties will be required in relation to their status.

Most business will require licences in relation to the use of software, which may have been purchased or licensed from a third party.

Information technology has gained in importance and the seller will be required to disclose details of IT systems, terms and conditions of maintenance etc.

Contracts and Finance

The buyer will want warranties in relation to materials contracts and the terms of business. Sometimes commercial contracts can be terminated where there is a change of control of the company. They may contain onerous terms or there might be outstanding claims under them. All of this needs to be carefully warranted.

The buyer will want warranties regarding the existing banking and loan facilities of the company. The buyer may wish to purchase the property debt free in which event it is necessary that part of the price is applied in procuring repayment of existing bank borrowing. If the buyer is taking over existing bank borrowings, it will want comfort in relation to their terms and conditions.

Employees

The status and rights of employees will be significant in both a business (asset) transfer and share purchase. The buyer will want full assurance that there has been compliance with all employment legislation including obligations in relation to information and consultation. The buyer will want details of employment agreements, trade union agreements, full details of salaries and terms of employment. Details of all employment

terms and promises made must be disclosed as they will be binding on a company purchase.

When a business is being purchased, TUPE automatically transfers the employees to the buyer, including outstanding obligations. There are also detailed consultation obligations and provisions dealing with certain dismissals in connection with the transfer. They may be deemed unfair unless they can be justified and appropriate procedures are followed.

Pension warranties are important. The cost of pension promises made to employees can be extremely onerous. In addition, pensions are regulated and significant issues can arise in relation to adequacy of funding. At the very least, the buyer will want warranties in relation to the existence of pension schemes and that they do not contain hidden surprises.

Regulatory Compliance

Many businesses are regulated and must comply with legislation. In many cases the business can be subject to regulatory sanctions or be closed down if it is not compliant. Regulatory legislation may require records etc. to be kept. There is usually a warranty to the effect that regulation and registration requirements have been complied with.

Tax Warranties and Indemnities

There is usually a tax indemnity dealing with unexpected tax claims arising after completion due to pre-completion transactions and events. The tax indemnity or covenant or deed will cover pre completion tax liabilities which are not dealt with in the accounts or do not arise in normal course of trading or not otherwise disclosed. They will also cover situations where tax reliefs were assumed to be available at closing but which prove not ultimately to be available. If there are identified tax risks or liabilities, the tax covenant may cover them specifically.

There will generally be both tax warranties and indemnities. The indemnity would generally be a stronger basis for recovery than the tax warranties. In the case of asset purchases, tax warranties would be much more limited and relate to matters such as ongoing VAT and PAYE accounting.

The tax indemnity is usually drafted in favour of the buyer. Previously, it was common to provide the indemnity in favour of the company. This has certain adverse taxation consequences and is not now usually done. Tax covenants will generally be given by the same sellers who give the general warranties.

The seller will generally seek to exclude liability for liabilities arising in the normal course of business, those provided for in the accounts, those arising by retrospective changes in the law or caused by voluntary acts of the buyer.

Where the sold company is a member of a group, it will be necessary to include provisions to deal with the implications of the company leaving the group.

A seller will seek to impose limitations on the tax indemnity. There will generally be a maximum liability cap usually for the amount of the purchase price. The liability period is normally for 6 to 7 years. Unlike the case of warranties, buyers will rarely accept any limitation of liability under the covenants.

Tax covenants usually provide a mechanism for the seller to take control of the conduct of the claim given rise to liability. The seller would normally be notified as soon as reasonable practicable.

Full Disclosure

The buyer may seek confirmation that the seller has given all information which ought to have been produced in order to allow the buyer to make a proper assessment and does not know of anything which could affect the decision to buy. This will be resisted by the

seller as being too wide. They will argue that it is a matter for the buyer to assess the prospects and that a seller should not be held to such a wide and potentially vague obligation.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.

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