Complying with SPA notice provisions

When it comes to a sale and purchase agreement (SPA), it is important to comply with all the legal minutiae of the provisions, as a recent decision in the High Court has made clear. While this may sound arcane, Ivan Shiu and Karla Dudek of law firm Hogan Lovells argue that this decision will be of great practical relevance to private equity practitioners and directors looking to sell their company.

The High Court decision in the 2017 case of Zayo Group International Ltd v Ainger and others (*Zayo*) delivers a pertinent reminder of the need to comply with the strict terms of notice provisions in an SPA, both in terms of the contents of those notices and how they are served. In addition, all parties should consider the effects of limitations of liability *(see box)*.

Anyone considering the sale of a company should take note of this decision. One of the key issues the court considered was the interpretation of a so-called musketeer clause in the SPA, which said that no management seller would be liable for a warranty claim unless a notice of the warranty claim was given to all of the management sellers.

The dispute

A dispute arose between Zayo Group International Limited and a group of management sellers after the 2014 sale of Ego Holdings Limited and its subsidiaries. The subsidiaries included Geo Networks Limited, which provides a fibre optic network in the UK. Zayo claimed the management sellers had breached their warranties on the accuracy of the target companies' accounts, resulting in significant losses.

The SPA provided that the management sellers would not be liable for a warranty claim unless all of them had been given notice of the claim, and that Zayo would have 18 months from the date of a claim to give this notice. Zayo did not give notice of its claims until the last day permitted under the SPA. Unfortunately for Zayo, the courier did not deliver one of the notices to the address specified in the contract as he was told that the addressee no longer lived there. So only six of the seven management sellers received notice of the claim.

The management sellers denied all claims and issued an application for them to be struck out or for summary judgment, or both.

High Court decision

The court held that the notice had not been validly served, and it granted the management sellers' application to strike out all of Zayo's claims. The court said that, even if the notice had been served on time, it failed to comply with the SPA requirement to state a reasonable estimate of the amount claimed.

The notice merely stated the target companies' liability in relation to the alleged breach of warranties and did not provide any information on Zayo's loss, which would have been the resulting reduction in the value of the shares it had acquired. The court also found that, even if the claims had been advanced as claims for diminution in value, they would still have been lacking important information. Therefore, Zayo would have had no real prospect of succeeding on these claims.

SPA notice provisions

Although practitioners often regard notice provisions as boilerplate, *Zayo* confirms that generally these notice provisions must be complied with and, if they are not complied with, then it is not necessary for the court to go on to consider the seller's liability. So, if a notice is not served correctly or its contents are deficient, the courts will have grounds to dismiss the warranty claim without even having to consider the merits of the claim.

Below we outline some of the key lessons from *Zayo*:

Information in the notice – during SPA negotiations, practitioners should consider carefully what information needs to be included in a warranty claim notice, whether a notice will be invalidated if this information is not included and, when there are several sellers, whether a notice must be served on

each seller in order to be valid against any seller. The buyer may instead require all the sellers to appoint a representative and insert a provision in the SPA that service of a notice on this representative will be deemed to be service of notice on each of the sellers.

Correct measure of loss – most SPAs require a notice of warranty claim to give a reasonable estimate of the amount claimed. Unless the SPA provides that warranties are given on an indemnity basis, this should be based on the estimated reduction in the value of the shares resulting from the warranty breach. It should not be based on the amounts paid by the seller or the target company as a result of an alleged breach, as Zayo did in this case.

Where an incorrect measure of damages is included in the notice, a court will probably determine that the notice did not include a reasonable estimate and the claim may be dismissed. The court in *Zayo* noted that this is not a technical point. Rather, it goes to the commercial purpose of the notice clause: the failure to provide an estimate of the loss based on the correct measure of damages would affect the defendants' ability to put monies aside or pay the claim, or reach a settlement on the claim.

Claim details – warranty claim notices should provide a reasonable level of detail about the claims being made. In *Zayo*, the court held that Zayo had failed to provide sufficient detail in several ways including by: not specifying what the level of accounting provision should have been, nor what its impact was on maintainable earnings or the value of the shares; not separating out the value of different claims; and significantly changing the amounts claimed for in its particulars of claim.

Instructions to couriers – practitioners should give couriers clear instructions on what to do if they are told the intended recipient no longer lives at the address stated in the SPA or is not at home. In *Zayo*, if the courier had left the notice at the address stated in the SPA, the notice would have been deemed to have been delivered.

Timing of the claim – don't leave it until the last minute. If the warranty claim notice is not served within the periods stipulated in the seller limitations of liability provisions in the SPA, the claim will be dismissed by the courts.

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Accounting provisions

The High Court in *Zayo* also considered the interpretation of a common limitation of liability provision. This provides that a seller won't be liable for a warranty claim to the extent that a provision in respect of the liability giving rise to the claim has been made in the accounts of the target company. The court noted that the management sellers had made provisions in the accounts for several of Zayo's claims and said that these provisions amounted to "buyer beware" flags that transferred the risk to the buyer.

For buyers, *Zayo* reinforces the importance of:

- giving full consideration to accounting provisions;
- deciding whether to investigate the relevant matters further;
- and considering the impact of the liability on the valuation of the business, including whether to seek a price reduction or a specific indemnity, which could be negotiated to fall outside this limitation of liability provision.

The court in *Zayo* also said that, if the buyer knows a provision has been made in the accounts, the seller will have no liability at all for a breach of warranty in respect of the matters giving rise to that claim, whether or not the provision is sufficient. The decision did not address whether the situation would be different where the limitation refers to a provision that may subsequently be made in the completion accounts.