

Warranties and Indemnities on Share Sales

Neil Sinclair

THIRD EDITION

LONGMAN
COMMERCIAL
SERIES

LONGMAN 

Warranties and Indemnities on Share Sales

Second Edition

Neil Sinclair

Solicitor, Partner, Berwin Leighton

LONGMAN 

© Neil Sinclair 1992

Published by
Longman Group UK Ltd
21-27 Lamb's Conduit Street
London WC1N 3NJ

First published 1984
Second Edition 1989
Third Edition 1992

Associated Offices
Australia, Hong Kong, Malaysia, Singapore, USA

A CIP catalogue record for this book is available from the British Library

ISBN 0 85121 8776

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without either the prior written permission of the copyright holder for which application should be addressed in the first instance to the publishers, or a licence permitting restricted copying issued by the Copyright Licensing Agency Ltd, 90 Tottenham Court Road, London W1P 9HE

Printed in Great Britain by Mackays of Chatham.

Extract from Preface to First Edition

One of the most intimidating documents that is in regular use by solicitors is a full scale agreement for the purchase of a group of companies. Over the years these documents have grown, to some extent by a process of accumulation unaccompanied by energetic pruning, until they have reached a length approaching a hundred pages. The main bulk of the document consists of the warranties and indemnities which are sought, frequently in a blanket form, from the vendors.

The purpose of this book is to assist all the parties who have to deal with these agreements in handling them efficiently and with confidence. For the purchaser's solicitors, who would normally prepare the first draft, the book is intended to provide a precedent of suitable warranties and indemnities, but with sufficient guidance to enable an over-inflated standard form to be modified and shaped so that it is appropriate to the companies which are in fact being purchased. For the vendors' solicitors, the objective is to provide a guide to the purpose which each warranty they might normally meet is intended to serve, what the dangers are to their clients and what, if any, amendments they should make. Additionally, protective clauses are suggested for the benefit of the vendors and the commentary on these is intended to help the purchasers' solicitors to assess their impact. For other professional advisers of the parties, the intention is that this book should, by summarising the effect of each warranty and indemnity, enable a commercial decision to be reached as to whether there is likely to be a problem for the vendors and, if so, whether it should be avoided by amending the documentation or making appropriate disclosures.

Even for those who are dealing with agreements of this kind regularly it is often difficult to remember precisely what a particular warranty is intended to achieve. Frequently there are shorthand references to statutory provisions, which in the case of tax are often of enormous complexity, and sometimes clauses have grown up over the years which were originally intended to cover a

rather special case but have through inertia become absorbed into standard forms. It is hoped that this book will enable practitioners to remind themselves readily as to the broad impact of a warranty but it must be emphasised that no detailed legal analysis is given. It is not the intention to provide a text book on tax or other matters which arise from the warranties. The commentaries are intended to provide pointers only to the subject matter so that further research can readily be made if it is required.

The views expressed as to the fairness of the various clauses and as to the appropriateness of the suggested amendments are frequently subjective. Even where the reader disagrees with them, it is to be hoped that the discussion will of itself be helpful in enabling a proper assessment to be made.

As each commentary on the detailed provisions of the warranties, indemnities and other clauses is intended to stand alone, a certain amount of duplication inevitably occurs. Similarly, as the intention of the analysis of the warranties is to deal with as many common-form clauses as possible, it will be found that some overlapping results. The variability of the wording of warranties is considerable although there is a rather surprising amount of conformity to be found between the standard forms used by different firms of solicitors or appearing in precedent books. If the parties are faced with warranties which are completely different from those used in this book, it is hoped that the various indexes and appendices which are provided will assist in tracking down the closest comparable clauses.

As the chapter on the taxation warranties contains the most detailed references to statutory provisions, it was thought that it might be helpful to have a special index of the sections which are mentioned. Furthermore, to assist identification, each section reference includes its title as well as the number.

The chapter on property warranties has been contributed by my partner Lawrence Heller.

September 1984

Neil Sinclair

Complete List of Warranties by Vendors

<i>Clause</i>	<i>Title</i>	<i>Page in text</i>
1	Taxation Warranties	
1	Returns and clearances	43
2	PAYE and other deductions at source	46
3	Penalties	49
4	Claims, elections, liabilities and reliefs	49
5	Unremittable income and capital gains	56
6	Tax avoidance	57
7	Depreciatory transactions and value shifting	61
8	Disallowances of deductions	63
9	Transactions not at arm's length	64
10	Disallowance of losses and ACT	65
11	Distributions	66
12	Close companies	68
13	Sale and leaseback of land	70
14	Payments from pension funds	71
15	Group relief and group surrenders	71
16	Acquisitions from group members	76
17	Demergers and purchase of own shares	78
18	Stock dividends	78
19	Capital allowances	79
20	Base values and acquisition costs	81
21	Replacement of business assets	85
22	Chargeable gains: special cases	86
23	Capital losses and limited partnerships	88
24	Gifts involving group companies	89
25	Gains accruing to non-resident companies	90
26	Foreign businesses	90

Complete List of Warranties by Vendors

27	Foreign loan interest	93
28	Value added tax	93
29	Inheritance tax	95
30	Stamp duty	97

2 Property warranties

1	Title	106
2	Encumbrances	109
3	Planning matters	113
4	Statutory obligations	117
5	Adverse orders	118
6	Condition of the properties	119
7	Insurance	121
8	Leasehold properties	122
9	Tenancies	124
10	Contamination	126

3 Commercial warranties

1	PRELIMINARY	130
1.1	Capacity and authority of Vendors and Warrantors	130
1.2	Ownership of Shares	130
1.3	Details of Group Companies	133
1.4	Directors and shadow directors	134
1.5	Subsidiaries and branches	134
1.6	Options over Group companies' capital	135
1.7	Commissions	135
1.8	Elective and written resolutions	136
1.9	Memoranda and articles of association, statutory books and resolutions	137
1.10	Documents filed	139
1.11	Possession of documents	140
1.12	Investigations	140
1.13	Information disclosed to Purchaser correct	141
2	ACCOUNTS	142
2.1	The Last Accounts	142
2.2	Valuation of stock in trade and work in progress	145
2.3	Depreciation of fixed assets	146
2.4	Deferred taxation	146
2.5	Accounting reference date	147
2.6	Books and records	147
3	FINANCE	148
3.1	Capital commitments	148
3.2	Bank and other borrowings	149

Complete List of Warranties by Vendors

3.3	Bank accounts	150
3.4	Continuation of facilities	151
3.5	Debts due to Group Companies	152
3.6	Liabilities	154
3.7	Working capital	155
3.8	Dividends and distributions	156
3.9	Government grants	157
4	TRADING AND CONTRACTS	157
4.1	Changes in business activities and financial position since Last Accounts Date	157
4.2	Vendors' other interests and liabilities to Group Companies	159
4.3	Effect of sale of Shares	160
4.4	Conduct of businesses in accordance with memoranda and articles of association	162
4.5	Joint ventures and partnerships	163
4.6	Agreements relating to the management and business	163
4.7	Agency agreements and agreements restricting business	164
4.8	Unfair trade and restrictive practices	164
4.9	Litigation, disputes and winding-up	167
4.10	Compliance with statutes	169
4.11	Documents stamped	169
4.12	Business names	170
4.13	Transactions involving directors	171
4.14	Powers of attorney and authorities	171
4.15	Licences and consents	172
4.16	Subsisting contracts	174
4.17	Other party's defaults	175
4.18	Outstanding offers	175
4.19	Defective products	176
4.20	Service liabilities	177
4.21	Purchases and sales from or to one party	177
4.22	Data protection	178
4.23	Guarantees and indemnities	179
4.24	Insider contracts	179
4.25	Management reports	180
4.26	Environmental liabilities	180
5	EMPLOYMENT	181
5.1	Employees and terms of employment	181
5.2	Claims by employees	182
5.3	Changes in remuneration	183
5.4	Termination of contracts of employment	183

Complete List of Warranties by Vendors

5.5	Industrial disputes and negotiations	184
5.6	Industrial agreements	185
5.7	Redundancies	185
5.8	Pensions	185
6	ASSETS	187
6.1	Ownership of assets	187
6.2	Assets sufficient for the business	188
6.3	Stocks and work in progress	188
6.4	Insurance	189
6.5	Leased Assets	190
6.6	Plant in working order	191
6.7	Industrial property rights	192

4 Miscellaneous clauses

[1A]	Claims under warranties to precede claims under indemnity	4
[2A]	Restrictions on distributions by trustee warrantors	7
[2B]	Liability of warrantors to assignee	11
[2C]	Indemnity to lapse on disposal of company	11
[2D]	Sharing of liability between warrantors	13
[3A]	Right to rescind prior to completion	14
[3B]	Measure of damages for breaches of warranty	15
[3C]	Credit for improvements	17
[3D]	Set-off of improvements	17
[3E]	Time limit for warranty claims	21
[3F]	Exclusion of small claims	22
[3G]	Ceiling on claims	24
[4A]	Application of warranties to past events	27
[4B]	Effect of post-completion events	28
[4C]	Statutory references	28
[4D]	Full enquiry by the warrantors	29
[4E]	Awareness of one of the warrantors	29
[4F]	Accuracy of the report	30
[4G]	Effect of investigation or waiver of liability	31
[4H]	Events occurring prior to completion	31
[4I]	Conduct of companies pending completion	33
[4J]	Warranties to apply at completion	33
[4K]	Definitions	34
[4L]	Ejusdem generis rule	37
[4M]	Overseas companies or business	38
[4N]	Failure to follow warrantor's instructions	39
[4O]	Information supplied to warrantors	39
[4P]	Warranties independent	40
[4Q]	Warranties to survive completion	40

[4R]	Delay in enforcing warranties	41
[4S]	The warranties	41

5 Warranties and undertakings by the purchaser

[10A]	No payment of abnormal dividends	238
[10B]	Indemnity in respect of ICTA 1988, ss 703–709	238
[10C]	Shares not acquired as trading stock	240
[10D]	No cessation of trade	240
[10E]	Payment of dividend after completion	241
[10F]	Land sold in course of trade	242
[10G]	Utilisation of advance corporation tax	243
[10H]	Refund when tax repaid or relieved	243
[10I]	Assignment of rights or reimbursement	244
[10J]	Warrantors rights to acquire warranted debts or rights of reimbursement	245
[10K]	Conduct of claims	246
[10L]	Conduct of claims in relation to taxation warranties	247
[10M]	Indemnity against secondary tax liabilities	248
[10N]	Undertakings from future purchaser of group company	248
[10O]	Surrenders of group relief and claims for capital allowances	249

Table of Cases

Borax Company, <i>Re</i> [1901] 1 Ch 326.....	157
Houldsworth v City of Glasgow Bank and Liquidators (1880) 5 AC 317.....	10
J Sainsbury plc v O'Connor [1991] 1 WLR 963; [1991] STC 318; (1991) 135 SJ 46	72
Knight Sugar Company Limited v The Alberta Railway Irrigation Company [1938] 1 All ER 266.....	40
Leggat v Barratt 15 Ch 306.....	40
NV Slavenburg's Bank v Intercontinental Natural Resources Ltd [1980] 1 WLR 1076; [1980] 1 All ER 955; (1980) 124 SJ 374	140
Oswald Tillotson Ltd v IRC [1932] All ER 965	36
Sandeman v Breach 7 B & C 99	38
Shepherd v Land Law plc [1990] STC 795.....	72
Stokes v Costain Property Investment Co Ltd [1984] 1 WLR 763; [1984] 1 All ER 849; (1984) 57 TC 688	81
Zim Properties Limited v Proctor (1984) 58 TC 371; [1985] STC 90; (1985) 129 SJ 68.....	25, 217

Table of Statutes

Business Names Act 1985	170	s 213	138
Capital Allowances Act 1990	81, 307	s 221	144, 148
s 4	82	s 222	147
Part II		s 224	147, 280
Chap V	79	s 225	147
s 24	79, 80, 82, 267	ss 226, 227	142
(4)	51, 56	s 252	136
s 26	79, 80, 267	s 256	35
s 37	52, 81	s 259	316
s 40	79	s 270	7
s 42	81	s 288	138
s 46	80, 81, 267	s 317	134, 179
Chap VI	81, 267	s 318	134
s 51	81, 267	s 319	181, 290
ss 52, 53	52	s 320	139, 171, 286
s 61	80	s 321	286
s 73	80	s 235	138
s 75	58, 59, 262	s 330	171
s 77	52, 82	ss 330–340	154
s 142	60	s 331	154
s 144	80	s 332B	133
s 145	50	s 346	171
s 153	157	s 352	138
s 158	52	s 352A	133
s 159	58, 59	s 354	138
Sched A1	50	s 359	138
Capital Gains Tax Act 1979—		s 362	138
s 41	24, 25	s 379A	136, 277
s 79(1)	25	s 380	137
Companies Act 1985 156, 162, 279, 282, 284		(2)	137, 277
s 24	133, 134	ss 381A–C	136
Part IV	16	s 381B	136, 277
s 80	136	s 381C(1)	136
s 88	197	s 382B	133
s 101	131	s 395	131, 139, 140
s 103	16	s 404	139
s 111A	10	s 407	138
s 112, (3)	133	s 409	139
s 150	18	Pt XII	139, 188, 278
s 151	136	Chap II	139
s 190	138	s 410	139

s 424	139	s 105	92, 270
Part XXIII	140	Sched 7	91
ss 431, 432	140	Finance Act 1989—	
s 735	304	s 102	75, 266
s 736	36, 319, 320	s 127	92
s 741	134, 276	s 134	54, 92, 210, 270, 313
(3)	134	Finance Act 1990	
Sched 4	145, 279	s 11	52, 94, 95, 270
paras 26–28	145	s 46	203
para 50(3)	144	Sched 17	51
para 57(3)	143	Finance Act 1991—	
para 89	144	s 15	52
Sched 9	143	Finance (No 2) Act 1992—	
Companies Act 1989	36, 136	s 31	67
s 61	37	Sched 6	72
Competition Act 1980	285	Financial Services Act 1986—	
s 2	167	s 1	173, 287
Consumer Credit Act 1974	253, 285	s 46	202
Parts III, IV, V	165	Highways Act 1980—	
Consumer Protection Act 1987	176, 288	s 38	116, 273
Control of Pollution Act 1974	180	Income and Corporation Taxes Act 1988	304
Data Protection Act 1984 178, 253, 288, 289		s 10	44
Employment Act 1982	183, 184, 290	(1)(a)	300
Employment Protection (Consolidation) Act 1978	182, 183, 184, 290	(d)(1)(a)	227
Environmental Protection Act 1990 126, 180, 275		s 11(2)(b)	92
Equal Pay Act 1970	252	s 13	212, 220
Fair Trading Act 1973—		s 14	66
s 13	165, 285	s 23	48, 260
Part II	165	s 38(1)(b)	268
Part XI	164, 285	s 43	47, 260
Finance Act 1927—		s 56	57, 58, 261
s 55	98	s 74	63, 64, 263
Finance Act 1930—		s 75	66
s 42	97, 211, 271	s 116	57, 58, 262
Finance Act 1940—		s 118	89, 269
s 46	3	s 123	47, 260
Finance Act 1967—		s 125	63, 263
s 27	67	s 134	46
Finance Act 1972—		s 139	262
s 68	59	s 143	45
Finance Act 1973	58	s 145	69
Sched 19,		s 148	46
para 10	97	Part V	
Finance Act 1984		Chap II	69
s 64	87	ss 152–154	85, 268
Finance Act 1985—		ss 153–168	46
s 14	49	s 203	46
s 14A	49, 95, 270	Part VI	156, 264, 282
s 15	49	Chap II	307
s 19	95, 271	s 209	67, 156, 264
Finance Act 1986	250	(2)(b)	66
ss 75, 77	98	(c)	66
Finance Act 1988	45, 238	(vii)	67
s 66	91, 92	s 210	66
(1)	91	s 211	66
s 78	44	ss 213–218	78, 266
s 85	44	s 214	266
		ss 219–229	78
		s 225	45, 78

Table of Statutes

s 231	210	s 729	57, 58, 262
s 234	43	s 730	58, 262
s 239	50, 51, 209	ss 731–735	57, 59, 262
s 240	57, 58, 73, 262, 265	s 732	47
(8)	74	s 733	47, 260
s 242	51	s 736	58, 59, 262
s 245	56, 65, 264	s 736A	47, 48, 260
s 247	48, 49, 260	s 737	48, 58, 59, 262
s 249	78, 79, 266	ss 739–746	60
s 254	67, 264	s 745	66
s 255	45	s 747	91, 269
s 279	98	s 752	91, 270
s 338	63, 64, 263	s 756	44
s 346	54, 67, 264, 312	s 765	45, 60, 61, 254, 262
s 347	225, 247, 248, 312, 326	s 765A	44
ss 349, 350	47, 260	s 768	56, 65, 66, 211, 264
s 349	47	s 768A	56, 65, 66, 264
s 393	51, 65, 66, 210, 264	s 770	63, 64, 263
s 393A	51, 66, 224	s 771	64
s 395	57, 58, 262	s 773	64, 263
s 399	57, 58, 262	(4)	64
s 400	157	s 774	58, 59, 262
Part X		s 775	47, 48, 60, 260
Chap IV	73, 265, 307	s 776 45, 47, 48, 60, 61, 240, 260, 262, 324	
s 402	71, 74, 265	(10)	240, 323
s 403	210	s 777	47, 48, 240, 260, 324
s 404	75, 265	(9)	48
s 409	74, 75, 265	s 779	58, 59, 63, 64, 262, 263
(2)	75	s 780	70, 265
s 410	57, 58, 71, 72, 73, 225, 262, 265	s 781	58, 59, 63, 64, 262, 263
s 412	51	s 786	58, 59, 262
s 413	71	s 787	63, 64, 263
(5)	72	s 798	93, 270
s 414	68, 264, 307	s 825	234
s 418	69, 156, 264, 282, 307	s 838	73, 76
Part XI		s 839	35
Chap II	68, 69, 264	s 840	34, 35, 319
s 419	13, 54, 70, 210, 241, 242, 312	Sched D	
(5), (6)	70	Case VI	53, 71
s 419–422	69	Sched E	187
ss 421, 422	70	Sched 13	43
s 524	47, 260	Sched 16	43
s 536	47, 260	Sched 17A	51
ss 555–558	47, 260	Sched 18	71
ss 559–567	47, 260	para 5	72
s 573	51	Sched 19	45, 68, 264
s 582	47, 260	para 16	69, 307
s 584	56, 261	Sched 23A	47, 48, 260
s 592	186, 291	Income Tax Act 1952—	
s 601	53, 71, 210, 261, 265	s 245	3
s 602	53, 71, 210	Industrial Development Act 1982	157
s 612	310	Industry Act 1972	157
(1)	186, 291	Inheritance Tax Act 1984—	
s 703	211, 239, 241	s 3	95, 271
ss 703–707	61	s 94	95, 313
s 703–709	60, 61, 237, 238, 262, 323	s 199	313
s 704	238	s 202	312
s 707	45, 238	s 204(6)	96, 271
s 709(4)	238, 323	s 212	96, 271

ss 237, 238	96, 271	(2)	62
s 239	96	s 31	62, 263
Insolvency Act 1986	8, 20	s 32(2)	62, 263
s 74	131	s 35	52, 83, 267
s 122	168	(5)	83
s 123	168, 286	s 38	10, 82, 84, 267
(2)	168	(1)(a)	84, 268
ss 238, 239	131, 276	(b)	84
s 240	132	s 39	82
s 241(3)	132	s 42	82
s 339	132	s 43	83
s 341	132	s 44	85, 268
(3)	132	ss 46, 47	85
s 342(4)	132	s 49	25
s 423	132	s 53	83, 84, 268
Interpretation Act 1978—		s 69(4)	313
Sched 1	37	s 106	58, 60, 262
Landlord and Tenant Act 1927—		s 125	89, 269, 313
Part I	124, 125	s 126	87, 268
Landlord and Tenant Act 1954—		ss 127–131	87, 269
s 37	125	s 128	87
Part 2	125	(2)	87, 88, 269
Land Registration Act 1925—		s 132	86
s 123	107, 108	s 135	55
Law of Property Act 1925—		ss 135–138	60, 262
s 45(2)	122	s 136	55, 82, 87
s 146	123	s 137	55
s 205	107	(4)	55, 313
Licensing Act 1964	273	s 138	45
Licensing Act 1988	117, 118	s 139	45, 55, 60, 61, 82, 312
Limited Partnership Act 1907	89	(5)	61
Misrepresentation Act 1967	100	s 140	53, 90, 269
Partnership Act 1890—		s 141(1)	78, 79, 266
s 2	154	ss 152–154	85
Patents Act 1977—		s 153	82
ss 40, 41	193, 294	s 170	76
Planning and Compensation Act 1991	113	ss 170–181	76, 266
Railway Premises Act 1963	117, 273	s 171	76
Resale Prices Act 1976	166, 285	s 173	76, 266
Restrictive Trade Practices Act 1976	165, 285	s 175	85, 86
s 38	166	s 176	61, 262
Restrictive Trade Practices Act 1977	165, 285	s 177	61, 262
ss 6, 35	166	s 178	77, 247, 248, 266, 326
Stamp Act 1891—		(5)	312
s 14	170	s 210	87
s 15	49	s 247	85, 86
s 117	170, 209	s 251	86, 244
Taxation of Chargeable Gains Act 1992—		ss 253, 254	86, 268
s 13	90, 269	s 279	56, 261
s 17	25, 65, 263	s 280	53, 261
s 18	82	s 282	89, 269, 313
(3)	88, 269	Sched 2	88, 269
s 23	85, 86, 268	para 16(18)	88
s 24	82	para 17	52
(2)	51, 53, 261	paras 19, 21	88
s 25	268	Sched 3,	
s 28	82	para 8	83
s 29	58, 60	Sched 4	52
s 30	62, 263	Taxes Management Act 1970	49

Table of Statutes

s 10	44
s 11	43
s 15	44
s 29	49
s 34	20
s 36	49
s 42(8)	50
s 54	49, 214, 234, 298
s 55	53
s 78	46, 47, 260
s 79	47, 260
Town and Country Planning Act 1971—	
s 52	115, 273
Town and Country Planning Act 1990	309
s 55	114
s 106	115, 273
s 236	36, 320
Trade Descriptions Act 1968	164, 285
Trustee Act 1925—	
s 57	8
Value Added Tax Act 1983—	
s 2	93
s 29	44, 55, 94, 247, 248, 313, 326
(7)	248, 326
s 32	94, 270
Sched 1	93
Sched 7	
para 5(2)	94
para 10A	49
Water Resources Act 1991	180

Table of Statutory Instruments

Anti-Competitive Practices (Exclusions) Order 1980 (SI No 979).....	167
Companies and Business Names Regu- lations 1981 (SI No 1685)	170
Companies (Single Member Private Lim- ited Companies) Regulations 1992 (SI No 1699).....	133
Companies (Table A to F) Regulations 1985 (SI No 805).....	138
Control of Substances Hazardous to Health Regulations 1988 (SI No 1657)	180
Income Tax (Employments) Regulations 1973 (SI No 334)	44, 46
Restrictive Trade Practices (Services) Order 1976 (SI No 98)	166
Town and Country Planning General Development Order 1988 (SI No 1813)	114
Town and Country Planning (Use Classes) Order 1987 (SI No 764).....	114
Transfer of Undertakings (Protection of Employment) Regulations 1981 (SI No 1794)	161
Value Added Tax (General) Regulations 1985 (SI No 886)	44