

‘Reps’ and Warranties: One Could Cost More Than the Other Under English Contract Law

By Raymond L. Sweigart and Christopher D. Gunson

Contractual representations and warranties are often grouped together, referred to in shorthand as “reps and warranties.” The differences between the two concepts are often forgotten, but the distinction is important: a representation is a statement of fact made by one party to another party that, if untrue, may create grounds for a claim under tort for misrepresentation; a warranty is a contractual promise that, if untrue, may create a cause of action for breach of contract. The measurement of damages for each cause of action is different, and a failure to appreciate the distinctions when entering into a contract governed by English law could be quite expensive, as recently illustrated by the English High Court decision in Sycamore Bidco Ltd v Breslin & Anor., [2012] EWHC 3443 (Ch).

According to the findings of Mr. Justice Mann, the claimant Sycamore was formed for the special purpose of acquiring from the defendants all the shares in a private limited company known as Gissings Group Ltd, the principal asset of which was an operating subsidiary known as Gissings Advisory Services Ltd., for an amount in excess of £16 million. The share purchase agreement (SPA) contained an express warranty that the acquired company's accounts gave a true and fair view of the company's finances and had been prepared in accordance with generally accepted accounting principles.

Sycamore subsequently determined that certain amounts had been improperly included in the company's accounts as turnover and that this rendered the accounts inaccurate. It began court proceedings against defendants alleging, amongst other things, a breach of their accounting warranty. Sycamore further claimed in its legal action that each express warranty in the SPA was also a representation that had induced it to purchase the company shares, and therefore each also amounted to an actionable misrepresentation under both common law and the Misrepresentation Act 1967.

Mr. Justice Mann, after consideration, held that there had indeed been a breach of the express warranty but dismissed Sycamore's claim for misrepresentation. The SPA provided that "Each party acknowledges that it has not relied on or been induced to enter into this agreement by a representation other than those expressly set out in the Transaction Documents." Another factor in this decision was that the SPA's limitation of liability clause referred only to warranties. In Mr. Justice Mann's view, it could not have been the reasonable intention of the parties to apply a strict limitation to any claim for breach of a warranty but then to turn around and provide for unlimited liability if a warranty was also considered a representation. He found that the contract language of the SPA clearly distinguished between representations and warranties and there was no reason to conflate or extend those terms beyond their natural meanings.

The distinction between warranty and representation came to have very real consequences for Sycamore because of the difference in the measure of damages for the claim for breach of warranty compared with that for misrepresentation, which under English law are different in the following ways:

- damages for breach of a contractual warranty are to be calculated so as to put the claimant in the position it would have been in but for the breach, that is, as if the warranty had in fact been true rather than untrue –the books and records fair and accurate rather than improperly inflated; whereas
- damages for a tortious misrepresentation that induced the contract are calculated to put the parties back to their pre-contract positions.

Sycamore argued under its rejected claim for misrepresentation that, if it had been aware of the target company's true financial position, then it simply would not have bought the company and demanded repayment of the entire £16 million it had paid. In awarding Sycamore only damages for breach of warranty, Mr. Justice Mann based his calculation on the difference between the amount Sycamore paid for the company and what the company was actually worth, or what he found Sycamore would have paid had the warranty of financial condition been true. That came to around £4.75 million.

The value of these terms and the distinction between representations and warranties thus came to about £11 million. This case serves as a reminder that it is well worth the time to carefully consider the full implications of the contract wording, and to remember the critical importance between the consequences of making and receiving a representation and a warranty.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Raymond L. Sweigart [\(bio\)](#)
London
+44.20.7847.9607
raymond.sweigart@pillsburylaw.com

Christopher D. Gunson [\(bio\)](#)
Abu Dhabi
+971.2.596.8924
christopher.gunson@pillsburylaw.com

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