LK SHIELDS
YOUR LEGAL COUNSEL

MERGERS AND ACQUISITIONS

Warranty Claims and the Interpretation of Exclusion Clauses

by **Jennifer McGuire**

Warranty Claims and the Interpretation of Exclusion Clauses

5th May 2016 | by Jennifer McGuire

A recent decision from the English Court of Appeal, *Nobahar-Cookson v The Hut Group Limited*, is notable for its consideration of exclusion clauses in the context of warranty claims.

It highlights how important careful drafting of the clauses in sale and purchase agreements, dealing with warranty claims and the related limitations and exclusions, can be. The case confirmed that, if necessary to resolve ambiguity, exclusion clauses should be narrowly construed.

Exclusion Clauses in Sale and Purchase Agreements

In this case the buyer had the benefit of various warranties, subject to limitations and exclusions of liability in favour of the sellers. The buyer wanted to bring a claim against the sellers for breach of the warranty on management accounts.

The agreement contained the following exclusion clause:

The Sellers will not be liable for any Claim unless the Buyer serves notice of the Claim on the Sellers (specifying in reasonable detail the nature of the Claim and, so far as practicable, the amount claimed in respect of it) as soon as reasonably practicable and in any event within 20 Business Days after becoming aware of the matter.

The interpretation of the phrase “aware of the matter” was a source of dispute, as this triggered the beginning of the notice period of twenty business days.

The sellers argued that the timing under the exclusion clause began when the buyer became aware of the factual grounds for the claim, as opposed to when they became aware that the factual grounds could amount to an actionable claim. On that basis the sellers argued that the buyer had become aware of the factual grounds of the breach when they received the target company’s management accounts, and therefore the buyer was time barred from bringing the claim.

Essentially the Court of Appeal had to decide whether a claim had to be brought within twenty business days of the buyer:

1. becoming aware of the underlying facts;
2. becoming aware that there might be a claim; or
3. becoming aware that there was proper basis for a claim.

The Court found that on balance the third interpretation was applicable, which meant that the time limit did not start to run until the buyer knew there were proper grounds for the claim, after it had received advice from its forensic accountants; and not when the buyer became aware of the factual grounds of the breach,

when they received the target company's management accounts.

In adopting the narrower interpretation the Court held that the purpose of the clause was to prevent the buyer from pursuing claims previously undisclosed. This purpose was aligned with an interpretation which focused upon the awareness of a claim rather than its awareness of facts which might give rise to a claim. It meant that the buyer was afforded time to investigate the facts and to take professional advice in order to understand whether the facts gave rise to a warranty claim.

Contra Proferentem Rule

The leading judgment, delivered by Briggs LJ, in the case accepted that if linguistic, contextual and purposive analysis of the disputed exclusion clause does not resolve the issue with sufficient clarity, as was found in this case, then the “contra proferentem” rule could be applied. Briggs LJ considered that the word “matter” within the wording of the exclusion clause did not clearly mean claim and it could easily refer to some entitlement to bring the claim or to some basis of fact or mixed fact and law from which the claim would arise.

The “contra proferentem" rule broadly states that where there is doubt about the meaning of a contractual provision the words will be construed against the person who puts them forward. This rule may apply against either a party responsible for drafting or incorporating a clause for its own benefit or where a clause is relied on that benefits, or is likely to benefit, only the party relying on it. In this case it meant that the narrowest interpretation of the clause could be adopted if the meaning remained doubtful after its wording, purpose and context had been considered. In other words, the sellers’ liability for breach of warranty was not excluded simply because the buyer made its claim more than twenty business days after becoming aware of the underlying facts. The court considered that clear words are required before it would conclude that the parties intended to limit their ability to seek recompense for breaches of contract. Briggs LJ held it is irrelevant that the exclusion clause applies to both parties in the same way and this should not prevent the “contra proferentem” rule from being applied.

The Court of Appeal was very critical of the application of the “contra proferentem” principle in an interpretation of an exclusion clause in a share purchase agreement. The rule was only used as an aid to construction as a last resort.

Comment

This decision confirms that if there is ambiguity in the meaning of an exclusion clause, parties must first consider the linguistic, contextual and purposive analysis. However in the event that such analysis fails to provide sufficient clarity to the clause, the “contra proferentem” rule applies whereby the ambiguous clause should be construed in its narrowest form, irrespective of whether the clause in question applies to both parties.

It illustrates the importance of careful drafting of clauses in sale and purchase agreements in order to minimise the risk of claims. Buyers should carefully check the provisions in their sale and purchase agreements to ensure they do not miss any limitation periods or formal requirements for notifying claims.

For further information contact Jennifer McGuire, Partner, Mergers & Acquisitions at jmcguire@lkshields.ie.

About the Author

Jennifer McGuire
Partner

Jennifer is the Head of the Mergers and Acquisitions team.
T: + 353 1 638 5851 **E:** jmcguire@lkshields.ie