Representation or Warranty?
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A recent English High Court decision reminds us the vital differences between representations and warranties - features that are commonly, but unwisely, glossed over when drafting agreements.

Background

Sycamore Bidco Ltd v Breslin[1] involved the sale and purchase of a company by shares. After completion of the transaction, the buyer discovered errors in the target company's audited accounts, resulting in an overvaluation of the target company and an inflated purchase price. The relevant accounts were the subject of express warranties in the share purchase agreement ("SPA") as to their accuracy. The buyer sued for breach of warranty and claimed, in the alternative, that the breached warranty was also a false representation that had misled him into entering into the SPA.

For the buyer's claim for breach of warranty, the maximum claim for damages was around £6 million. Had the alternative claim for misrepresentation succeeded, damages may have equalled or exceeded the purchase price of £16.75 million.

What's the damage?

A **representation** is a statement of fact, which is relied upon by a buyer and induces him to enter into a contract. Where a false representation has been made (*misrepresentation*), a contract may be voidable (*rescission*): the buyer was misled into making the contract, may set it aside and be put back in the position he was in before the contract, as though it had never existed.

A **warranty** is a term of the contract. The remedy for breach of a contract term is to put the wronged party into the position that he would have been, had the breached term been performed correctly. If the breach is fundamental to the contract (*repudiation*), the wronged party may also have the right to terminate the contract, with damages assessed at the point of termination. However, the contract is not undone as though it never existed.

The importance of drafting

The *Sycamore* decision made the following points about the drafting of the SPA and the circumstances of the agreement:

- The SPA and referenced disclosure letter used clear language to describe the warranties and distinguish them from being treated as representations. It is not enough that the subject matter of a warranty is capable of being a representation, there must be a clear reason if an obligation is to be extended beyond the natural meaning of the language used;

- The limitation of liability clause referred to warranties. If a warranty could also amount to a representation, the limitation of liability would not apply in the case of misrepresentation, depriving the seller of substantial protection. This could not have been the commercial intention, given the liability structure of the SPA.

- A misrepresentation is typically made *before* entering into the contract, and *results in* making the contract. If the purported misrepresentation is only found in the contract itself, conceptually there is a timing issue with a claim that such a statement induced a party to enter into the contract[2].

Conclusion

There are cases where warranties have also been found to be representations. Where the axe falls in each case will hinge on the specific wording of the contract and facts of the case.

Accordingly, appropriate and accurate language should always be included when drafting contracts. Where a warranty is relied upon as a representation, this should be clearly stated, and equally so where exclusions are intended to apply.

[1] [2012] EWHC 3443 (Ch) – Judgment dated 30 November 2012.

[2] There would be no timing issue if the contract expressly provided for certain contractual provisions to be treated as representations but that was not the case in *Sycamore.*

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