PAUL HASTINGS

Stay Current

**October 2020**

Follow **@Paul_Hastings**

# *Recent U.K. Cases Highlight Potential Pitfalls in Acquisition Agreements*

By Simon Airey, Garrett Hayes, Abigail Hung & Catherine Kennedy

## Falling foul of notice provisions in sale and purchase agreements

In the recent case of *Dodika Ltd & Ors v United Luck Group Holdings Ltd* [2020] EWHC 2101, the High Court ruled that a buyer's written notice of a claim under the tax covenant contained in a sale and purchase agreement ("SPA") was inadequate as it failed to comply with the specific notification provisions set out in the SPA.

The SPA provided that "*the rights of the buyer in respect of: any… claim under the tax covenant shall be enforceable if the buyer gives written notice to the warrantors stating in reasonable detail the matter which give rise to such claim, the nature of such claim and (so far as reasonably practicable) the amount claimed in respect thereof on or before [a specified date]*".

The buyer sent a letter to the warrantors purporting to be a notice of claim under the tax covenant in relation to an investigation by the Slovenian tax authority into transfer pricing practices at the target group; the notice set out the chronology of the investigation and a claim for an amount equal to any liability that the Slovenian tax authority might impose on the target group following its investigation.

The warrantors disputed the validity of the notice of claim and asserted that it was unenforceable as the letter purporting to notify them of the claim failed to comply with the specific notification requirements of the SPA.

The buyer argued that a general reference to the tax investigation in the notice was sufficient because the details of all communications and correspondence with the tax authority were already known to the warrantors, and that the notice should be construed in light of such pre-existing knowledge. The judge rejected this argument, highlighting that the key question was whether the notice provided reasonable detail of the matter that gave rise to the claim. The warrantors' existing knowledge could not be relied upon by the buyer in order to rectify the buyer's failure to provide reasonable detail and render the notification compliant with the requirements of the SPA.

The notification clause required particulars of the claims to be provided, including "details of the specific matter as are available to the purchaser in respect of which such claim is made". The judge indicated that there was no rigid formula for what has to be notified, and in each case this will largely depend on the nature of the claim, the facts known to the purchaser at the date of the notice, and whether it is realistic to put any monetary quantification on the amount claimed. As a minimum, he said, "*a compliant notice would identify the particular warranty that was alleged to have been breached; … at least in general terms the notice would explain why it has been breached, with at least some sort of particularisation of the facts upon which such an allegation was based, and would*

*give at least some sort of indication of what loss had been suffered as a result of the breach of warranty*".

The judge held that the letter relied on by the buyer as being a notice of claim under the SPA lacked reasonable detail (in fact, any detail) of the actual matters giving rise to the claim, based on the following:

- There should have been a statement setting out the facts based upon which the claim was made or contingently made. A mere statement that the claims notified related to the tax investigation was insufficient.
- The notice required a degree of specificity in accordance with the contractual notification clause. While it contained a description of the tax investigation, it did not specify "the matters giving rise to the claim" since it did not set out explicitly how the existence of the tax investigation gave rise to a claim under the SPA.
- The requirement for commercial certainty is paramount so that the notified party can make financial provision for it. The letter did not identify what facts unearthed during the tax investigation were being relied upon by the buyer in support of its claim and, as such, the warrantors were not in a position to assess the prospects of liability for breach of the tax covenant.
- The words "giving rise to" indicate that the relevant fact or matter is one on the basis of which the claim can be formulated. The claim itself would not be based on the existence of a tax investigation, but on the factual reasons why a tax liability accruing before completion had accrued or might accrue.

***Practice points:***

This case reaffirms the importance of ensuring that a notice of claim complies with the specific requirements of the contractual notification clause under which it is given. The notice of claim is essentially a legal step and ought to be treated and drafted accordingly.

Every notification clause turns on its individual wording and the courts have found that a failure to observe the requirements of a contractual notification provision can rarely be dismissed as being a technicality: accordingly, it is important that proper consideration is given to these clauses to ensure that, in circumstances where a purchaser expects to be able to bring a claim under a share purchase agreement, it is likely to be able to comply with the requirements of the notification clause.

A clause which requires particulars "of the grounds on which a claim is made" sets a high bar for the notification of a claim. Upon receipt of the notice, the vendor should know in sufficiently formal written terms that a particularised claim is to be made to enable it to make an informed assessment of the claim and take such steps as are available to it in order to deal with the claim, whether in terms of defending or settling the claim, or notifying others about it, such as insurers or accountants.

There could be circumstances in which an investigation in respect of a post-closing period is commenced before the expiry of any time limit on bringing warranty claims under an SPA but the investigation is not sufficiently advanced before the expiry of that time limit to enable the purchaser to provide specific details of the matter that gives rise to the potential claim or the amount claimed in respect of it. Most purchasers would expect to be able to bring a claim in respect of any such investigation, and it is therefore important to ensure that the notification provisions in the share purchase agreement do not frustrate their ability to do so.

If a notification clause requires the provision of "reasonable detail" of the matter that gives rise to the claim, this is to be interpreted as adding something to the need to specify the nature of the claim and the amount of the claim. What constitutes reasonable detail will depend on the nature of the claim. However, it is unlikely to amount to the level of detail that would be required, after further investigation, in any legal proceedings that might be commenced after the notification of the claim. In drafting a notification provision in an SPA from a purchaser's perspective, consideration should be given to specifically limiting the extent to which the purchaser is required to make additional investigation for the purposes of submitting a claim.

If a notice of claim does not specifically refer to earlier correspondence between the parties where further details of the potential claim are set out, that earlier correspondence will not be taken into account. It is important to ensure either that the notification is a stand-alone document or that it clearly cross-refers to and is deemed to incorporate any earlier correspondence which is relevant. Naturally, any such earlier correspondence should also be carefully drafted.

Owing to the strictness with which a notification clause and a related notice of claim are likely to be interpreted, careful thought should be given to the terms of the relevant clause when drafting or negotiating the same. Purchasers should give early and detailed consideration to the nature and extent of any potential claim and should pay careful attention to the form and content of any related correspondence and of course the notice of claim itself.

## Give careful consideration to the circumstances in which a tax gross up should apply

In the recent case of *AXA SA v Genworth Finance International Holdings LLC* [2020] EWHC 2024, which concerned the recovery of certain losses pursuant to an SPA, the High Court had to consider the phrase "subject to Taxation in the hands of the receiving party" in the context of a gross-up clause.

The parties disputed the interpretation of this language. AXA argued that the gross-up operated in relation to any payment made under the sale and purchase agreement that was "within the scope of a tax and not exempt". Such an interpretation could result in the beneficiary being overcompensated as the beneficiary would be able to recover any potential tax liability, even in circumstances where that liability never materialised (for example, through the use of any tax deductions or reliefs that are or become available to the recipient). Genworth took a different interpretation of the language and argued that the gross up should only apply to a payment that was actually subject to tax (rather than a payment that was only in principle subject to tax).

The High Court agreed with Genworth's interpretation and held that the phrase "subject to Taxation in the hands of the receiving party" meant "actually taxed in the hands of the receiving party", with the judge stating that the language should bear its ordinary and natural meaning and be interpreted in a manner that is consistent with the obvious commercial purpose of the clause. The judge noted that this interpretation would result in an outcome that reflects business common sense as there should be no reason why the parties would have intended to overcompensate the beneficiary.

### *Practice Points*

Key takeaways from this case include the fact that the contractual interpretation of provisions in an SPA will depend on the objective commercial purpose of the relevant provision. Clear and explicit language should be used where the parties wish to provide for an outcome that may not be commercially obvious.

The parties to an SPA should carefully consider how they expect a tax gross up provision to operate given the particular circumstances of the transaction and the parties to it. Should it only apply where

the recipient of the payment actually pays tax in connection with the receipt of that payment? What if the receipt of the payment does not result in payment of tax by the recipient, but reduces any reliefs that would otherwise be available to the recipient? Should the recipient have to use available reliefs to avoid tax on the receipt? What if the liability to tax, or the availability of reliefs, is disputed and needs to be referred to a tax tribunal or court to be determined?

### Exclusion from recovering goodwill on a breach of warranty

In the recent case of *Primus International Holding Company and others vs Triumph Controls UK Limited and others* [2020] EWCA Civ 1228, Primus was in breach of certain warranties given in an SPA entered into between the parties to the effect that certain long range projections for the target business had been "honestly and carefully prepared". The SPA contained a limitation which excluded liability for warranty claims "to the extent that… the matter to which the claims relates… is in respect of lost goodwill".

Primus sought to argue that, in this context, goodwill should have an accounting meaning, i.e. an intangible asset recorded when a company acquires another company and the purchase price is greater than the sum of the fair value of the identifiable tangible and intangible assets acquired and the liabilities that were assumed". At first instance, the judge disagreed saying "*the plain and natural meaning of goodwill in a commercial contract is business reputation. The losses sustained by reasons of the breaches are lost revenues and increased costs, leading to reduced profitability and loss of share value*".

Primus appealed to the Court of Appeal and argued for a slightly different meaning for loss of goodwill, being "a loss of share value, where that value represents the difference between the cost of the acquisition and the fair value of its identifiable net assets and/or where that loss of share value is caused by the impairment of the value of non-identifiable assets".

Rejecting Primus' appeal, the court found that:

- the ordinary legal meaning of goodwill is the good name and public reputation of the business concerned;
- this was not a claim for loss of share value: it was a claim for overpayment as a result of the careless long range projections. The loss was the difference between the price actually paid, and the lower price which Triumph would have paid had they known the true position. A businessman or lawyer would consider it to be an entirely different sort of claim to one for loss of goodwill;
- if a contract contains a term to which the parties intend to give an unusual or technical or non-legal meaning, that must be spelt out;
- it should ordinarily be presumed that language is used consistently within the four corners of an agreement. As such, the judge considered other usage of the term "goodwill" in the share purchase agreement in reaching his decision; and
- if Primus were right in its interpretation, this would significantly reduce Triumph's remedies for a breach of warranty. The judge felt that the parties are not likely to be taken to have intended to cut down the remedies that the law provides for breach of important contractual obligations without using clear words to that effect.

The court noted that claims for loss of goodwill are unusual; they are difficult to formulate and hard to quantify; they can be seen as the sort of marginal or speculative claim which a seller might reasonably want to exclude in an SPA. The purpose of the exclusion clause was to exclude any claim

by Triumph for damages to its reputation, good name or business connection arising from a breach of the SPA.

***Practice points***

If the intention is to exclude a specific type of loss or liability in an agreement, it is important to be emphatically clear.

It may be impossible to prevent a counterparty to an SPA taking a perverse interpretation, but if there is more than one possible meaning of the words under negotiation (even if one is more obvious than the other(s)), use different wording, clarify the intended meaning and/or utilise appropriate definitions.

Ensure consistency of terminology throughout agreements—if different terminology is used, even if the terms are intended to have the same meaning, courts can use this as evidence that the parties intended there to be different meanings.

✧ ✧ ✧

*If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings London lawyers:*

Simon Airey
+44.20.3023.5156
simonairey@paulhastings.com

Garrett Hayes
+44.20.3023.5153
garretthayes@paulhastings.com