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Breach of the "true and fair view" of accounts warranty in company sales and purchases

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A recent UK Commercial Court decision regarding the measure of damages recoverable for breach of warranty in a sale and purchase agreement is described and contrasted with the solution that could be reached in Spain.

1. Subject matter

I will briefly set out the conclusions of a recent UK judgment – specifically, of the High Court of Justice in *Oversea-Chinese Banking Corp v ING Bank NV [2019] EWHC 676 (Comm)* – on the matter of the measure of damages for breach of warranty in a private merger andacquisition (M&A), a matter whose importance then merits translating to Spanish law.

2. The English judgment

In 2009, Oversea-Chinese Banking Corp (OCBC) entered into a sale and purchase agreement (SPA) with ING for the acquisition of ING Asia Private Banking Limited (ING-APBL). The latter had a financial exposure to Lehman Brothers (LB). Following a lawsuit concerning the value of this exposure after the LB crisis, a settlement is reached in 2012 pursuant to which ING-APBL makes a payment of $14.5 million to LB. ING had warranted that the accounts for 2008 of the target company contained a true and fair view of ING-APBL's state of affairs. OCBC argues that but for the seller's breach, the buyer would have known the true accounting position of the company being purchased and would have required the inclusion in the contract of an

indemnity equivalent to ING-APBL's liability to LB. According to the buyer, the diminution in the value of shares is not the *only* measure of loss, and the normal measure of damages for breach of accounts warranty is the estimated loss directly and naturally resulting from the breach, i.e., $14.5 million.

According to the court, the accounts warranty was a contractual warranty of quality, and the measure of damages recoverable for breach of such a warranty in a sales and purchase agreement consists of the difference between the true value of the asset and the value it would have if it had the warranted quality, by analogous application of s 53 of the Sale of Goods Act (not directly applicable to the sale of shares). Neither the authorities nor the textbooks supported the proposition advanced by the buyer, the claim that the measure of damages could be a hypothetical indemnity having to be rejected.

3. Translating the case to Spanish law

Naturally, we start from a sale and purchase agreement where the parties have not expressly agreed on the amount of indemnity in the event of a breach of representation or warranty. Although the usual provisions in contracts are quite detailed, specifying this is not the norm. All costs and losses in general are mentioned and then indirect, consequential, loss of earnings, etc. are usually excluded. These routine formulas are not specific to the correct measure of recoverable damages in a dispute such as that heard by the English court.

Unlike English precedents, Spanish (Supreme Court) case law has no established practice on the issue at hand. It is very probable that, if the contingency were the loss of an asset of the company that is the target of purchase, the buyer would be able to recover the replacement value, higher, in such a case, than the impact on the value of the shares, as held in judgment of the Supreme Court of 30 June 2000 *(Tauro)*. But neither would it reject a method of calculation such as that considered in the High Court judgement if the buyer, in his best interests, proposes it. It would certainly disregard any impact of replacement value or loss of earnings when the lost asset or emerged contingent liability was not particularly "warranted" in the list of representations and warranties. Consequently, the measure of damages remains an open issue in our case law, which, moreover, is neither abundant nor eloquent.

If the contingency that makes a representations and warranties clause - the contingency, for example, that the representation and warranty that the company's accounts show a true and fair view is not correct - were a latent defect in the sale and purchase of shares, Art. 1486 of the Civil Code could be applied, so that the buyer "would have to compensate for the difference between the price he paid for the shares and the price he would have paid if he had known of the negative contingency". But this limit to compensation (limit because the lower price may not equal the replacement cost) would not apply, under the same rule, if the seller had "conducted himself with malicious intent". In this case, the buyer could additionally claim "the remainder of damages", without the rule specifying what those damages are.

But let us take note of the structure of Art. 1486 of the Civil Code (assuming that there is no malicious intent). The seller does not have to compensate for the difference between the present value of the company's capital and the value it would have had if it had not been for the contingency, but the difference between the *price paid* (perhaps less than the value with the quality as warranted) by the buyer and the price he would have paid had he known the contingency. The difference is important, as the High Court itself explains in another recent case where precisely this circumstance applied *(116 Cardoman Limited v MacAlister [2019] EWHC 1200)* where the price as warranted was £500,000 below the value of the company as warranted, so that the buyer was only able to recover *the price paid*, assuming a present value of the shares not exceeding zero.

But the Supreme Court has *occasionally* held that warranted and produced contingencies do not constitute latent defects of the shares sold in a sale and purchase agreement because the shares as such do not have a defect, but are simply worth less (Judgments no. 1059/2008 of 20 November, *ENA*, and no. 230/2011 of 30 March, *Dental 900*). This is probably an argument appropriate to the way in which the parties presented the debate in each case, but I believe that, if the buyer makes a good argument, no court would deny the possibility of compensation in the form of an *actio quanti minoris* (action to reduce the price) equal or equivalent to the model of Art. 1486 of the Civil Code. In fact, it has operated in this way many times, outside the scope of the sale and purchase of companies.

Our courts would not accept, as far as can be predicted, that such a price reduction would be the only possible compensatory alternative, especially if, as it seems - and is almost always the case - the representations and warranties are wilfully breached. It is true, however, that they would not have awarded the buyer damages the *amount of an "indemnity" that they would have possibly or probably sought and obtained at the time of negotiation,* because these damages would be based on a hypothetical legal transaction to be entered into by the seller himself. And such a thing is not possible because the negotiation of indemnity is not a certain fact, foreseeable in the sense of Art. 1107 of the Civil Code, since it depends on the discretion of the counterparty, depending in turn on the respective bargaining power of the parties and the respective interest that each one had in the transaction. It is not so much the proposed compensation that is inadmissible, but rather the speculative nature of the event on which the buyer bases the same.

Notwithstanding how little our judicial praxis teaches us and the scarce expressivity of contracts, I am sure that in Spanish law, damages such as those intended by OCBC are not excluded as a matter of principle, provided that the loss is presented as a necessary consequence of the breach and not as the price of indemnity that would have been negotiated. The only anchor that we would have to fix a legislative solution such as the one upheld by the High Court would be Art. 1486 of the Civil Code, and for a long time this provision has been overtaken in indemnity-related matters.

The above conclusions apply if it is a simple case of acquisition by outsiders of 100 % of the share capital of the company in question. If this is not the case - if who acquires is someone who was already a shareholder – said person is not entitled to the replacement value of the revealed liability. Neither does he who acquires a package of shares *far from* 100 % of the share capital. In such cases, an indemnification for breach of warranty on the part of the seller must be expressly provided for.