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BREACH OF WARRANTY CLAIMS: THE DEVIL IS IN THE DETAIL

We recently considered the position of buyers wanting to bring a breach of warranty claim who are faced with unclear notification provisions in the purchase agreement. In this publication, we consider the case of *Teoco UK Limited v Aircom Jersey 4 Limited and others* [2015] EWHC (Ch) and the perils of a tentative warranty claim notification letter.

In the *Teoco* case, the seller successfully applied for parts of the purchaser's breach of warranty claim (worth an estimated £3.5m) to be struck out as having no reasonable chance of success because of deficiencies in the purchaser's notification letter.

NOTIFICATION LETTER

The SPA contained standard contractual notification provisions which said, "*No Seller shall be liable for any Claim unless the Purchaser has given notice to the Seller of such Claim setting out reasonable details of the Claim (including the grounds on which it is based and the Purchaser's good faith estimate of the amount of the Claim…)*". Once notified, the purchaser had six months to issue and serve a claim against the seller.

In February 2015, the purchaser's solicitor sought to notify the seller of various claims being made against it relating to the target's tax liabilities. However:

- the letter was tentative. Although the introductory paragraphs of the letter referred to "*the existence of Claims*", the rest of the letter was couched in terms of "*tax exposures* [which] *may exist*", "*potential… liabilities*", "*possible quantum*" and the results of a "*preliminary*" report by PwC, all of which indicated that certain tax liabilities may exist which were not disclosed to the purchaser at the time the SPA was signed;

- the letter did not identify which specific warranties the seller was alleged to have breached, and instead sought to reserve its right to specify that detail later; and

- the letter said that it constituted "*notification in accordance with … schedule 4 of the SPA*". As well as dealing with the notification requirements for making a breach of warranty claim, schedule 4 (headed "*Seller's Limitations*") also contained provisions about providing information to the seller of "*any matter or thing of which the Purchaser's Group becomes aware that indicates that the Purchaser has or is likely to have a Claim*".

The purchaser followed up with a further letter in June 2015, which provided some additional information.

In August 2015, the purchaser issued and served a claim against the seller for breach of warranties in the High Court. In its High Court claim, the purchaser advanced claims in respect of quantifiable amounts of Brazilian and Philippine tax that it said were due and payable. The seller sought to strike out those claims.

The Court found that the February and June 2015 letters were not valid notification letters, and the seller could not be liable for breach of the warranties.

- The applicable legal principles were summarised and not in dispute. The key question was how a purported notification would be understood by a reasonable recipient with the knowledge of the context in which the notification was sent.

- Viewed in this way, the purchaser's letters had a number of failings:
  - A reasonable recipient reading the letters would not have understood the purchaser to be making claims against the seller, as opposed to intimating a possible claim which may or may not be made in the future.
  - The letters did not identify which warranties had been breached by the seller. This was considered fatal. A generic reference coupled with a reservation of rights was not sufficient.
  - The letters did not make reference to the relevant paragraph in schedule 4 of the SPA. Reference to the whole of schedule 4 was not sufficient, as it could indicate to a reasonable recipient that the purchaser was simply notifying the seller of "*any matter or thing …that indicates that the Purchaser … is likely to have a Claim,*" as opposed to notifying the seller of the claim being advanced against it.
  - For those reasons, the letters would be understood by a reasonable recipient to be setting out a contingent claim for breach of the warranties, and not an actual claim.

- In addition, the Court held that even if the February and June letters were competent notification letters (which they were not), the High Court claim issued by the purchaser was not in respect of the same matters set out

in those letters. This is because the claims advanced in the High Court were in respect of quantifiable amounts of Brazilian and Philippine tax, which did not match the tentative and contingent language used to express the tax claims in the February and June 2015 letters. On the terms of this SPA, the claim pleaded had to be the claim set out in the notification.

IMPORTANCE OF GIVING NOTICE OF A CLAIM "AS SOON AS REASONABLY PRACTICABLE"

The SPA stated that "*No Seller shall be liable for any Claim unless the Purchaser has given notice of such Claim as soon as reasonably practicable after… the Purchaser Group becomes aware that the Purchaser has such a claim…*", and in any event by a longstop date.

The Court found that the purchaser was aware of (most of) the claims by November 2014. In respect of one of the tax claims, the purchaser had delayed notifying the seller because it was considering taking a course of action which would have eliminated the loss arising from the breach of warranty. In the Court's view, the purchaser should have notified the seller of its claims as soon as it became aware that it had them. If the purchaser decided later that it no longer wished to pursue a claim, it could have withdrawn it.

Even if the notification letters had been competent notification letters (i.e. even if they did not suffer from the failings set out above), the delay in sending them until February 2015 (some three months after the purchaser was aware of the claims) meant that the seller could not be liable for breach of the warranties. The purchaser had not notified the seller "*as soon as reasonably practicable*".

CONCLUSION

In this case, the purchaser's claims were scuppered by not acting fast enough or decisively enough, and by not being unambiguously clear that it was making claims against the seller rather than indicating the possibility of making claims in the future. This was despite the notification letter appending a preliminary report prepared by PwC on the tax issues in question.

- While it may appear to be a triumph of form over substance, referring to the applicable sections of the SPA (including specific reference to the relevant warranties) are important signposts to the reasonable recipient of the purpose of the letter.
- Whilst it is important to be specific, ensure you include all identifiable claims at the time, even if you do not ultimately intend to pursue them.
- While the period of time within which it is "*reasonably practicable*" to give notice of claim may vary from case to case, in this case three months was considered too long a period of time to sit on a claim before notifying the seller of it.

This is yet another reminder of the importance of getting breach of warranty claims off on the right foot by focusing on the notification letters.

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MAY 2016

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