Cripps

Overpaid for a business: what are your options?

You have bought the shares in a company and within a few weeks you discover a black hole in the accounts, some liabilities you did not know about and the termination of some key customer contracts. The business is in your view worth much less than you thought it was. What can you do?

The answer to this question depends upon the terms of the agreement you made with the seller of the shares, often called a Share Purchase Agreement, or SPA for short.

The starting point in any share purchase is "buyer beware". In other words, the business is sold as seen. The onus is on the buyer to ensure that they understand what they are buying and that they have a route to recover money from the seller if things are not what they seem.

This is done in a well drafted SPA by the use of a Disclosure Letter together with Warranties and Indemnities. There may also be a mechanism for adjusting the purchase price by reference to accounts produced after completion. These provisions should be your starting point in determining whether you have a claim. There may also be other protections in the SPA such as a retention of part of the purchase price for a period post completion.

Warranties are assurances given by the sellers about certain facts. Often there are many pages of these in the SPA. Indemnities are an agreement to compensate on a pound for pound basis in certain defined events and are likely to be narrower and much more limited in number. Much time can be spent by lawyers negotiating these provisions and depending on the balance of power in the negotiations they can favour either the buyer or the seller.

If the problems identified in our example are covered by an Indemnity then you are likely to have a

straightforward claim against the seller.

If they are covered by a Warranty then the position is a little more complicated. The first thing to check is whether the fact which turned out to be incorrect was revealed in the Disclosure Letter. If there is a document that has been disclosed which indicates the potential liability that has arisen then no claim may be possible. There can be a lot of argument about what amounts to proper disclosure and the Disclosure Letter itself is often one of the most heavily negotiated parts of the SPA.

Assuming that there is no disclosure then the next consideration is what can you claim. Take the example of the unexpected liability. You cannot simply claim the amount of the liability. The legal measure of loss that can be claimed is the difference between the value of the shares / company as warranted (i.e. without the liability) and the true position (i.e. with the liability). This is often the subject of much legal argument and ultimately the value of the claim may depend upon expert accountancy evidence.

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