**Drafting the sale and purchase agreement (‘SPA’) – Seller protection provisions**

This section considers the effect of seller protection provisions in the SPA to limit the seller’s potential liability

# Limitation

As we have already seen, the SPA will invariably include extensive warranties and, possibly, some indemnities - particularly if the first draft of the agreement is prepared by the buyer. Under the normal limitation rules, this will mean that the **seller is exposed to being potentially sued for any size of claim, without qualification or limitation** (subject to the normal contractual rules on loss and damages), for up to 6 years (or 12 years if the SPA is executed as a deed).

The seller’s solicitors will therefore wish to introduce terms seeking to limit their client’s exposure. They will generally do this by including a set of limitation clauses in the SPA. These are known as seller protection clauses or limitation of liability clauses (or sometimes vendor protection clauses).

We will look at how this provision might be affected by warranty and indemnity insurance in Element 4 of this Topic.

# Cap on liability

The seller will want to include a clause in the SPA that places a **maximum cap on its liability** otherwise it is exposed to any size of claim, including a claim for more than the price that the seller was paid for the target.

The seller will therefore want to ensure that there is a **monetary cap** on its liability so that it cannot be held liable to pay the buyer more than a certain amount – in a bilateral sale this can be set at the purchase price for fundamental warranties in relation to title of the shares. For warranties other than the fundamental warranties it is common to set a cap lower than the purchase price.  In auction sales and particularly large transactions, it is more likely to be set at significantly less than the purchase price.

Most buyers are willing to accept such a limitation but will usually seek to ensure they have adequate protection, particularly in relation to fundamental warranties. The limit is usually driven by the commercial circumstances of the parties and market norms.  If the buyer does accept a liability cap, then it should try to ensure that this limitation does not apply to protect the seller in relation to any claims which arise as a result of dishonesty, fraud or wilful concealment by the seller.  The buyer will also seek to provide that the cap applies only to **warranty claims** rather than all claims (including indemnity claims) under the SPA.

Where a buyer has warranty and indemnity insurance in place this cap may be as low as £1.

# Limitation for small claims

The seller will also want to impose a limit on small claims. Both parties usually agree that the expense incurred and the inconvenience caused in pursuing claims cannot be justified if the claim is below a certain threshold. There are usually two elements to this limitation:

**De minimis**

Firstly the seller may want to include is a de minimis amount (sometimes known as a “disregard” or “throw-away”). No claim can be made for any claim that is below this amount and such claims will not count towards the “basket” described below.

**Basket**

Secondly, a minimum threshold will be agreed between the parties meaning that the buyer cannot bring any claims unless the aggregate value of those claims (that are above the de minimis amount) is at least the amount of the threshold (also sometimes referred to as the “basket”). Once that threshold has been exceeded the buyer will usually insist on a right to recover the whole amount not just the amount of the claim which exceeds the threshold.

**Market Practice**

In a large number of transactions the de minimis/throwaway is set at around 0.1 per cent of the consideration paid for the target and the basket/threshold will be around one per cent but this will depend on the size and nature of the transaction and the relative bargaining strengths of the parties.

**An example**

Suppose, for example, that you are acting on a transaction where the consideration is £5,000,000. The de minimis may be set at £5,000 and the basket at £50,000.

The buyer has a number of unconnected claims of less than £5,000. They will be unable to claim these from the seller, regardless of the total value of these claims.

The buyer has additional claims of £6,000 and £48,000. As these claims, which exceed the de minimis, when combined also exceed the basket of £50,000 the buyer will be able to bring a claim for the whole amount of £54,000.

# Time limits

The seller protection provisions usually also contain a **detailed procedure** that must be followed by the buyer in order to bring a claim. This procedure will set out a number of time limits for notification and commencement of claims. The theory behind having time limits is that once one complete audit has been carried out on the target following completion, any problems should have come to light and that the buyer should not be able to hold claims over the seller indefinitely

There are generally three key time limits to consider:

The buyer often will be under an obligation to notify the seller of a claim within a **reasonable time** of becoming aware of circumstances of the claim.

Any notification of a claim should be made by the buyer within a period of time following completion. It is common practice for parties to agree a time limit of between **one and two years** in respect of non-tax warranties.

Finally, once a claim has been notified legal action should usually be commenced within a certain time after notification.

This is often between **six and twelve months**

# Tax liabilities

1. A longer period is generally allowed in relation to **tax liabilities** to allow for the time for which **HM Revenue & Customs (‘HMRC’)** may bring claims.
2. HMRC can bring corporation tax claims up to four years from the end of the accounting period within which the tax liability arose and **up to six years** in respect of careless behaviour.
3. A period ending on the sixth anniversary of the end of the accounting period in which completion occurs (for simplicity, more **usually seven years after the completion date**), has in the past generally been agreed for tax warranties and indemnities as HMRC used to have six years to bring a claim for any matter. This remains a common limitation but strong sellers may negotiate a lower limitation to four years.

# Other seller protection clauses

Other seller protections that sellers will often want in the SPA include clauses that:

* the seller will not be held liable if the loss is covered by the target’s insurance, provision in its accounts or if there is a right of recovery from another third party;
* the seller will not be held liable for losses arising as a result of changes in legislation, tax rules or accounting policy after the date of the agreement, or for acts or omissions of the purchaser; and
* the buyer is not entitled to recover damages more than once in respect of the same loss.

# Conduct of claims

If a third party makes a claim against the target, which may give rise to a breach of warranty or indemnity claim against the seller, the seller will ultimately bear the liability if the third party is successful. The seller will therefore want conduct of the claim made by the third party because it may think that the buyer will not defend the claim as vigorously as it would normally because it will be able to recover its loss from the seller whatever the outcome of the claim by the third party.

However, the buyer will probably want to retain control of the claim because it will be concerned about the potential damage that such a claim could do to the reputation of the target and to the relationship (if there is one) with the third party. If the buyer allows the seller control of the claim the seller is likely to defend the claim as vigorously as possible – it may not be concerned about the target’s reputation and/or relationship with the third party.

# Summary

* Seller protection provisions are another means by which the seller’s solicitors can seek to limit the potential liability of the seller for breach of warranty or other claims arising under the SPA.
* These provisions generally contain a time limit as well as an upper limit on the value of any claim for damages that can be brought by the buyer.