



JONES DAY
COMMENTARY

SOME DIFFERENCES IN LAW AND PRACTICE BETWEEN U.K. AND U.S. STOCK PURCHASE AGREEMENTS

As M&A becomes increasingly international, historic differences between U.K. and U.S. practice are diminishing. The vagaries of the underlying legal considerations in each of the jurisdictions are responsible in part for the differences, but custom and practice play a major role in shaping the form and substance of U.K. and U.S. stock purchase agreements (or, to use U.K. nomenclature, share sale and purchase agreements). This *Commentary* focuses on differences in the following areas:

- Whether “representations and warranties” or just “warranties” are given by the seller;
- The standard of disclosure against warranties/representations;
- The effect of the buyer’s knowledge on its ability to bring a claim under the warranties;
- Repetition of warranties/representations;
- Material adverse change clauses;
- Quantification of damages for breach of warranty/representation; and
- Procedural and substantive matters relating to enforcement of claims/litigation.

Of course, in the U.S., except in certain limited circumstances, contract and tort law are matters of state rather than U.S. federal law. While there are broad similarities between the laws of the various states, there may be important differences.

REPRESENTATIONS OR WARRANTIES?

In the U.K., it is common for the seller to resist giving representations as well as warranties and to delete the word “representation” from the agreement. The deletion of the term “representation” is considered, in some quarters, to minimize the risk of a tortious claim for damages under the Misrepresentation Act 1967 and to remove the possibility that the buyer will attempt to rescind the agreement *ab initio* under the provisions of that Act. In reality, the simple categorization of a statement as a warranty (without any further provisions) probably has little bearing on whether the statement is susceptible to being treated as a representation for purposes of that Act. Accordingly, a

well-advised seller will always seek to exclude the remedies of tortious claims and rescission by express provision to that effect (see “Pre-Contractual Representations” below), rather than by arguing that those rights are excluded by virtue of simply characterizing the statement as a “warranty” and not a “representation.”

It is customary in the U.S. for the statements regarding the target to be characterized as both representations and warranties. A U.S. court also is unlikely to find that a cause of action for misrepresentation does not exist just because a contract states that a party “warranted” a particular statement and did not “represent” it. As in the U.K., the nature of the remedies available to the buyer will depend, in part, on whether certain remedies have been contractually excluded and, in part, on the extent of the buyer’s knowledge and reliance. In the *Ziff-Davis* case, 75 N.Y.2d 496 (1990) (see “Buyer’s Knowledge” below), it was clearly demonstrated that a plaintiff may have a cause of action under contract law for breach of warranty, even if it knew that the matter being warranted was false. The buyer would not in such circumstances have a claim in tort for misrepresentation, as it would not be able to establish the necessary element of justifiable reliance on the statement in question; in order to do that, the buyer must have believed it to be true.

A well-advised seller in the U.S. will also seek to expressly exclude any tortious remedies available for misrepresentation. However, in contrast to practice in the U.K., the statements of fact are likely to continue to be characterized as “representations” and “warranties,” even in circumstances where the parties expressly exclude tortious remedies that may otherwise be available for misrepresentation. This appears to be simply a matter of custom.

Pre-Contractual Representations. In both jurisdictions, a seller will want to ensure that it cannot subsequently be found liable for representations and/or warranties that are not incorporated in the written agreement. Sellers therefore will invariably seek to include in the agreement an “entire agreement clause” and a provision to the effect that the buyer has not relied on any statement or promise not included in the written agreement (a “nonreliance statement”). Care must be taken in drafting such a clause in English-law-governed agreements if it is to have the desired effect. Realistically, in both jurisdictions, a well-advised buyer will take all steps

to ensure that it has recorded in the written agreement all of the statements upon which it was seeking to rely and which had induced it to enter into the written agreement. It is no surprise, therefore, that a misrepresentation claim founded upon a statement that has not been included as a warranty in the written agreement is, so far as U.K. practice is concerned, quite rare. In the U.K., entire agreement clauses and nonreliance statements are hardly ever a matter of dispute.

However, in those rare cases where a buyer can demonstrate that it was actually induced by a pre-contractual statement (which had not been incorporated in the written agreement) to enter into the bargain, under English law, it may still have the ability to challenge the entire agreement clause and a nonreliance statement. In the cases of *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573 and *EA Grimstead & Son Ltd v McGarrigan* [1999] WL 852482, the court held that an “entire agreement” clause alone will not exclude remedies for pre-contractual misrepresentations, and an acknowledgment of nonreliance can be challenged if in fact the buyer relied on a pre-contractual statement and was thereby induced to enter into the contract. The statement does not have to be the only inducement, but it must have been an inducement that was actively present in the buyer’s mind when it agreed to enter into the contract (*Edgington v Fitzmaurice* (1885) 26 Ch. D 459).

In *Witter* the buyer relied upon certain pre-contractual statements that induced it to enter into the contract. The seller’s defense was founded upon the following clause:

This Agreement sets forth the entire agreement and understanding between the parties or any of them in connection with the Business and the sale and purchase described herein. In particular, but without prejudice to the generality of the foregoing, the Purchaser acknowledges that it has not been induced to enter into this Agreement by any representation or warranty other than the statements contained or referred to in [the warranty schedule].

The court held that, on any literal interpretation, the first sentence of the clause could not operate as an exclusion of any remedies available at law for pre-contractual misrepresentation because the clause did not say that such remedies are excluded. To be effective, such a clause must therefore state

expressly that the remedies the seller is seeking to exclude are excluded.

The court decided that even if a contract includes a nonreliance statement, the remedies in tort available for misrepresentation may nonetheless be available to a buyer. Section 1 of the Misrepresentation Act 1967 provides that, where a buyer has entered into a contract following a misrepresentation having been made to it, and

- the misrepresentation has become a term of the contract, and/or
- the contract has been performed,

the buyer is entitled to rescind the agreement. The effect is to preserve both tortious and contractual remedies even in circumstances where, in the absence of provisions to the contrary, the representation has become a term of the contract and the contract has been performed. Any seller should therefore expressly include in the agreement, in addition to the entire agreement clause and the nonreliance statement, a provision to the effect that the only remedies available to the parties shall be for breach of contract and that the buyer shall not have the right to rescind the agreement after closing.

In *Grimstead*, the Court of Appeal held, by way of *obiter dicta*, that a nonreliance statement could nevertheless operate as an evidential estoppel if:

- the statement of nonreliance was clear and unequivocal;
- the buyer intended the statement of nonreliance to be acted upon; and
- the seller believed that the statement was true and acted upon it.

If the seller knew that the nonreliance statement was not true, it would not be permitted to hold the buyer to its acknowledgment. The burden of proof is on the party seeking to rely on the nonreliance statement. The Court of Appeal upheld this approach in *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] EWCA Civ 317.

U.S. states are split on whether pre-contractual representations can form the basis of a claim in tort for misrepresentation in circumstances where the written agreement contained an entire agreement clause and/or nonreliance statement. Some states, including New York, generally follow a “contractual approach,” which seeks to prevent sophisticated parties

from circumventing through the law of torts barriers to suit to which they have agreed contractually.

Even courts favoring this approach make some exceptions to permit evidence of fraudulent misrepresentation. These exceptions can, however, be limited. New York courts will bar both fraudulent and nonfraudulent misrepresentation claims where the contract contains a specific statement of nonreliance on the very representations that are later claimed to have been fraudulently made. The leading New York case for this view is *Danann Realty v. Harris*, 184 N.Y.2d 599 (1959), where the court held that while an entire agreement clause alone will not be enough to exclude evidence, in a case where the parties had negotiated a specific nonreliance provision, the plaintiff could not later claim that it was fraudulently induced to enter into the contract by reference to the very representations that it has contractually agreed it was not relying upon. The *Danann* case was more recently upheld in *Grumman Allied Industries Inc. v. Rohr Industries*, 748 F.2d 729 (2d Cir. 1984), where the federal district court, applying New York law, prohibited the plaintiff from claiming reliance on pre-contractual statements made by the seller in circumstances where the buyer had disclaimed reliance on the very representations at issue. While this case may well have been decided on the facts—the buyer had access to the information necessary to confirm the veracity of the representations—it demonstrates that the courts in New York are perhaps more inclined to seek to give effect to entire agreement clauses and/or nonreliance statements than those in the U.K.

The courts of other states have taken a different approach and, much like the English courts in the *Witter* and *Grimstead* cases, have decided that a nonreliance statement, while valid in the context of a contractual claim, does not automatically preclude a finding that the buyer did in fact rely on a representation that was not included in the agreement in a noncontractual claim (*i.e.*, in a tort claim), even in cases not involving fraud. For example, in *Keller v. A.O. Smith Harvestore Products*, 819 P.2d 69 (Colo. 1991), Colorado’s highest court held that the seller could not be shielded from claims of negligent misrepresentation by a disclaimer of liability contained in a sales contract. Many of these cases, however, seem to rely on specific facts and circumstances in determining whether a nonreliance statement should shield the seller from liability.

Reasonableness of the Exclusion: Fraudulent Misrepresentation. Any attempt to exclude or limit liability in an English-law-governed agreement must be reasonable if it is to be effective. In the *Witter* case, the court held that it was never reasonable to exclude liability for fraudulent misrepresentation. Any entire agreement clause or nonreliance statement that fails to provide that it does not apply in the case of fraudulent misrepresentation is likely to result in the court finding that the entire clause is unenforceable under English law (whether or not the matter to which the seller is seeking to apply the exclusion or limitation actually involved a fraudulent element). Although the *Witter* case was heard only in the high court, no subsequent attempt has been made to challenge the decision.

U.S. jurisdictions generally hold that it is against public policy for parties to contract out of liability for fraudulent misrepresentation, and therefore any contractual provision purporting to do so will be unenforceable. For that reason, it is not uncommon for a clause limiting liability in a U.S. share purchase agreement to expressly specify that it does not apply in the case of fraud. However, in contrast to the *Witter* case, a court in a U.S. jurisdiction is not as likely to declare an entire agreement clause unenforceable simply because it does not have a fraud exception. A U.S. court is more likely to look to the facts of the particular case and disallow the provision if the case involves fraud and enforce it if the case does not.

For example, in the decision in the recent Delaware case of *ABRY Partners V, L.P., et al. v. F&W Acquisition LLC* (Del. Ch. February 14, 2006), the court upheld an entire agreement clause and nonreliance statement notwithstanding that it did not contain a fraud exception. The court therefore decided that the agreement of the parties to limit remedies to contractual damages should be upheld, unless fraud was actually involved, and so upheld the freedom of sophisticated contracting parties to agree in their contracts to apportion the risk of misrepresentation between them as they think fit. This decision would not allow parties to exclude liability for fraud were it in fact present.

DISCLOSURE

In respect of a U.K. sale and purchase agreement, the seller's disclosures against the warranties are typically contained in

a separate Disclosure Letter, rather than in schedules to the agreement itself, as is sometimes the case in the U.S. The Disclosure Letter usually contains "general" disclosures (for example, matters that appear in public records), which qualify *all* warranties, and "specific" disclosures, which, although usually cross-referenced to specific warranties in the agreement, are often treated as effective disclosures in relation to *all* warranties (whether or not specifically referenced to a particular warranty).

The Disclosure Letter invariably has annexed to it a large volume of documents (often called "the Disclosure Bundle"), some (but not all) of which are included because they are expressly referred to in the Disclosure Letter itself. The seller almost invariably seeks to treat the entire contents of the documents contained in the Disclosure Bundle as disclosed in relation to all the warranties. In some cases (particularly auction sales), the seller also seeks to treat as generally disclosed in relation to all warranties/representations the contents of the documents contained in the data room (if there is one); buyers will usually resist wholesale disclosure of a data room.

U.S. convention has been for the buyer to allow specific disclosures only in respect of each warranty and representation against which disclosure is being made. General disclosures are not common, and a buyer under a U.S. agreement will commonly seek to provide in the agreement that specific disclosures are not treated as effective disclosures in relation to *all* warranties unless specifically cross-referenced. Since the case of *IBP, Inc. v. Tyson Foods, Inc.* (Del. Ch. June 15, 2001), this type of clause is all the more important. The acquisition agreement declared, in the Undisclosed Liabilities Schedule, that IBP had no undisclosed liabilities, "[e]xcept as to those potential liabilities disclosed [elsewhere], and any further liabilities (in addition to IBP's restatement of earnings in its 3rd Quarter 2000) associated with certain improper accounting practices at DFG Foods, a subsidiary of IBP."

This disclosure itself did not include any specific cross-references to any other warranties or representations contained in the agreement, but the agreement did contain a general provision to the effect that a disclosure against one representation and warranty would be a disclosure against all representations and warranties. During the period between signing and closing, the issues arising from the improper accounting practices at DFG Foods deepened, and the SEC

required increased charges to IBP's earnings and, consequently, the restating of its financial statements. Tyson Foods sought to argue that the increased charges to earnings and restatement of the financial statements made several of the representations and warranties untrue at the time they were made, and it attempted to terminate the acquisition agreement pursuant to a material adverse effect clause. IBP brought an action for specific performance. The court found that the Undisclosed Liabilities Schedule qualified all of the IBP representations in the agreement, even though it would appear that the buyer failed in this case to appreciate the extent of the implications of the disclosure for other warranties and representations. The court took the view that a restatement of the financial statements was a risk the buyer assumed when it accepted the disclosure in respect of DFG Foods, and held that the representations and warranties relating to the financial statements had been qualified accordingly.

The practice and mechanism for disclosure in the U.K. are arguably more favorable to the seller than in the U.S. However, the advantage is somewhat diluted by the requirement of English law that, to be effective, a disclosure must be "fair"—in the sense that a seller is normally required to disclose "facts and circumstances sufficient in detail to identify the nature and scope of the matter disclosed and to enable the purchaser to form a view whether to exercise any of the rights conferred on him by the contract." (*Edward Prentice v Scottish Power* [1997] 2 BCLC 264). Merely making known the means of knowledge or reference to a source of information that may enable the buyer to work out certain facts and conclusions may not itself be sufficient.

However, this position must be measured against the requirement of the sale and purchase agreement in question and the particular circumstances of the case. In *MAN v Freightliner Limited* [2005] EWHC 2347 (Comm), the court indicated (*obiter*) that it could give effect to a disclosure clause specifically providing that *inferences* capable of being drawn from disclosed documents would be deemed to be generally disclosed. The court's position in this case and its ruling in the *Infinitelands* case (see "Buyer's Knowledge" below) emphasize that the buyer should pay particular attention to the language contained in the agreement and Disclosure Letter and resist any attempt on the seller's part to include language to the effect that, where only brief particulars of a matter are set out, a document is referred to but not attached, or reference is

made to a particular part of a document, full particulars shall be deemed to have been given. Equally, language that seeks to imply that the buyer accepts the content of the Disclosure Letter as constituting fair disclosure should be resisted by the buyer. The seller's first draft of its Disclosure Letter will invariably attempt to include provisions to this effect, but they are obviously unacceptable on their face, even without the guidance of the relevant case law.

Notwithstanding the general concept that a disclosure must be fair in order to qualify any of the warranties given by the seller, in light of the *MAN* and *Infinitelands* cases, buyers and their legal advisors should consider carefully whether to include an express concept of "Fair Disclosure" in their agreements pursuant to which a disclosure, in order to be effective, must contain such information as would enable a reasonable buyer to make a reasonably informed assessment of the matters, facts, and circumstances giving rise to the inconsistency with the warranties and their implications. This practice is becoming more and more commonplace.

BUYER'S KNOWLEDGE

In the U.K., if a buyer had actual knowledge prior to execution of the written agreement of facts, matters, or circumstances that would be inconsistent with or that would result in a breach of warranty when given, that buyer may well be precluded from raising a successful claim for breach of warranty, even if that matter was not expressly disclosed in the seller's Disclosure Letter. In the U.S., state laws differ on this question, and even within jurisdictions, such as New York, the situation is confused. In some states, there is a requirement that the buyer show reliance upon a particular contractual representation or warranty made by the seller in order to sustain its contractual claim for breach of that representation or warranty. Other states hold that a buyer claiming a breach of a contractual representation or warranty need only show that there was in fact an untrue statement and that the buyer's knowledge will not generally preclude such a claim. Some states, including New York, have introduced concepts such as "waiver" and look to factors such as timing and the source of knowledge.

In the U.K. case of *Eurocopy plc v Teesdale and others* [1992] BCLC 1067, the agreement contained the usual provision that

the warranties were given subject only to the matters set out in the Disclosure Letter but that no other information of which the buyer had actual, constructive, or imputed knowledge would preclude the buyer claiming breach of warranty or reduce any amount recoverable in respect of breach of warranty. Although only an interlocutory application and not a final decision, this case casts doubt on the viability of such provisions. The court's decisions in this application suggested that a buyer may not be able to rely on such a clause where it has actual knowledge of certain facts not disclosed in the Disclosure Letter.

Comments by way of *obiter dicta* in *Infiniteland and another v Artisan Contracting Ltd* [2005] EWCA Civ. 758 seemed to bolster the view that a buyer will not be able to rely upon this type of provision.

The *Infiniteland* case concerned a warranty claim that the accounts did not show a "true and fair" view of the profit and loss of the target. The acquisition agreement in this case included a knowledge-saving provision to the effect that a claim for breach of warranty would not be affected by any of the buyer's due diligence investigations of the target, except to the extent that such investigations gave the buyer actual knowledge of the relevant facts or circumstances giving rise to the breach. In this case, the seller provided materials that, if examined by the buyer in the ordinary course of due diligence, would have revealed (and in fact did reveal to the buyer's accountants) the inconsistency of the financial statements with the warranty. The buyer claimed to be unaware of the problem and that the buyer's accountants had not informed it of the issue they had discovered. The court found that the actual knowledge of the buyer would defeat any claim for breach of warranty but constructive knowledge would not prevent the buyer from relying on the knowledge-saving clause in the agreement; however, the more difficult question was whether actual knowledge includes imputed knowledge (i.e., the knowledge of the buyer's agents). The court found in this case that the knowledge of the buyer's agents would not be presumed to be that of the buyer unless the contract provided for that to be the case. A seller might specifically attempt to include the knowledge of agents and advisors in the knowledge-saving provision in light of this case, but the facts in the case itself demonstrate the importance to a buyer of resisting such a provision.

As noted, the position of the U.S. states on the issue of buyer knowledge varies. The leading New York case on buyer knowledge is the *Ziff-Davis* case. The seller provided representations and warranties regarding the financial condition of the division being sold to the buyer. As part of due diligence by the buyer's accountants, the buyer learned that the financial condition of the target business was not as represented and warranted. Nevertheless, the parties closed the transaction and the buyer subsequently sued. The court ultimately held that the buyer had the right to sue for breach of contract, notwithstanding its prior knowledge. The court rejected the argument that the buyer must show a belief in the truth of the warranties and said that "the critical question is not whether the buyer believed in the truth of the warranted information, . . . but whether [it] believed [it] was purchasing the [seller's] promise" as to the truth of the statement. However, the court did make note of three key points: (i) that the parties had an express provision in the agreement providing that warranties would "survive the closing, notwithstanding any investigation made by or on behalf of the other party," (ii) that the parties disagreed prior to closing over whether a breach had occurred and the parties had agreed that closing "would not constitute a waiver of any rights or defenses," and (iii) that the buyer learned of the breach after signing but before closing. These points have been used in subsequent New York law cases to limit the effect of the *Ziff-Davis* case.

In *Galli v. Metz*, 973 F.2d 145 (2d Cir. 1992), and *Rogath v. Siebenman*, 129 F.3d 261 (2d Cir. 1997), the federal appeals courts, applying New York law, focused on the fact that the buyer learned about the incorrect representation from the seller and that therefore, since the buyer could not be said to have negotiated the seller's promise that the fact was true, the buyer waived the breach by closing with such knowledge (where there was no express reservation of rights prior to closing). Both cases also involved situations where the buyer obtained the knowledge prior to signing. Also, in *Coastal Power International, Ltd. v. Transcontinental Capital Corporation*, 10 F. Supp. 2d (S.D.N.Y. 1998), the federal circuit court, again applying New York law, held that because the source of the information was the seller, and because there was no rights-saving provision, the buyer was barred from suing for breach of warranty, even though the buyer learned of the breach between signing and closing. See, also, *Paraco Gas Corp. v. AGA Gas, Inc.*, 253 F. Supp. 2d 563 (S.D.N.Y. 2003) (noting that under New York law, buyer's

knowledge if disclosed by the seller can foreclose a breach-of-warranty claim).

Finally, as noted above, states other than New York take differing positions. For example, in *Hendricks v. Callahan*, 972 F.2d 190 (8th Cir. 1992), the U.S. Court of Appeals for the Eighth Circuit (purporting to apply Minnesota law) held that “to enable a party relying upon a breach of express or implied warranty to recover, it must be clear and definite that there was actual reliance upon the warranties involved.” In other words, if the plaintiff knew of the false warranty, it could not have been said to have relied on it and therefore could not recover contractual damages as a result of the warranty being incorrect. On the contrary, in *Southern Broadcast Group, LLC v. GEM Broadcasting, Inc.*, 145 F. Supp. 2d 1316 (M.D. Fla.), the federal district court, applying Florida law, stated that “the Florida Supreme Court would embrace the modern view that express warranties are bargained-for terms of a contractual agreement, any breach of which is actionable notwithstanding proof of non-reliance at the time of closing.”

Clearly there is substantial variation in the way buyer knowledge of breaches of warranty is viewed by the courts in U.S. jurisdictions. As a result, a buyer would be well advised to negotiate clauses specifying that buyer knowledge does not have an impact on its ability to seek indemnification after closing and that closing the transaction with knowledge of a breach of representation will not be considered a waiver of the buyer’s right to later sue for indemnification.

REPETITION OF WARRANTIES/REPRESENTATIONS

In the U.S., the practice is invariably to require warranties and representations to be repeated as at closing, and usually the accuracy of warranties/representations at closing is a condition to closing. In the U.K., while it is not uncommon for warranties to be repeated at closing, sellers will seek to resist that principle and at worst argue for repetition of only those warranties over which they have direct control.

In addition, in the U.K. it remains unusual for the accuracy of all warranties at closing to be a pre-condition of closing. In some U.K. deals, the buyer may have the right to terminate as a result of a material breach of the warranties given at signing and, in some cases, as repeated at closing.

MATERIAL ADVERSE CHANGE

In the U.S., buyers frequently seek to include a material adverse change clause (“MAC clause”) whether expressed as a condition or as a termination right. A MAC clause gives the buyer the right to refuse to close, if an event occurs between signing and closing that has an effect on the target that is material and adverse. Sellers obviously resist these provisions on the basis that they require certainty that the deal will close.

General MAC clauses entitle the buyer to terminate in circumstances where the economic position of the target has been materially and adversely affected. Specific MAC clauses entitle the buyer to terminate if a specified event occurs. The law relating to MAC clauses is fact- and language-specific. In the *Tyson Foods* case, which has received significant attention in recent years (although it appears not to have been cited by any New York court), the buyer (in addition to the claim for breach of warranty discussed above) sought to rely on a broadly drafted MAC clause (which took the form of a warranty) citing that the increased charge to earnings constituted a material adverse change. The court held that the broadly drafted MAC clause was a capricious provision that put the seller at risk for a variety of uncontrollable factors that might materially affect its overall business or results of operations. The court went on to state that general economic and industry declines and short-term, cyclical downturns would not be sufficient to entitle the buyer to rely on a broadly drafted MAC clause. The court took the view that the buyer ought to make a very strong showing of its case that a material adverse effect has occurred and held that:

... even where a Material Adverse Effect condition is as broadly written as the one [in the present case], that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner...

The court’s logic in relation to the effect that the buyer’s knowledge of certain facts and matters would have on a claim for breach of warranty was similarly applied in relation to the MAC clause. Thus, the court held that a buyer could not seek to invoke a MAC clause in circumstances where the consequences of a fact known to the buyer were reasonably foreseeable at the time it entered into the agreement. This again emphasizes the importance a buyer should attach to

the disclosure process and the due diligence review of the target company.

MAC clauses that take the form of a general condition to closing are not commonplace in the U.K. If a MAC clause is incorporated in a U.K. sale and purchase agreement, it is more likely that it will take the form of a termination right capable of being exercised in circumstances where the seller, by its act or omission, has caused an event that would be materially inconsistent with the warranties if they were deemed repeated at closing.

There is very little case law on the subject of MAC clauses in the U.K. The only significant case is *Levinson v Farin* [1977] 2 All ER 1149, which concerned a MAC clause that took the form of a warranty that since the balance-sheet date, there was no reduction in the net asset value of the target. In the absence of a definition of “material,” the court indicated that a reduction in the region of 20 percent would be seen as material for purposes of such a warranty. In relation to public takeovers, the U.K. Takeover Panel, which governs the rules on the acquisition of U.K. public companies, has ruled on this subject in relation to the WPP Group’s bid for Tempus Group. Although not a court, it may offer some indication of the attitude of the English courts toward MAC clauses. WPP’s offer for Tempus (which was announced in August 2001) contained a MAC clause that took the form of a condition to the offer. WPP argued that following 9/11, a material adverse change had occurred. The Takeover Panel took the view that 9/11, while exceptional, unforeseeable, and a contributor to the decline that had already affected the advertising industry, did not undermine the rationale for the terms and the price of WPP’s offer. The Takeover Panel therefore ruled that the MAC condition could not be invoked, stating that “meeting [the materiality] test requires an adverse change of very considerable significance striking at the heart of the purpose of the transaction in question, analagous ... to something that would justify frustration of a legal contract.”

Commentators have argued that the Takeover Panel’s logic was flawed, insofar as circumstances sufficient to justify frustration would entitle a bidder to avoid the contract in any event. The consequence was that a MAC clause gives a buyer no protection beyond what is generally available to it

under contract law. The Takeover Panel has since issued a clarifying statement that a bidder need not demonstrate legal frustration in order to be able to rely on a MAC condition, but it did reemphasize the need to satisfy a stringent test.

QUANTIFICATION OF DAMAGES FOR BREACH OF WARRANTY/REPRESENTATION

In the U.S., buyers are invariably “indemnified” for breach of warranties/representations, subject to negotiated caps, thresholds, and deductibles. In the U.K., although broadly the same scheme of caps/deductibles/thresholds applies, the precise method by which damages for breach of warranty are calculated is often heavily negotiated. Depending on the outcome of those negotiations, the consequences for the buyer may be:

- An inability to recover for certain elements of loss that were not reasonably envisaged by the parties when the transaction was entered into; or
- Where the price of the business is based principally on profits, an inability to recover in respect of a shortfall in warranted assets, if those assets do not affect the profit-earning capacity of the business.

The second deficiency identified in the previous paragraph can be overcome by successful negotiation, although this is often difficult. The first deficiency is principally a reflection of how English law quantifies damages for breach of contract and can effectively be overcome only by including in the agreement an express indemnity by the seller in favor of the buyer for all losses (including consequential loss) and liabilities arising, directly or indirectly, as a result of a breach of warranty/representation. It would be extraordinary, however, to find such an indemnity in an English sale and purchase agreement.

ENFORCEMENT OF CLAIMS AND LITIGATION

The following are the principal differences, substantive and procedural, between U.K. and U.S. litigation in relation to claims for breach of contract (including breaches of warranty, etc.):

U.S. LITIGATION	U.K. LITIGATION
Extensive discovery, including document requests, interrogatories, request to admit.	Less involved discovery, document disclosure.
Depositions taken.	No depositions, only witness statements.
Jury-trial right for civil cases (unless waived by the parties).	Judge tries; no general right to jury trial for commercial cases.
Each party generally bears its own costs.	Costs are ordered by court; part of costs normally paid by the unsuccessful party.

CONCLUSION

Although market practice in the U.K. and the U.S. is becoming increasingly aligned, certain important distinctions do remain (in particular, with respect to warranties, representations, and disclosure). The U.S. and English courts have adopted differing approaches to the interpretation and enforcement of certain provisions of sale and purchase agreements that can have important implications for the allocation of risk as between a buyer and a seller. The differences between the underlying legal considerations need to be borne in mind by the parties to any transatlantic transaction.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our “Contact Us” form, which can be found at www.jonesday.com.

Leon Ferera
44.20.7039.5213
Inferera@jonesday.com

John Phillips
44.20.7039.5215
jrphillips@jonesday.com

Julian Runnicles
44.20.7039.5187
jarunnicles@jonesday.com

Jeffery Schwartz
7.495.648.9210
jefferyschwartz@jonesday.com

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