Selling your company – handle warranties with care

After years of hard work building up a business, the prospect of selling it on to another company or the current management team will be the light at the end of the tunnel. Unless you are a serial entrepreneur, a more leisurely life is ahead when the stresses and strains of running a business will be behind you.

While the purchaser should have a good idea of the business that they are buying, the last thing they want is for some nasty skeletons to appear from the cupboards, while you are enjoying your new-found freedom. For example, they would not want to discover a problem over rights of access or a major dispute with a key supplier which could disrupt their ability to carry on the business. Consequently, they will demand warranties from the seller.

Alongside the sale price for the business, the issue of warranties will be one of the principal concerns to anyone selling a business.

What is a warranty?

In the course of a company sale, the shareholders as sellers will need to disclose information and relevant documentation to the buyer through the 'due diligence' process. Alongside this, the buyer will expect the seller to provide binding statements regarding the business, its assets and liabilities, in the form of warranties which give the buyer some contractual protection over the value in the business and all that comes with it. This information concerning the target company will typically cover aspects such as the company's accounts & records, its trading position, details of employees, premises, the company's commercial contracts with suppliers and customers and its other assets & liabilities.

For example, you may give a warranty as to the status of a commercial contract which is important to the business and expected to deliver a specific financial outcome. If this warranty turns out to be inaccurate or false, then the buyer could bring a claim for breach of warranty to recover compensation for any quantifiable loss flowing from the breach.

Types of warranties

The extent and nature of the warranties that a seller will be asked to enter into is driven by both the structure of the target business and the value of the target. As a general rule of thumb, the greater the value of the target company the more extensive the level of warranties will be.

There are a number of common areas that warranties will focus on and these include:

- corporate warranties which cover the share structure and identify the legal and beneficial ownership of the shares;
- employment warranties which cover the number of employees in the business, their length of service, any employment breaches and ongoing employment investigations;
- property warranties identify if the business owns specific buildings and on what basis, and there may also be warranties on the condition of the buildings;
- litigation, regulatory and environmental warranties are often included to ensure that the business has not breached any regulation or environmental measure and that if litigation is ongoing a warranty as to the status of that dispute and the potential prospects of success;
- contractual warranties frequently appear in transactional documents and cover both supply of goods and services but also agency and distribution agreements; and
- financial and tax warranties cover both the company accounts and also the company's tax position.

Mitigating and managing warranties

You should only to give a warranty insofar as you are aware of the specific, relevant facts. Often the first draft document that the buyer sends over will contain a full set of extensive warranties, some of which may be too widely drawn or perhaps not even relevant to the nature of your company and business. Your solicitor will be able to remove or modify the warranties at this stage.

For the warranties which are relevant to your business; your solicitor can also seek to include provisions in the sale contract which limit your liability as seller, for example:

- capping maximum liability, say to a specified percentage of the purchase price
- setting a minimum thresholds for claims;
- providing a procedure for notifying and resolving claims and
- setting time limits within which claims can be made.

Warranties can prove to be highly technical and are a feature of any business sale contract which require special care and attention. A seller faces the risk of claims and future litigation if something later occurs which has not been adequately disclosed against a warranty. This can be time well spent if it avoids future claims and the legal expenses of a dispute – never mind the disruption to your retirement!

May 2019

Our key contact at DMP for further advice and assistance on warranties is:

William Montague, Partner

BillMontague@dextermontague.co.uk

tel: **0118 939 3999**