

## Case Study: Disputes concerning representations and warranties.

The SPA was concluded for the transfer of shares in a limited liability company constituting 30% of the share capital. The price in aggregate was 1,000,000 Euro. The company's scope of activity comprises mainly holding and managing shopping malls. The closing of the contract took place a year earlier. The contract included dozens of R&W, three of which were not true. The SPA does not contain any particular provisions concerning liability of the Seller in case of breach of R&W. The following R&W were broken:

1. **Undisclosed Liabilities:** "Except as set forth in the Disclosure Letter, the Acquired Company has no liabilities or obligations of any nature (whether known or unknown and whether absolute, accrued, contingent or otherwise), except for liabilities or obligations reflected or reserved against in the Balance Sheet and current liabilities incurred in the Ordinary Course of Business since the respective dates hereof". In reality, meanwhile, there was a liability of the Company amounting to 3,000,000 Euro which was disclosed in one of the hundreds of documents in the data room but not disclosed in the Disclosure Letter or in the Balance Sheet, or in any other attachments to the SPA. The SPA also contained a general clause which provided that all relevant information and documents were disclosed in the R&W or in the Disclosure Letter. On the other hand, the SPA neither (i) contained any provision stating that the Seller does not bear liability in respect of any data or information which was known or might have been known or was made available to the Buyer nor (ii) any opposite statement, like "knowledge or awareness of the Buyer does not exclude or limit liability of the Seller, except for circumstances expressly revealed in the SPA or in the attachments thereto". Buyer's claim amounts to 30% of the value of the undisclosed liability, which is 900,000 Euro.
2. Lease agreements: "The Seller hereby warrants to the Buyer that aggregate Gross Rents actually received by the Company for the first two years will not fall under the amount of 2,000,000 Euro for the first year and under the amount of 3,000,000 Euro for the second year. For the sake of clarification, the calculation of the Gross Rent starts on the day of signing of the present SPA". In reality, the Gross Rent for the first year amounted to 50% of the guaranteed amount, i.e. 1,000,000 Euro. One of the designees of the Purchaser was a member of the management board of the Company, and this was the Company responsible for promotion activity for the entire shopping mall. The Rent included in the lease contracts for retail space was based on income derived by the Lessees from their activity. Buyer's claim amounts to 30% of the shortfall in Gross Rent for the first year, which is 333,333 Euro.
3. With respect to the breaches described in items 1 and 2 above, due to the absence of liability clauses in the SPA, the Buyer is also considering increasing the value of its claims in order to reflect the effect of these breaches on the valuation of the Company (and, in consequence, of the purchased shares) calculated according to EV/EBITDA formula which constituted for the Buyer the basis of the price offered by

the Buyer. This valuation has not been expressed or even referred to in the SPA. This valuation has, however, been known to the Seller, as it has been discussed during the SPA negotiation process.

4. Title in the shares: "The Seller is, and will be at the Closing Date, the record and beneficial owner of the Shares, free and clear of any and all Encumbrances". In reality, the Shares were pledged to a bank, being one of the collaterals of a bank loan in the amount of 300,000 Euro. The issue of the pledge over the shares has been examined in the legal due diligence during which the Buyer's legal counsel only verified and relied upon the Company's share register, which did not reveal any pledge over the shares. The pledge has been, however, entered in the register of pledges, and the Buyer and its legal counsel might have easily obtained a certificate from the register attesting that the shares were subject to the pledge. The Buyer now claims the value of the loan, i.e. 300,000 Euro.