Damages for breach of warranty – how should contingent risks be assessed?

A share purchase agreement (SPA) will typically include warranties that are given by the seller in favour of the buyer. They provide the buyer with a level of assurance as to the condition of the target company, providing recourse against the seller should matters concerning the target company prove not to be as they thought. But how should a buyer be compensated in a situation where a seller provides a false warranty, but the issue in question is contingent and the risk has not in fact materialised?

This issue was addressed in the recent Court of Appeal decision in *MDW Holdings Ltd v Norvill & Ors* [2022] EWCA Civ 883, [2022] WLR(D) 283 and the outcome will be of interest to a buyer who is looking to maximise the damages they may be awarded for a breach of warranty claim.

Background

The case concerned the sale of shares in a waste disposal company (the company). The claimant (buyer) discovered various breaches of environmental regulations by the company contrary to the warranties that the defendant (seller) had given (for example, warranting that the company had conducted its business in accordance with all applicable laws). The claimant sued the defendant for breach of warranty in the High Court and was awarded damages.

The defendant appealed the judgment arguing that when assessing damages, the judge had inflated the damages awarded to the claimant by taking into account risks which had not, in fact, materialised when valuing the shares of the company. In these circumstances the defendant argued that the company had not suffered any reputational harm, nor had it been prosecuted for anything / lost any licences to carry on its business so (the defendant argued) these should not impact on the value of the company's shares (i.e. there may have been a breach of warranty, but no harm was done).

What did the Court of Appeal decide?

The Court of Appeal agreed that the trial judge was right to disregard the fact that hypothetical reputational damage had not occurred, as had the claimant known about the breach of warranty at the time of the SPA (and the potential risks it carried) then it would have factored this into its appraisal of the value of the business which would have been lower. The court therefore recognised that the breach in question represented a risk to the business (which therefore negatively impacted its value) even where that risk never materialised into any actual harm.

The take home message from this case is that a warranty is either true or false and the fact that a warranted risk did not materialize is unlikely to provide assistance to a seller who has given a false warranty. The parties to any business sale should therefore seek proper legal advice to ensure that the terms are well drafted and (in particular) the warranties are properly considered so that risk is sensibly apportioned between the parties and any identified risks are disclosed by the seller.

Written by

Tom Bourne

Partner