

Last month we saw Cleaver Fulton Rankin address the issue of new premises and the impact of relocation for its US technology client as it seeks to expand its existing operations.

Sale & Purchase Agreement: Damage Limitation



Scott Kennedy, corporate partner at Cleaver Fulton Rankin.

In this issue, with completion deadline looming, the team of lawyers advise on some tricky negotiations between the locally-based vendors and their client relating to the Sale and Purchase Agreement (SPA). Scott Kennedy, corporate partner and project manager on the deal, gives us an insight into the firm's work via his blog diary:

Weds 25th:

The principle of "buyer beware" applies in much the same way in the US as it does here so the fact that our client is seeking extensive warranties in the SPA as to the state of the target's business was never likely to prove particularly controversial. The vendors are unhappy with a few areas where they feel the warranties are being used as risk allocation devices rather than a method to confirm information to us about the business which is within their knowledge. This is a fairly usual argument and a sensible compromise is nearly always found.

The one area however where it does look like there might be more of a battle is the question of how damages should be calculated in the event that a warranty is actually breached.

US purchasers often expect that if a warranty is breached the vendors will compensate or indemnify them on a pound for pound basis against all losses arising out of the breach. However in the absence of such an indemnity, courts in the UK when calculating damages for a breach of warranty simply do so on a 'loss of bargain' basis or, to put it another way, if the purchaser had known about the breach in advance would it still have paid the same price it did for the business. There may not seem to be much between these two methods but in certain circumstances the differences in outcome could be marked.

The vendors are refusing to accept this "US style" indemnity not so much because the principle is objectionable but more so because it's "not the way we do things here!" What's more they want to cap their maximum liability under the warranties and also the period during which our client can make a warranty claim against them after completion.

At this late stage we don't want to find ourselves at loggerheads with the vendors if possible. We need to find a way round these potential disputes and fast.

A restriction on making a claim within a certain period of time is fair enough; nobody wants a potential claim hanging over their head for ever and a day and two years should be long enough for our client to uncover any problems. This is a fairly standard approach as is agreeing that the vendors' liability should be capped at the amount our client actually pays for the business.

The indemnity damages point is more problematic. Our client is insistent that because the business has no physical assets, and that they are in essence simply buying the intellectual property and goodwill in the contracts, if there turns out to be a problem with either of these then the business may well be worthless to them. It strikes me on hearing this that in reality we can probably achieve the required comfort for our client by limiting the indemnities to these very specific areas rather than

in respect of all the warranties. Happily we have just run this past the vendors and they are happier with this more focused approach— they can appreciate the intellectual property and the contracts are "the business" we are buying so if there is a problem with either it really would be a disaster for us.

Thurs 26th:

Another day another issue! This time it's an employment related problem.

Part of the purchase price being paid by our client is dependent upon the business achieving certain levels of sales in the two years following completion, what we call an 'earn out period'. Effectively our client is saying they are happy to pay a higher price for the business but only if it performs in the manner hoped for.

A number of the vendors are staying on to work in the business and are to be employed on our client's standard terms. One of the problems is that the notice period for employees at this level is only three months. This is obviously causing concern since a three month notice period would mean those employees could have their employment terminated during the earn-out period which in itself would be bad enough but would also mean they would not be around to ensure that the now important sales targets are met.

What these vendors are looking for is a contract of employment which prevents them from being fired at any time during the earn-out period. Our client's concern with this however is what if they are simply not competent or the employment relationship breaks down generally? The client needs flexibility as to how they manage their business going forward and if that means making tough decisions based on inadequate performance then so be it.

On that basis we've advised the client to include a clause which says that if they terminate an employee's contract, and that employee is subsequently found to have been unfairly dismissed by a court, then the client will pay that person the maximum purchase price they would have received under the terms of the SPA. However if no unfair dismissal is proved the employee gets nothing. In this way if the dismissal can be justified then we are entitled to get rid of them. The client wants to be fair but it won't tolerate employees who are not contributing to the business.