# Breach of warranty claims

This section considers who can bring a breach of warranty claim and how any damages are calculated.

# Who can bring a breach of warranty claim?

The buyer, as a party to the acquisition agreement, will be able to bring an action against the seller in the event of a breach of warranty.

There may also be some circumstances where a person who is not a party to the agreement may wish to bring a claim. For example, following completion, there might be a **reorganisation of the corporate buyer’s group** and the target might be transferred within the buyer’s group so that it is no longer directly owned by the buyer. Alternatively, the target might be sold on to a third party **not connected to the buyer’s group.**

There are two possible ways in which a person who is not a party to the acquisition agreement might nevertheless be able to bring a claim against the seller:

1. **Assignment; or**
2. **Contracts (Rights of Third Parties ) Act 1999 (‘CRTP’).**

We will now consider each method in turn.

# Assignment

First, the benefit of the warranties and indemnities in the acquisition agreement might be **assigned to the third party** if that is **permitted** by the agreement. It is unusual for the seller to agree to such assignment to an external third party except, for example, where the buyer needs the assignment as part of the security for the bank which is providing some or all of the finance to the buyer for the acquisition. However, **intra-group assignments** are usually acceptable and are often included.

If such an assignment is required by the buyer for any other reason, then the buyer will generally try to ensure that there is an **express provision in the acquisition agreement** to allow such an assignment. The seller will try to resist such a clause. The outcome of this will depend on the bargaining power of the parties. If, however, assignment is permitted then, under equitable principles, an assignee **cannot recover from the debtor (in this case the seller) more than the assignor could have recovered** had the assignment never taken place.

# The Contracts (Rights of Third Parties) Act 1999 (‘CRTP’)

CRTP allows warranties and indemnities to be given for the benefit of third parties. CRTP allows a third party to enforce a term of a contract if:

* the contract expressly provides that it may; or
* the term purports to confer a benefit on it.

If a third party has the right, under CRTP, to enforce a particular contract term then it will have the same remedies for breach of contract as if it were a party to the contract.

A buyer may often seek to exclude the application of CRTP, thus preserving privity of contract. It may be advantageous, however, to provide that certain specific terms do confer rights upon third parties.

For example: A corporate buyer wishing to transfer the target to another company within the buyer’s group will want the latter to have the benefit of the original seller’s warranties. If the target is to remain in the corporate buyer’s group, the seller should not generally have any objection to this, but the seller would probably resist any attempt to confer any rights on an unconnected third party.

# How are damages calculated for breach of warranty?

1. If a warranty is untrue, the buyer’s remedy is for **breach of contract.** Any award of damages would seek to put the buyer in the position in which it would have been if there had been no breach; in this case, the position in which it would have been had the warranty been true.
2. To recover damages, the buyer must. In the context of an acquisition agreement, this will mean that the buyer must establish that the value of the target has been diminished by the breach of the warranty.
3. Even where loss is proved, the damages will be limited by the **general rules of remoteness** and **the buyer’s duty to mitigate its loss**. You will remember from studying Contract Law, that loss is only recoverable where it:
   1. flows naturally from the breach; or
   2. was in the reasonable contemplation of the parties at the time the contract was entered into as the probable **prove loss** result of a breach of it.

Even if loss is not too remote, it will be subject to the duty to take reasonable steps to reduce such loss. What the “reasonable steps” will be will depend on the particular circumstances of each individual case.

# Limited remedies

Where a particular warranty is regarded as being key, and it may be particularly difficult to evidence the diminution of value of target as a result of breach, the buyer may try to stipulate that damages for breach of this warranty should be awarded on an **indemnity basis**. This is where a specific warranty is backed by an indemnity. This is rarely agreed in a UK deal and should be resisted by a seller.

In addition to the usual limitations on recovery under contract law (as noted on the previous slide) a seller will also include limitations on warranties and any indemnities to explicitly limit the types of loss that a buyer may recover (e.g. limiting indirect loss, consequential loss or loss of profit).

# Summary

* The acquisition agreement may expressly provide for an assignment of the warranties and indemnities to a third party or for the application of the Contracts (Rights of Third Parties) Act 1999 allowing a third party to enforce a term of the acquisition agreement. The seller will usually seek to limit such provisions to companies within the buyer’s group.
* Even where loss is proved, the damages which can be recovered by the buyer may be limited, following usual contractual principles, by the rules of remoteness and the requirement to mitigate. Proving loss and showing that the loss is not too remote may present practical problems.