

What is the difference between a Warranty and an Indemnity?

Warranties and indemnities are frequently used during negotiations over the acquisition of a company, yet there is often confusion over the differences between them and their ramifications.

A warranty is a contractual statement by the seller, assuring the buyer as to the condition of various aspects of the business, with a particular focus on disclosing any existing liabilities. As such, a standard share purchase agreement typically includes many warranties.

Warranties are intended to protect the buyer by disclosing all information about a business and by providing a remedy if any statements about the business are found to be incorrect.

For the seller, warranties provide an opportunity to disclose against any issues within the target company to the buyer, thereby removing any liability for said issues after the sale is complete. The seller would essentially be protected from warranty claims if any potential issues are disclosed beforehand.

A warranty should never be viewed as a substitute for a buyer raising enquiries as breaches of warranties can and do happen with incorrect or incomplete information being disclosed. In the event of a breach, the buyer's claim is subject to the same legal requirements of proving loss as in the case of a breach of contract.

While a warranty removes liability from the seller by disclosing a business' problems before the sale is finalised, an indemnity shifts liability from the buyer to the seller. An indemnity is effectively a promise by the seller that he or she will reimburse the buyer if a specific liability arises. This way, the buyer faces a

lower risk when acquiring the business, having a guaranteed remedy for specific matters of concern.

Indemnities are usually included in a purchase agreement if there are certain problems or issues of concern to the buyer which could jeopardise the completion of the acquisition or the future running of the business.

Indemnities are also common when covering any of the target company's tax liabilities which may not have been included in the latest audit accounts. Generally speaking, if there are any specific risks which could seriously deter the buyer, these can be covered by indemnities to lower the buyer's risk and to make it easier to bring an indemnity claim later or if and when needed.

Sellers should therefore proceed with extreme caution when negotiating indemnities as part of a purchase agreement. An experienced solicitor should undertake all negotiations at every step of the way to ensure that the acquisition is fair and mutually beneficial to both the buyer and seller and the parties have not committed themselves to any terms that they are not fully comfortable with.

For more information, or for expert advice on business or personal legal issues, call us on +44 (0)20 3475 6751 or via email at info@carterbond.co.uk

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