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Key Differences in US and UK Stock Purchase Agreements

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Although market practice in the UK and US in respect of share/stock purchase agreements is becoming more closely aligned, there are still some important M&A distinctions of which lawyers working on transatlantic transactions, and their clients, should be aware.

PRE-CONTRACTUAL REPRESENTATIONS

In both jurisdictions, it is usual to include an "entire agreement clause" to ensure that the seller cannot subsequently be found liable for representations and/or warranties that are not expressly incorporated into the written agreement. However, there is a developing theme emerging from case-law in the UK to suggest that an entire agreement clause alone will not exclude remedies for pre-contractual misrepresentations, and therefore in the UK it is also important to expressly provide in the agreement that the only remedies available to the buyer shall be for breach of contract and, importantly, that the buyer shall not have the right to rescind the agreement after closing.

FRAUDULENT MISREPRESENTATION

An attempt to exclude or limit liability in an English law governed agreement must be reasonable to be effective. For example, if an entire agreement clause fails to provide that it does not apply in the case of fraudulent misrepresentation it is likely to result in the court finding that the entire clause is unenforceable under English law (whether or not the matter to which the seller is seeking to apply the exclusion or limitation actually involves a fraudulent element).

Similarly in the US, it is generally held to be against public policy for parties to contract out of liability for fraudulent misrepresentation so it is common to see a clause limiting liability to expressly provide that it does not apply in the case of fraud. However, a court in a US jurisdiction is not likely to declare the entire clause unenforceable merely because it does not carve out fraud as an exception.

DISCLOSURE

Under an English law governed share purchase agreement, the seller's disclosures against the warranties are typically contained in a separate disclosure letter, rather than in the schedules to the agreement itself, as is often the case in the US. The disclosure letter will usually set out a series of general disclosures (for example, information that appears in public records), which act to qualify all of the warranties in the agreement, and specific disclosures, which, although usually cross-referenced to specific warranties in the agreement, are often treated as effective disclosures in relation to all of the warranties. The disclosure letter will usually have annexed to it a disclosure bundle of all of the documents which are referred to in the disclosure letter. The seller will generally seek to treat the entire contents of the disclosure bundle as disclosed in relation to the warranties.

In the US, the buyer will usually allow specific disclosures only in respect of each warranty and representation against which the disclosure is being made. General disclosures are not common, and the buyer will usually seek to provide in the agreement that specific disclosures are not treated as effective disclosures in relation to all warranties (unless specifically cross-referenced).

English law requires that, to be effective, a disclosure must be "fair". Merely making known the means of knowledge, or reference to a source of information that may enable the buyer to work out certain facts, is often

insufficient. It is becoming common practice for buyers in the UK to seek to include a concept of "fair disclosure" in the share purchase agreement pursuant to which disclosure, in order to be effective, must contain such information as would enable a reasonable buyer to make a reasonably informed assessment of the matters, facts and circumstances giving rise to the breach of warranty.

BUYER'S KNOWLEDGE

In the UK, if a buyer has actual knowledge, prior to execution of the agreement, of facts that would result in a breach of warranty, the buyer may be precluded from raising a successful claim for breach of warranty, even if the agreement contains the customary provision that the warranties were given subject only to matters set out in the disclosure letter.

The laws of the various US states differ on this point. Some states require that the buyer show reliance on a particular representation or warranty in order to sustain a claim for breach of that representation or warranty. Other states hold that a buyer need only show that there was an untrue statement and that the buyer's knowledge will not generally preclude a claim. Due to these differences, it would be advisable when acting for the buyer to include a clause specifying that the buyer's knowledge does not have an impact on its ability to seek indemnification after closing.

QUANTIFICATION OF DAMAGES FOR BREACH OF WARRANTY

In the US, the buyer will usually be indemnified on a dollar-for-dollar basis for breach of warranties/representations, subject to negotiated caps, thresholds and deductibles. In the UK, it is much less common for the seller to indemnify the buyer for breach of warranty, so the buyer's remedy will usually be a contractual claim for damages. The measure of damages is usually the difference between the price paid for the shares, and their actual value at closing, given the breach of warranty. Under English law, the buyer has a duty to mitigate its loss and the damages must have been reasonably foreseeable. As a result, the measure of damages will generally result in an award of damages lower than would have been given on an indemnity basis.

SUMMARY

In order to manage clients' expectations and protect their interests when they are acquiring or disposing of shares/stock in a company, lawyers must be aware of the fundamental differences in approach between US governed agreements and English law governed agreements. At the outset of any such transaction involving UK or US buyers and sellers not accustomed to the relevant differences between a US and English law governed agreements, it would be prudent for the advisers to explain the above-mentioned distinctions, and the legal effect of these distinctions, to the client.

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