para.11-02). If the claim can be quantified before the accounts for the period in which the sale takes place are adopted, it may be possible to adjust the accounts to provide for the claim.

CHAPTER 4

General Points Relating to Warranties

DEFINED TERMS

4-01 To facilitate the drafting of the warranties, it is usual to make use of a number of defined terms. In this book, the term "Company" (meaning the target company) is used generally in the draft clauses.

Typical examples of further definitions are set out below, and these definitions are used in the warranties and indemnities and draft clauses discussed throughout the book. Definitions which relate to tax matters are, as explained in Chapter 10, often contained in a separate tax schedule and these are, where relevant, discussed in Chapter 10. The definitions intended for the tax covenant are contained within it or referred to by reference to those definitions outlined in the sale agreement.

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[3A] Definitions

4-02 **In this Agreement, the following expressions have the meanings stated, namely:**

> **"Accounts" the audited financial statements of the Company as at and to the Balance Sheet Date including the balance sheet and profit and loss account together with the notes on them, the cash flow statement and the auditor's and directors' reports.**

In the case of a business sale, this definition should be amended so that it refers to the accounts of the vendor. It should be borne in mind by the vendors that, by virtue of this definition, the accounts warranty will also cover the directors' report.

> **"Accounting Standards" Statements of Standard Accounting Practice, Financial Reporting Standards, Urgent Issue Task Force Abstracts, Statements of Recommended Practice and all other generally accepted accounting principles applied to a United Kingdom company [at the date hereof] [at the Balance Sheet Date] (excluding International Accounting Standards and International Financial Reporting Standards issued by the International Accounting Standards Board).**

This definition essentially encapsulates UK GAAP, excluding International Accounting Standards. The definition will need to be amended if they are relevant. The appropriate applicable date for determining which accounting standards are to apply will need to be considered. For the purposes of the warranties that relate to the last statutory accounts, it will be by reference to the Balance Sheet Date, as that will have been the last date to which the accounts were made up. In the case of completion accounts, the accounting standards in force as at completion may be the most appropriate, although if they have changed since the Balance Sheet Date that may

result in inconsistent accounting between the two. Depending upon the circumstances, this may be an issue. In relation to earn-out accounts, which might relate to two or three financial periods after completion, it may be appropriate to refer to the accounting standards then in force at the time of preparation of each set of earn-out accounts, although this might give rise to a lot of uncertainty for the vendors, and in some cases might have an unanticipated or adverse effect upon the earn-out. Careful thought needs to be applied to ensure an outcome satisfactory to both the vendors and the purchaser.

"Agreement" this agreement [and the schedules hereto] for the sale and purchase of the Shares.

If the general interpretation clauses do not make it clear that schedules are included as part of the agreement, then the wording in brackets should be added to this definition.

"Associate" in relation to any person, a person who is connected with that person within the meaning of the Corporation Tax Act 2010 ss.1122 and 1123.

"Balance Sheet Date" [.....] 20[.....] (being the date as at and to which the Accounts were prepared).

"BA 2010" the Bribery Act 2010.

The BA 2010 received Royal Assent on 8 April 2010, and came into force on 1 July 2011. On its implementation, the BA 2010 repealed existing bribery laws and is commonly considered to be one of the most stringent anti-corruption laws in the world. It is not retrospective and therefore applies only to bribery and/or corruption that has taken place since its coming into force.

The BA 2010 introduced the following offences:

(1) offering, promising or giving a bribe (BA 2010 s.1);
(2) requesting, agreeing to receive or accepting a bribe (BA 2010 s.2);
(3) bribing a foreign public official (BA 2010 s.6); and
(4) commercial organisations failing to prevent bribery by those acting on their behalf, where the bribery was intended to retain a business advantage for the commercial organisations (BA 2010 s.7).

The offences under BA 2010 ss.1, 2 and 6 apply to incidents both in the UK and outside the UK (if the act would constitute an offence if carried out in the UK) providing there is a close connection (as defined in BA 2010 s.12(4)) between the person offering, promising or giving the bribe and the UK. The offence under BA 2010 s.7 is a strict liability offence and applies to commercial organisations incorporated in the UK or foreign companies carrying out business in the UK, however minor that may be.

"Business Day" 9.00 am to 5.00 pm on any day other than Saturdays and Sundays and bank holidays during which clearing banks are open for business in the City of London.

This definition is usually relevant only if there is a gap between exchange of contracts and completion where conditions are to be satisfied and completion is expressed to take place on the next "Business Day" following satisfaction of the conditions. The definition may also be used where deferred payments are to be made, to ensure that such payments are made on business days when banks are open for business.

"CA 1985" the Companies Act 1985, as amended.

"CA 2006" the Companies Act 2006.

"Civil Sanction" any of the sanctions referred to in the Regulatory Enforcement and Sanctions Act 2008 s.36(1).

Under the Regulatory Enforcement and Sanctions Act 2008, the Environment Agency has been given new powers to impose "civil sanctions", including fixed and variable monetary penalties. Using these powers, the Environment Agency can, in effect, impose fines (and determine the amount) without going through the courts. Other civil sanctions that are open to the Environment Agency include: (i) issuing compliance notices and stop notices, which can affect how and what a company is permitted to do; (ii) issuing a restoration notice, requiring remedial action to be taken; and (iii) accepting enforcement undertakings from companies—these are "voluntary" agreements to take corrective actions. Failing to comply with an enforcement undertaking is a criminal offence, hence they are voluntary only in the sense that they are offered voluntarily; once accepted by the Environment Agency, they effectively have the force of law.

"Companies Acts" CA 2006 and CA 1985, and in each case, in so far as the same are in force at the date of this Agreement or in force at the time of the relevant event for the purposes of the Warranties.

This definition goes further than being simply a consolidating definition since it seeks to apply the relevant Companies Act to the relevant point in time for the purposes of the warranties.

"Completion" completion of the sale and purchase of [the Shares] [the Business].

"Confidential Business Information" all or any information relating to the following (details of which are not in the public domain) existing in any form:

(1) the business methods, corporate plans, management systems, finances, new business opportunities or development projects of the Company;
(2) the marketing or sales of any present or future product of the Company including, without limitation, customer names and lists and other details of customers, financial information, sales and targets, sales statistics, prices, market research reports and surveys and advertising or other promotional material; and
(3) any trade secrets or other information relating to the provision of any product or services of the Company to which the Company attaches confidentiality or in respect of which the Company owes an obligation of confidence to any third party.

This is a wide definition, the primary function of which is to provide expansive warranty cover; however, it is equally applicable to the usual non-compete restrictions that are generally contained in the sale agreement. In the context of a business sale, definitions such as "Confidential Business Information" and "Intellectual Property Rights" are usually relevant for the purposes of identifying the assets that are to be the subject of the sale. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"Criminal Property" shall be defined by reference to the Proceeds of Crime Act 2002 s.340(3) (but disregarding paragraph (b) of that section).

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The definition is derived from the interpretation section of the Proceeds of Crime Act 2002 and relates to money laundering offences. The disregard of para.(b) excludes knowledge or suspicion from the definition of "criminal property" (the primary defence in cases of inadvertent receipt of criminal property) so as to make the definition, absolute. Given the far-reaching nature of this definition, vendors should take great care in the consideration and negotiation of the relevant warranties.

"Cyber Security Controls" security controls to protect network and information systems and data against threats coming from the internet.

The purchaser will want to know that the company has adequate cyber security controls in place to resist cyber attacks. The definition covers not just basic protection from the most prevalent forms of threats coming from the internet, such as common threats which require low levels of attacker skill, but also internet-based threats generally which may compromise systems as well as data. Some threats are direct, such as a Distributed Denial of Service (DDoS) attack on the company website, or a ransomware attack, locking out the user and offering to restore access for a fee. Others are indirect, for example to carry out a CEO phishing attack, a criminal may first hack into an organisation's mail server and then send an internal email from the CEO's actual email account, instructing a payment to be made to a third party account.

In other scenarios, criminals may have entered the company's systems but either do nothing (perhaps because a second criminal gang is then to take over where the first criminal gang left off) or simply use the system resources (e.g. to launch DDoS attacks) rather than using the data. The systems and data to be protected may be hosted anywhere: for example company servers on company premises; company's servers colocated in a third party data centre; third party servers hosted in a third party data centre; or desktop machines, laptops, tablets, smartphones or removable storage media. Systems include not just IT or telecoms systems but any device attached to the internet such as CCTV systems, digital video recorders and other embedded computers attached to the internet. The description in the definition is general because specific descriptions or lists risk quickly becoming out of date due to the rapid pace of change in this area.

"Demand" any action, award, claim or other legal recourse, complaint, cost, debt, demand, expense, fine, liability, loss, penalty or proceeding, and legal and other professional fees and expenses.

"Disclosed" disclosed with sufficient information or particularity in the Disclosure Letter to enable a reasonable purchaser to make an informed assessment of the impact upon the Company of the matter disclosed [after taking appropriate advice upon the matter and the relevant disclosure].

This is an attempt at defining the more or less established common law principle of "fair disclosure". A purchaser may seek to change the objective reference to a reasonable purchaser to the subjective "Purchaser" and may find the concept of having to take advice upon the subject matter and the terms of the disclosure itself unacceptable. In most cases, where the vendors and the purchaser are well advised, this simply reflects reality. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"Disclosure Letter" the disclosure letter (together with all documents attached or appended to it), having the same date as this Agreement, from the Vendors to the Purchaser and delivered to the Purchaser immediately prior to execution of this Agreement.

As to the form and content of the disclosure letter, see Chapter 9.

"Encumbrance" any mortgage, charge, debenture, assignment or assignation by way of security, guarantee, indemnity, hypothecation, restriction, right to acquire, right of pre-emption, option, right of conversion, pledge, declaration of trust, lien, right of set-off or counterclaim, combination of accounts, retention of title arrangement, third party right or equity or any other security interest, encumbrance or preferential arrangement whatsoever, howsoever created or arising and any agreement or arrangement to create any of the above.

"Environment" includes any or all of the following media: air, water and land; the medium of air includes the air within buildings and the air within other natural or man-made structures above or below ground and the medium of water includes ground water and aquifers.

"Environmental Claim" any actual, pending or threatened claim, notice of violation, prosecution, demand, action, official warning, abatement or other order or notice (conditional or otherwise) relating to any Environmental Matters or Environmental Liabilities and any other notification or order requiring compliance with the terms of any Environmental Licence or Environmental Laws.

"Environmental Damage" any pollution, contamination, degradation, damage or injury caused by, related to or arising from or in connection with the presence, generation, use, handling, processing, treatment, storage, transportation, disposal or release of any Hazardous Substance.

"Environmental Laws" any Official Requirements relating to the protection of the Environment or the control or prevention or remedying of Environmental Damage or the control of Hazardous Substances.

"Environmental Liabilities" any liabilities, responsibilities, claims, losses, costs (including remedial, removal, response, abatement, clean-up, investigative and/or monitoring costs), damages, expenses, charges, assessments, liens, penalties and fines which are incurred by, asserted against or imposed upon a person as a result of or in connection with any violation of or non-compliance with Environmental Laws (including the failure to procure or violation of any Environmental Licence required by Environmental Laws); or any Environmental Damage.

"Environmental Licence" any permit, licence, authorisation, consent, registration, exemption or other approval obtained or which ought to have been obtained pursuant to any Environmental Laws at any time by either the Company and/or in relation to the business carried on by the Company.

"Environmental Matters" means any of the following:

(1) any generation, deposit, keeping, treatment, transportation, transmission, handling or manufacture of any Hazardous Substances;

(2) damage to property, nuisances, noise, defective premises, health and safety at work or elsewhere;

(3) the carrying out of a development (as defined in the Town and Country Planning Act 1990 s.55(1)); and

(4) the pollution, conservation or protection of the Environment whether relating to man or any living organisms supported by the

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Environment or any other matter whatsoever affecting the Environment or any part of it.

The environmental definitions are extremely wide, and great care should be taken by the vendors when reviewing them for the purposes of the warranties. Where the purchaser requires an indemnity in respect of a specific environmental matter, or all environmental matters, then these definitions will double for that. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company. For further discussion on the environmental warranties, please refer to cl.5 in Chapter 7.

"FA" the Finance Act.
"Hazardous Substances" any solid, liquid, gas, noise and any other substance or thing which causes or may cause harm (alone or in combination with any other substance) to the Environment or any structure, thing or living organism within the Environment including any substance regulated under any Environmental Laws.
"HMRC" HM Revenue & Customs.

This definition is used in conjunction with the definition of "Taxation Authority".

"Intellectual Property" all copyright and related rights, moral rights, design rights, registered designs, database rights, [semi-conductor topography rights,] patents, rights to inventions, [utility models,] business names, trade marks, [service marks,] trade names, domain names, [rights in get-up,] know-how, trade secrets and rights in Confidential Business Information, rights to goodwill or to sue for passing off or unfair competition, and any other intellectual property rights or rights of a similar nature (in each case whether or not registered) and all applications for any of them which may subsist anywhere in the world.

As this definition will form the basis of numerous intellectual property warranties, the vendors should consider whether its scope is unduly wide and whether certain of the rights referred to are inappropriate, for example semi-conductor topography rights. In particular, the general words "and any other intellectual property rights or rights of a similar nature … which may subsist anywhere in the world" may be unacceptable if the target company carries on business in a number of foreign jurisdictions. Conversely, in the context of a business sale the purchaser will want to ensure that it acquires all relevant intellectual property rights existing anywhere in the world and warranty protection in relation to all such rights, whether the sale is of a business or shares. The term "unfair competition" is included because under the 1883 Paris Convention for the Protection of Industrial Property (as revised), the UK is bound to assure its nationals of effective protection against unfair competition. Whilst the courts have preferred to consider cases under the narrower tort of passing off rather than recognising a general tort of unfair competition, the purchaser will want to acquire any such rights, and will need to do so where the target company conducts business in a jurisdiction which has "unfair" competition laws, such as the US, Australia and many European countries.

"Intellectual Property Rights" all Intellectual Property owned or used or exploited by the Company or in relation to its business.

In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"ITA 1984" the Inheritance Tax Act 1984.
"IT Contracts" all agreements and other arrangements whatsoever under which any third party (including a group company) provides any element of, or services relating to, the IT Systems, including without limitation leasing, hire purchase, licensing, subscription, supply, escrow, maintenance, support, hosting, colocation, monitoring and services agreements.

It may be necessary to list in a schedule to the sale agreement any such IT contracts that are in place. This is because IT systems are an essential but often a significant cost to a business. There are specific risks, such as underlicensing (not having enough software licences in place), associated with poor management of IT contracts. Asking the vendors to list the IT contracts will give the purchaser an overview of the arrangements in place, and will help to indicate issues at an early stage. For example, there may be obvious gaps in the list, indicative of underlicensing or poor management, such as a lack of an escrow agreement for a key software application; there may be issues of compatibility and therefore integration with the purchaser's own systems. Where dealing with groups of companies, note that a group company of the target company will be a "third party".

"IT(EP)A 2003" the Income Tax (Earnings and Pensions) Act 2003.
"IT Systems" all hardware, multifunctional devices, handheld devices, firmware, peripherals, communication links, storage media, back-up systems, networking equipment, telecommunications equipment, wi-fi equipment and other equipment used by or on behalf of the Company together with all software [and all source, object and executable codes], databases, social media, hosted services and websites used by or on behalf of the Company.

As most businesses are increasingly reliant on their IT and computer systems, it is usual to include specific warranties relating to them. Such warranties are included in para.7-251. The vendors are unlikely to want to give any warranties in relation to their IT infrastructure to the extent that IT is shared with others, for example if it is provided by third party service providers such as hosted services or other forms of cloud provision or social media. However, the purchaser will still expect information to be provided in relation to this area during the due diligence process, even if no warranties are given in relation to the infrastructure. The purchaser will need to know that these third party systems can continue to operate post-completion, and will expect warranties in relation to the target company's software or content held in the infrastructure. Likewise, information on BYOD (bring your own device), where employees' own mobile or tablet devices are configured for company purposes, will be required for due diligence. The wording in square brackets should be included where the software has been written by, or specifically for, the target company. Without the source code and object code libraries, the purchaser will not be able to continue to develop the software. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"Licence" a licence, permit, certificate, consent, approval, filing of notifications, reports and assessments, registrations or authorisations required by law for operation of the Company's business, its ownership, use, possession or occupation of any asset or the performance of this Agreement.

This is a consolidating definition which is designed to cover all types of licences,

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consents etc. which a target company is required to have in order to operate its business. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"LPMPA 1994" the Law of Property (Miscellaneous Provisions) Act 1994.

See para.4-08 for a discussion of the covenants that are implied under the Act into an instrument effecting a disposition of assets where the disposition is expressed to be made "with full title guarantee" or "with limited title guarantee".

"Management Accounts" the unaudited balance sheet of the Company as at [.....] and the unaudited profit and loss account of the Company for the period ended on [.....] copies of which are attached to the Disclosure Letter.

The period of the management accounts should run from the date of the last audited accounts to the date of the most recent management accounts. In the case of a sale of part of the business of a company, it may not be possible to extract relevant information from the last accounts, in which case the purchaser will be reliant upon management accounts produced in respect of the business to be acquired. In these circumstances, the purchaser may require that the management accounts cover a longer period, for example two or three years. In the case of a business sale this definition should be amended so that it refers to the vendor as opposed to the company.

"Non-Taxation Warranties" those warranties other than the Taxation Warranties.

The definition is included in order to differentiate between the non-taxation and taxation warranties. In the context of a share sale, the taxation warranties are now typically included in a tax schedule that deals with the taxation covenant, the taxation warranties and the limitations that are to apply to them. See Chapter 10 for further details of the tax schedule. Even where there is not a separate tax schedule, it is customary to distinguish between the taxation and non-taxation warranties, as there are usually different limitation provisions that apply to them.

"Official Requirement" any law, statute, ordinance, pact, decree, treaty, code, rule, regulation, directive, order, notice or official published plan or policy with legal or actual force in any geographical area and/or for any class of persons.

The vendors will undoubtedly be asked to provide a "compliance with all laws" type warranty, and this definition will form the basis of that warranty. The definition is wide-ranging, and the vendors are likely to wish to reduce the scope of it. See para.7-119 for a discussion of approaches that the vendors should consider when reviewing and negotiating the "compliance with all laws" warranty in the context of a share sale. In the context of a business sale this is likely to be less of an issue, as liabilities will generally remain with the vendor.

"Planning Acts" the Town and Country Planning Act 1990; the Planning (Listed Buildings and Conservation Areas) Act 1990; the Planning (Hazardous Substances) Act 1990; the Planning (Consequential Provisions) Act 1990; the Planning and Compensation Act 1991; the Planning and Compulsory Purchase Act 2004; the Planning Act 2008; and any other legislation from time to time regulating the use or development of land.

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"Properties" the [leasehold and freehold] properties briefly described in Schedule [.....] and reference to a "Property" include a reference to each of the individual Properties.

"Scheme(s)" [details of disclosed pension scheme(s) to be inserted].

A target company or target group may have one or more pension arrangements to include under this definition. A target company may also bear liabilities towards a group arrangement (or an otherwise unconnected arrangement) it no longer participates in, or in relation to which it has given guarantees or has other enforceable liabilities, but does not operate itself. Similarly, a target business may include employees who have rights under one or more pension arrangements, whether or not operated by the vendor.

These arrangements may take a number of forms, such as trust-based occupational pension schemes, contract-based individual or workplace pension plans, or trust-based death in service (also known as group life) schemes. With auto-enrolment being extended to all employers by February 2018, master trusts such as the National Employment Savings Trust (also known as NEST) will become more prevalent, as every employer will have to provide a pension arrangement by law. Following the extension of the Government's Fair Deal policy concerning outsourcing in October 2013, increasing numbers of companies may be participating employers in the National Health Service pension scheme and other public sector pension schemes that hitherto did not permit participating employers, in addition to the Local Government Pension Scheme, which was accessible before the policy change. These different forms of pension arrangement are subject to different legal regimes and hence the warranties required for each will be different. Although not strictly pension arrangements as defined in the legislation, similar benefit schemes such as income replacement or permanent health insurance schemes may also be included under the definition, of "Scheme(s)" for the sake of convenience, as they do not fit comfortably elsewhere. Clearly, different warranties will apply to these arrangements.

Where due diligence reveals that the target company has a number of arrangements of different types or links to more than one arrangement, it may be necessary to break down the definition of "Scheme(s)" into sub-categories.

As will be discussed in Chapters 7 and 8, pensions warranties fall broadly into four categories: those that apply to the target regardless of the arrangement; those that apply to all types of arrangements; those that apply only to "defined benefit" arrangements (also known as final salary, career average or cash balance arrangements); and those that apply only to "defined contribution" arrangements (also known as money purchase arrangements).

Hence, sub-definitions such as "the DB Scheme(s)" or "the DC Scheme(s)" may be used to target specific warranties to the appropriate categories of arrangements. Depending on the results of due diligence concerning the nature and status of each of the arrangements, it may be necessary to consider more specific sub-definitions under the definition of "Scheme(s)", such as "the Group Personal Pension" (or "GPP" for short), "the Workplace Plan", "the Open Scheme" (where benefit accrual is continuing), "the Closed Scheme" (where the scheme may have been closed to new members or new accruals of benefit), "the Small Self-Administered Scheme" (or "SSAS" for short), "the Self-Invested Personal Pension" (or "SIPP" for short), "the Unregistered Scheme", etc. Such precision is necessary to ensure that the scheme(s) is/are adequately defined and that the warranties provide appropriate comfort and risk apportionment.

In order to precisely define a pension arrangement, the draftsman should seek to

ascertain the arrangement's full legal name from the governing documents, the eight-digit pension scheme registration (PSR) number issued by the Pensions Regulator (for occupational schemes), the eight-digit and two-letter pension scheme tax reference (PSTR) issued by HMRC (which replaced the 15-digit and one-letter Superannuation Fund or Pension Schemes Office reference number for all "approved" schemes), or the name and reference number of the scheme administrator from the annual renewal documentation (for contract-based arrangements such as group personal pension and stakeholder plans). Certain unregistered pension arrangements will not have these reference numbers and other means of identification by reference to disclosed documents may be necessary.

"Sensitive Payments" means any of the following (whether or not illegal):

(1) **commercial bribes, bribes or kickbacks paid to any person including central or local government officials, trade union officials or employees including, without limitation, where the bribe is made with the intention of obtaining or retaining business for the Company or to obtain or retain an advantage in the conduct of the business of the Company, other than any circumstances which amount to an offence under the BA 2010;**

(2) **amounts received with an understanding that rebates or refunds will be made in contravention of the laws of any jurisdiction either directly or through a third party, other than any circumstances which amount to an offence under the BA 2010;**

(3) **political contributions;**

(4) **payments or commitments (whether made in the form of commissions, payments or fees for goods received or otherwise) made with the understanding or under circumstances that would indicate that all or part of the payment or commitment is to be paid by the recipient to central or local government officials or as a commercial bribe, influence, payment or kickback, other than any circumstances which amount to an offence under the BA 2010;**

(5) **any payment deemed illegal under the Prevention of Corruption Acts 1889 to 1916 (to the extent that such Act is still in force at the date of the payment);**

(6) **a financial or other advantage offered, promised, given or made or requested, agreed to or accepted in breach of s.1 (Offences of bribing another person), s.2 (Offences relating to being bribed) or s.6 (Bribing of foreign officials) of the BA 2010; and**

(7) **any bribe to a foreign public official where the intention is to influence such official in his/her capacity as a foreign public official other than any circumstances which amount to an offence under the BA 2010.**

"Shares" the fully paid-up shares in the capital of the Company to be bought and sold pursuant to clause [.....] and comprising the whole of the issued and allotted share capital of the Company.

This definition will be relevant only on a share sale, and the reference to "allotted" shares is unnecessary unless shares have been allotted—perhaps on provisional allotment letters—but without the allottees having been entered in the register of members (*National Westminster Bank Plc v Inland Revenue Commissioners* [1994] 3 W.L.R. 159).

This definition would not be relevant for a business sale.

"Social Media" all social media or social networking sites and services used by or on behalf of the Company for business purposes.

Companies increasingly use social media to promote their businesses. This definition is designed to cover all relevant activity carried out by the target company. Please refer to para.7-278 for discussion of the concerns the relevant warranty will seek to address. In the case of a business sale, this definition should be amended so that it refers to the vendor as opposed to the company.

"Subsidiary" a subsidiary undertaking as defined in CA 2006 s.1162 save that a company shall be treated, for the purposes of the membership requirement contained in subss.1162(2), as a member of another company even if its shares in that other company are registered in the name of: (a) another person (or its nominee) whether by way of security or in connection with the taking of security, or (b) its nominee.

It was held in *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16 that if a definition for "Group", "Subsidiary" or "Holding Company" is by reference to CA 2006 s.1159 or CA 1985 s.736, and a bank or other entity is registered in the register of members in respect of a company's shareholding in another, by way of taking security over those shares, then that company could not, for the purposes of the definition be classed as a subsidiary. Consequently, the definition of "Subsidiary" or equivalent should be defined by reference to the definition of "subsidiary undertakings" in CA 2006 s.1162. This definition is unlikely to be required on a business sale.

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"Taxation or Tax" all forms of taxation, duties, imposts, governmental charges (whether international, national or local) and levies whatsoever and whenever created, enacted or imposed and whether of the United Kingdom or elsewhere and without prejudice to the generality of that expression includes:

(1) **income tax, corporation tax, capital gains tax, inheritance tax, stamp duty, stamp duty reserve tax, stamp duty land tax rates, VAT, customs and other import duties, insurance premium tax, National Insurance contributions, amounts for which the Company is liable to account under PAYE and any payment whatsoever which the Company may be or become bound to make to any Taxation Authority or any other person as a result of any enactment relating to taxation and any other taxes, duties or levies supplementing or replacing any of the above; and**

(2) **all costs, charges, interests, fines, penalties and expenses incidental or relating to any taxation, duties, imposts, charges and levies whatsoever (including without limitation any such described above).**

The wide scope of the definition of "Taxation" can have unexpected results, particularly in relation to the more general warranties such as cl.1.1 in para.5-04. This is discussed in more detail in relation to the specific tax provisions at para.10-16.

In the case of a business sale, the definition should be amended so that it refers to the vendor as opposed to the company.

"Taxation Authority" HMRC, its predecessor bodies, or any statutory or governmental authority or body (whether in the United Kingdom or elsewhere) involved in the collection or administration of taxation.

"Tax Covenant" the covenant contained in Part 3 of Schedule [3].

The tax covenant is discussed in detail in Chapter 10. This is not applicable in relation to a business sale.

"Tax Warranties" the warranties in Part B of Schedule [3].

A definition referring specifically to those of the warranties dealing with taxation will be required if, as suggested in Chapter 10, the limitations applicable to the tax warranties are different from the limitations applying to the warranties generally.

"TCGA 1992" the Taxation of Chargeable Gains Act 1992.
"TMA 1970" the Taxes Management Act 1970.
"VATA 1994" the Value Added Tax Act 1994.
"Warranties" the warranties[, representations and undertakings] of the Vendors contained in [this Agreement] [clause [.....] and] Schedules [.....] and the Tax Warranties and "Warranty" means anyone of them.

It is assumed that the warranties discussed in the following chapters are contained in a schedule. This is the usual and most convenient way of dealing with them.

This definition needs careful attention. The agreement will invariably contain a clause similar to cl.3C which imposes an obligation on the vendors in relation to "the Warranties" which is of considerable importance. A general definition such as the above, if the words in brackets on the first line are included, as is often the case, obscures the commitments which are undertaken. When it is being reviewed, the following points should be taken into account:

(1) The warranty obligations accepted by the vendors will apply not only to warranties as normally understood but also to wider matters, which might amount to representations or undertakings assuming that the wording in brackets in the first line is included. It would be usual, therefore, for well-advised vendors to ensure that this wording is deleted so that the obligations extend only to the intended warranties.
(2) The final draft of the sale agreement, after it has been amended by the vendors' solicitors, will usually include restrictions on the period within which claims for breach of the "Warranties" must be brought and on the amounts which can be claimed (see paras 11-02 to 11-09). The definition of "Warranties" set out above would extend, for example, to the obligations on the vendors under covenants restricting the activities they can carry on after completion of the sale if, unusually, the wording in brackets on the first line were retained and the reference on the second line was to the agreement. This is not usually intended or likely to be acceptable to the purchaser. The purpose of seeking to suggest that the statements contained in the relevant clause or schedule (which to all intents and purposes is intended to be the warranties) are also expressed as representations is to seek to have the benefit of alternative remedies under the Misrepresentation Act 1967, as well as a conventional damages claim for breach of contract. Please refer to Chapter 3 for a discussion of the available remedies and their appropriateness or otherwise in the context of a share sale or a business and assets sale. In most cases, well-advised vendors will restrict their liability to contractual damages by exclusion of the reference to such statements being given as representations and, in practice, most purchasers will be sympathetic to this approach in the interests of achieving certainty. If a tortious basis of damages is intended, then the more direct way to achieve this is with an appropriately worded damages clause, rather than seeking to rely on the applicability of the Misrepresentation Act 1967.
(3) Any given problem may entitle the purchaser to alternative remedies either for breach of contract or for misrepresentation (see para.3-01).

Most vendors will wish to exclude liability for non-fraudulent misrepresentation and with a carefully drafted entire agreement clause (which does not purport to exclude fraudulent misrepresentation—see para.3-03 for further discussion of this) that should be perfectly possible. In most cases, both the purchaser and the vendors will want to achieve certainty in relation to the warranties and the limitations that are to apply to them. The use of the definition without the words in brackets achieves this by ensuring that the limitation provisions apply only to the warranties themselves rather than other parts of the agreement. Care also needs to be taken to ensure that the fundamental title warranties are not eroded by the warranty protection provisions and that is why reference should be made to a specific schedule of the sale agreement which will contain the non-taxation warranties but, importantly, not the fundamental warranties, which will be contained separately in a clause in the main body of the sale agreement.

"Warranty Claim" any claim made by the Purchaser for breach of any of the Warranties.

4-03 In addition to the definitions suggested above, the following are often included:

"month" a calendar month
the singular includes the plural and vice versa
any reference to one gender shall include all genders.

Express definitions are in fact not required as they are contained in Law of Property Act 1925 s.61 and apply, unless excluded, for the purpose of documents executed after the commencement of the Act. Section 61 also provides that "person" includes a corporation but does not expressly include partnerships (see Interpretation Act 1978 Sch.1). Where this could be a matter of concern, it would be appropriate to add:

"person" includes a firm or other body of persons.

STATUTORY REFERENCES

4-04 It is usual to find a definition concerning the statutory provisions referred to in the warranties and indemnities substantially in the following form:

[3B] Statutory references

4-05 **References to any statute, or to any statutory provision, statutory instrument, order or regulation made thereunder, include that statute, provision, instrument, order or regulation as amended, modified, consolidated, re-enacted or replaced from time to time, whether before or after the date of this Agreement and also include any previous statute, statutory provision, instrument, order or regulation, amended, modified, consolidated, re-enacted or replaced by such statute, provision, instrument, order or regulation.**

As drafted, this clause would cause the vendors to bear the risk of retrospective

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legislation causing, or increasing, a liability under the warranties or indemnities. This is generally inconsistent with the principle that, as from the exchange of contracts (or, at any rate, completion), the business of the target company (or the business which is being acquired) is conducted at the risk of the purchaser. Another circumstance in which an unexpected result can arise is where liability under a warranty which depends on a statutory reference may arise only a considerable time after the date of the sale agreement. An example is in the case of a warranty as to contamination which may state that there is no liability in regard to the target company arising from environmental laws. If this reference to laws is deemed to incorporate changes enacted after the date of the sale agreement, then the vendors may find that the scope of their liability is greatly increased as a result of legislative developments. The vendors should therefore amend this definition by reversing the phrases in brackets (re-enactments applying only if they do not modify the original legislation) and modifications being effective only if the relevant provisions are enacted before the date of the sale agreement.

An alternative way of limiting the effect of retrospective legislation is for the vendors to add the following words to the end of the above clause:

> **"... except to the extent that an amendment, modification, consolidation, re-enactment or replacement enacted after today's date would extend or increase the liability of the Vendors under the Warranties or the Tax Covenant."**

The purchaser should take into account that it is not unusual for legislation to take effect from an earlier date, being the date upon which a public announcement was made of the intention to bring in the legislation in question. This is particularly common with taxation matters and, indeed, the Finance Act each year will for the most part operate retrospectively to the date of the relevant Budget speech and, in the case of tax anti-avoidance measures, will often apply from the date on which the proposal to introduce legislation was announced. The purchaser should consider amending the suggested alternative wording so that it refers to legislation taking effect, rather than being enacted, after the date of the agreement.

THE WARRANTY OBLIGATION

4-06 It is convenient, and normal practice, for the warranties to be set out in a separate schedule, as will be seen from the definition of "Warranties" in para.4-01. The schedule would be adopted by a clause in the body of the sale agreement as follows:

[3C] The Warranties

4-07 **The Vendors [jointly and severally] warrant and [represent] to the Purchaser that, save as Disclosed, the Warranties are true in all respects.**

It is now convention to agree the warranties without seeking to amend the terms of them by reference to factual matters which are known to conflict with them. Qualifications to the warranties which are not intended simply to alter the drafting are collected together in the disclosure letter. Clause 3C accordingly provides for the warranties to be read subject to the disclosures. The use of the defined term "Disclosed" seeks to adopt current thinking at what ought reasonably to constitute fair disclosure in relation to exceptions to the warranties.

In addition, cl.3C, by inclusion of the word "represent", provides for the warranties to constitute representations as well as warranties. This provides the purchaser with additional remedies for breach of warranty at common law and under the Misrepresentation Act 1967. If, however, the relevant representations have been relied upon, see Chapter 3 for the remedies available in cases of misrepresentation. In practice, however, rescission is unlikely to be available by the time the representation has been found to be wrong, in which case the purchaser's remedy will be to seek damages—the same as if the warranties were not also representations. The vendors will nonetheless wish to delete references to representations, and to include an entire agreement clause excluding liability for representations made (see Chapter 3). Please refer to the definition of "Warranties" for further discussion on this point.

In a case where there is doubt about the abilities of the target company or the purchaser to continue in business, the vendors might wish to qualify the warranty by adding the words:

> **"... and all the Warranties are given on the basis that [the Company will carry on its business as a going concern] [the Business will be carried on as a going concern]."**

The purpose of this addition is to avoid any possibility that the vendors should bear extra liabilities which arise only by reason of a cessation of business—such as redundancy payments to employees or balancing charges in respect of plant and equipment—and should be acceptable to the purchaser.

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IMPLIED WARRANTIES AS TO TITLE

4-08 The LPMPA 1994 provides for certain covenants to be implied in an instrument effecting a disposition of assets where the disposition is expressed to be made "with full title guarantee" or "with limited title guarantee". In both cases, the implied covenants may be limited or extended by the instrument itself.

The covenants implied by using the formula "with full title guarantee" are that:

(1) the person making the disposition has the right to dispose of the asset as he purports to (s.2(1));
(2) he will, at his own cost, do all that he reasonably can to give the person to whom he disposes of the asset the title he purports to give (s.2(2)); and
(3) the disposer is disposing of the asset free from all charges and encumbrances and from all other rights exercisable by third parties other than rights which the disposer does not and could not reasonably be expected to know about (s.3(1)).

The first two of these covenants are also implied by the words "with limited title guarantee". The third covenant adds that the disposer has not, since the last disposition for value:

(1) charged or encumbered the asset by means of a charge or encumbrance which subsists when he makes the disposition; or
(2) granted third party rights in relation to the asset which subsists; or
(3) suffered the asset to be charged or encumbered or subjected to third party rights and that he is not aware that anyone else has done so since the last disposition for value (s.3(3)).

With both types of title guarantee, the covenants do not apply to anything of which

the person to whom the disposition is made is actually aware when the disposition is made, or which is a necessary consequence of the facts which are then actually known by him (s.6(2)).

4-09 The covenants implied by the limited title guarantee are unlikely to be sufficient for most purchasers, but the full title guarantee may be acceptable. If the words are used, the following points arise:

(1) The covenants are impliedly given by the vendors. While this is appropriate in the case of a business sale, it may not be correct in relation to a share sale if the vendors and the parties giving the warranties are not the same.
(2) Warranties by the vendors as to title, such as cll.1.2.1 and 1.2.2 in paras 7-05 and 7-06 will not be required.
(3) The purchaser will wish to amend the implied covenants by excluding the reference to the knowledge of the disposer which appears in s.3(1) and the exception in respect of matters of which the purchaser is aware which is provided by s.6(2). A suitable clause for this purpose is the following:

[3D] Restriction on implied covenants

4-10 **The express assurance in clause [.....] as to freedom from encumbrances and the covenants implied in that clause by ss.2 and 3 of the LPMPA 1994 shall apply to anything falling within the scope of such assurances and covenants notwithstanding that the Vendors do not know or could not reasonably be expected to know about it, or, at the time of transfer, it is within the actual knowledge, or is a necessary consequence of facts then within the actual knowledge of the Purchaser, and the operation of the covenants implied by ss.2 and 3 of the LPMPA 1994 shall be deemed to be extended so as not to exclude the liability of the Vendors thereunder in any such circumstances.**

An alternative way of dealing with this (and one that reflects current convention) is to amend the clause containing the express assurance such that it reads "sell with [full][limited] title guarantee free from Encumbrances"—by selling "free from Encumbrances", the vendors will be selling free from those that it did and did not know about—and then to deal with the exclusion of the purchaser's knowledge in a separate clause, similar to that at cl.3M. The wide-ranging definition of "Encumbrance" is used.

From the point of view of both parties, it will often be preferable to omit the implied covenants entirely and to rely instead on express warranties which take account of the circumstances relevant to the particular transaction. In practice, most sale agreements contain both.

RESTRICTION OF WARRANTIES TO PERIOD OF OWNERSHIP

4-11 The form of many warranties is such that there could be a breach, however long ago the occurrence of the relevant event. An example is a warranty that all statutory returns have been properly made and filed (see para.7-25, cl.1.11.1). If the period of ownership or involvement of the vendors has been short, they may wish to seek to avoid liability for defects attributable to an earlier period, and the following provision might be appropriate in these circumstances.

[3E] Application of Warranties to past events

The Vendors shall not be liable, in relation to a breach of the Warranties, if and to the extent that the breach is primarily attributable to anything which occurred prior to [.....]. 4-12

Although the vendors may seek to justify the principle underlying this clause on the basis that they cannot warrant the correctness of statements where they have no means of knowing whether or not they are accurate, this argument, which is based on the checklist function of the warranties, is flawed. Either the vendors or the purchaser must accept the risk of inaccuracy and, if neither of them has knowledge of the applicable facts, they must decide by negotiation where the risk is to lie. If the purchaser accepts the principle, the wording of cl.3E is more likely to be approved if "primarily" is omitted or replaced by "wholly". In addition, the purchaser should require the vendors to assign to it, or to enforce for its benefit, any warranties in relation to the target company or business which were obtained when the vendors made their acquisition (see para.2-12). In practice, most purchasers would expect the vendors to bear the risk in these circumstances.

The vendors may also wish to restrict the warranties so that liability will not arise if a breach of warranty results from the combined effect of events both before and after completion.

[3F] Effect of post-Completion events

The Vendors shall not be liable for a claim under the Warranties which would not have arisen but for anything occurring after Completion. 4-13

A purchaser will usually want to ensure that such a clause does not negate any warranty claim which arises as a result of a combination of circumstances occurring before and after completion when those that occurred after completion either are in the ordinary course of the business or were contractually committed to prior to completion.

DATE OF APPLICATION OF WARRANTIES

4-14 Although completion may follow immediately upon the exchange of the contracts for the purchase of the target company or business, it is sometimes the case that there is an interval between exchange of contracts and completion. This may arise, for example, because certain consents are required, or where the consideration is to be satisfied by a placing of shares. Where an interval exists, the target company or business will usually continue to be run by the vendors, although normally this will be for the benefit, and at the risk, of the purchaser.

The purchaser may therefore wish to include provisions in the sale agreement which restrict the way in which the business of the target company or the acquired business may be conducted in the intervening period (*interregnum* provisions) (see Appendix 2, which contains an example of generic provisions that would be suitable in such circumstances). In addition, the purchaser will wish the warranties contained in the sale agreement to apply both at the date of the exchange of contracts and at completion and perhaps even at every moment in between. The first of these dates is relevant as the purchaser will, in part, be relying upon the warranties in deciding to enter into the sale agreement. It is also appropriate, from the

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purchaser's point of view, for the warranties to be extended to completion, as the purchaser will wish to protect itself so far as possible against any changes occurring after contracts by passing the risk of them to the vendors.

As the vendors will generally control the target company or business until completion, it is difficult for them to resist some extension of the warranties to completion. It is likely that the vendors will be presented with clauses to cover these aspects, similar to those which follow in this section. Great care needs to be taken by the vendors in extending the warranties to completion, as that will substantially erode the usual basis that the company or business is carried on after exchange of contracts at the purchaser's risk.

[3G] Events occurring prior to Completion

4-15 **[Each of the Vendors] [The Vendor] will promptly disclose in writing to the Purchaser any [material] circumstance which arises, or becomes known to [him] [her] [it], prior to Completion and is inconsistent [in a material respect] with any of the Warranties or the matters Disclosed[, or which might be material to be known by a purchaser for value of [the Shares] [the Business]].**

The purchaser will be justified in seeking to include this clause where it has a right to rescind the contract if a breach of warranty occurs or is identified prior to completion. The purchaser might also wish to retain the clause in any case on the basis that, if difficulties arise before completion, notification should be given to it so that it can plan appropriate corrective action. Whilst this argument has some validity, the vendors might reasonably object to putting themselves in a position where a failure to comply with the clause could give rise to a claim for damages. Furthermore, they should not underestimate the considerable practical difficulty of keeping constantly in mind in the period up to completion the wording of lengthy and technical warranties.

The purchaser will probably insist that any disclosure under this provision is in writing, so that there can be no dispute afterwards as to whether the disclosure has taken place. The vendors should therefore ensure that a written record is made of any relevant discussions which take place with the purchaser between contracts and completion. It would be usual if there were any relevant matters for a supplementary disclosure letter containing details of them to be prepared and provided at completion.

The clause as drafted refers to all the warranties and the vendors should consider each warranty specifically to determine whether or not the obligations imposed by the clause should extend to that warranty. The vendors should also consider inserting the references to materiality that are included in square brackets.

4-16 The suggested wording would require a disclosure of information which is in the public domain and which does not relate specifically to the target company or business. Thus, for example, during the interval between contracts and completion, there might be an announcement of new legislation to be introduced with effect from the date of the announcement. This could render a warranty incorrect, but the vendors should not be required to make a disclosure of the announcement. It is therefore suggested that the vendors should consider qualifying the clause by adding the words:

> **"... being a circumstance relating specifically to [the Company] [the Business]."**

The vendors would also wish to consider carefully whether the words "or which

might be material to be known by a purchaser for value of [the Shares] [the Business]" are acceptable, as they have no way of knowing what might affect a purchaser in general rather than the actual purchaser. Even to amend the clause so that it applies only to matters which might be material to be known by the actual purchaser may not be acceptable, as the vendors may have little information about the purchaser's reasons for acquiring the target company or business.

A second clause which the purchaser would wish to include in cases of deferred completion, in addition to any express restrictions such as are contained in Appendix 2, would be to the following effect:

[3H] Conduct of the Company pending Completion

The Vendors shall procure that, save as may be necessary to give effect to this Agreement, the Company shall not, before Completion, without the prior written consent of the Purchaser [knowingly] do, procure or allow anything which might constitute or result in a [material] breach of the Warranties, or make any of them inaccurate or misleading, if they were given at Completion. 4-17

The equivalent wording in the case of a business sale would be:

> **"Save as may be necessary to give effect to this Agreement, the Vendor shall not, before Completion, without the written consent of the Purchaser [knowingly] do, procure or allow anything which might constitute or result in a [material] breach of the Warranties, or make any of them inaccurate or misleading, if they were given at Completion."**

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The purpose of this provision is to apply the warranties on a continuing basis throughout the interval between exchange of contracts and completion. It is accordingly an onerous clause, to be viewed with caution by the vendors. If they accept it in principle, they should at least make sure that extraordinary transactions are avoided during the period between contracts and completion. It would also be reasonable for the vendors to qualify the clause by adding the following wording:

> **"[The Vendors] [The Vendor] shall not, however, be liable under this clause for a breach which arises from the ordinary and proper course of [business of the Company] [the Business]."**

An example of an event which would come within this sentence is a routine change in the identity of named employees (e.g. cl.6.1.1 in para.7-166). The vendors should also consider whether the word "might" should be replaced by "would" or "would be likely to". The third clause which the purchaser will require, whether the interval between contracts and completion is short or long, is along the following lines:

[3I] Warranties to apply at Completion

Each of the Warranties shall be deemed to be repeated, with any necessary modification, immediately before the time of Completion, with reference to the facts then existing. 4-18

This clause differs from cl.3G in that it takes no account of whether any change has been caused by the vendors or was within their control. It is inconsistent with the concept, which is standard in conveyancing practice, that the risk of adverse

This information is of importance to a purchaser and enables it to assess the covenant strength of the tenant and its effect on the value of the property. In addition, persistent delay in paying rent or other substantial breaches of covenant by the tenant constitute grounds of opposition by the target company to the grant by the court of a new tenancy under the LTA 1954 Pt II.

10 Residual liability

6-82 **10.1 The Company has not at any time:**

10.1.1 surrendered any lease, licence or tenancy to a landlord without first satisfying itself that the landlord had good title to accept such surrender and without receiving from the landlord an absolute release from all liability arising under such lease, licence or tenancy;

10.1.2 assigned, or otherwise disposed of, any lease, licence or tenancy without receiving a full and effective indemnity from the assignee or transferee in respect of its liability under such lease, licence or tenancy;

10.1.3 been a guarantor of a tenant's liability under any lease, licence or tenancy or otherwise given any guarantee or indemnity for any liability relating to any of the Properties or any property or other land or buildings previously owned by the Company; or

10.1.4 assigned or otherwise disposed of, dealt with or held any property in such a way that it retains any other residual liability (whether actual or contingent) in respect thereof.

This clause is designed to flush out any residual liability that the target company may have in respect of any premises formerly occupied or owned by it or in which it otherwise had an interest and to protect the purchaser against any that are unknown or not disclosed. In practice, it is unlikely to cause the vendors any difficulty and will simply require disclosure of any relevant matters and, in any event, as such matters would be difficult to be established by a purchaser, otherwise than by enquiry of the vendors, it is not unreasonable for a purchaser to seek such a warranty.

CHAPTER 7

Typical Long Form Commercial Warranties on Share Sales

INTRODUCTION

7-01 The form that warranties may take where the shares of an active trading company are purchased is infinitely variable, and no standard set of warranties can be entirely suitable for every deal. In selecting which warranties are appropriate for a particular transaction, it is helpful to have a comprehensive standard form available which can be suitably edited to deal with the particular circumstances of the target company or deal. Vendors will not appreciate receiving an agreement that contains extensive warranties on areas that are of little or no relevance to the target company, or on areas where there is already a mechanism in the agreement for addressing the potential risk that the warranties are designed to cover. For example, in circumstances where there is to be a stock valuation exercise carried out and the purchase price adjusted based on the outcome of that, vendors will generally resist giving warranties about the quality of the stock.

For a systematic approach, it is essential, as well as being good practice, for the warranties to be grouped into sections dealing with related subject matters. The following is an example of the headings which might usefully be considered other than in relation to taxation and properties (which are dealt with separately in Chapters 5 and 6), each paragraph being analysed in some detail further on in this chapter. The warranties themselves are repeated in Appendix 4, with the omission of the amendments which are included within square brackets, which are put forward to assist and protect the vendors.

Clause	Title
1	*PRELIMINARY*
1.1	*Capacity and authority of the vendors*
1.2	*Ownership of shares*
1.3	*Share capital*
1.4	*Details of the company*
1.5	*Directors and shadow directors*
1.6	*Subsidiaries and branches*
1.7	*Options over the company's capital*
1.8	*Commissions*
1.9	*Elective resolutions*
1.10	*Constitutional documents, statutory books and resolutions*
1.11	*Documents filed*
1.12	*Possession of documents*

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Clause	Title
1.13	*Investigations*
1.14	*Information disclosed to the purchaser is correct*
2	*ACCOUNTS*
2.1	*The accounts*
2.2	*Valuation of inventory*
2.3	*Deferred taxation*
2.4	*Accounting reference date*
2.5	*Management accounts*
2.6	*Books and records*
3	*FINANCE*
3.1	*Capital commitments*
3.2	*Bank and other borrowings*
3.3	*Bank accounts*
3.4	*Continuation of facilities*
3.5	*Debts*
3.6	*Liabilities*
3.7	*Working capital*
3.8	*Dividends and distributions*
3.9	*Government grants*
4	*TRADING AND CONTRACTS*
4.1	*Changes in business activities and financial position since the balance sheet date*
4.2	*Vendors' other interests and liabilities*
4.3	*Effect of sale of shares*
4.4	*Business conducted lawfully*
4.5	*Joint ventures and partnerships*
4.6	*Agency agreements and agreements restricting business*
4.7	*Unfair trade and restrictive practices*
4.8	*Litigation*
4.9	*Winding-up*
4.10	*Compliance with statutes*
4.11	*Business names*
4.12	*Transactions involving directors*
4.13	*Powers of attorney and authorities*
4.14	*Licences and consents*
4.15	*Subsisting contracts*
4.16	*Breach of contract*
4.17	*Outstanding offers*
4.18	*Defective products*
4.19	*Service and product warranty liabilities*
4.20	*Purchases and sales from or to one party*
4.21	*Consumer protection*
4.22	*Data protection*

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Clause	Title
4.23	*Guarantees and indemnities*
4.24	*Connected persons contracts*
4.25	*Sensitive payments*
4.26	*Anti-corruption*
4.27	*Consultants' reports*
4.28	*Modern slavery*
5	*ENVIRONMENTAL*
5.1	*Required permits*
5.2	*Breaches*
5.3	*Audits and surveys*
5.4	*Prosecutions*
5.5	*No claims*
5.6	*Hazardous substances*
5.7	*Work carried out under notices*
5.8	*Prior use*
6	*EMPLOYMENT*
6.1	*Employees, terms of employment and status*
6.2	*Claims and potential employee claims*
6.3	*Changes in remuneration*
6.4	*Bonus and share options schemes*
6.5	*Termination of contracts of employment*
6.6	*Industrial relations*
6.7	*Redundancies*
6.8	*Employee shareholders*
7	*PENSIONS*
7.1	*No other pension arrangements*
7.2	*Other company liabilities*
7.3	*Additional member's rights*
7.4	*Workplace pension compliance*
7.5	*Full and accurate particulars*
7.6	*Member details*
7.7	*Taxation status*
7.8	*Proposed amendments to the scheme*
7.9	*Trustees*
7.10	*Appointments*
7.11	*No disputes*
7.12	*Scheme operated properly*
7.13	*Contracting-out*
7.14	*Non-discrimination*
7.15	*Insurance*
7.16	*Fees and charges*
7.17	*Scheme investments*
7.18	*Scheme surpluses and refunds*

Clause	Title
7.19	*Discretions and powers*
7.20	*Contributions paid*
7.21	*Benefits payable*
7.22	*Assets sufficient*
7.23	*Debts arising*
7.24	*Bulk transfers*
8	*ASSETS*
8.1	*Ownership of assets*
8.2	*Assets sufficient for the business*
8.3	*Stocks and work-in-progress*
8.4	*Insurance*
8.5	*Leased assets*
8.6	*Plant in working order*
8.7	*Assets register*
8.8	*Intellectual property rights*
8.9	*IT systems*
8.10	*Money laundering*

SHORT FORM WARRANTIES

7-02

If the target company's affairs are comparatively simple or if the consideration for the company is modest, the use of extensive warranties may not only be inappropriate but actually counter-productive. A shorter set of warranties would be suitable in such cases and a precedent is contained in Appendix 9. The precedent essentially takes the long form warranties and condenses them into a set of warranties which, while much shorter, cover for the most part the same areas. The effect of this is to put the burden on the vendors and their advisers to consider fully the potential scope of each of the warranties, as the warranties themselves will not direct their minds specifically to all relevant areas. The purchaser will enjoy a similar level of cover as if long form warranties had been used, save the costs of negotiating long form warranties and, to unsuspecting vendors, the purchaser may appear to be more reasonable.

While the warranties in Appendix 9 would be particularly useful in a low value transaction where little is known of the target company, in circumstances where details are known and the target company's affairs are relatively simple, consideration should be given as to whether it would be preferable to tailor the long form warranties to cover relevant areas to try to ensure that the vendors' attention when making disclosures is focused on all of the pertinent areas and that the purchaser is provided with details of all relevant matters which it can carefully consider.

ANALYSIS OF INDIVIDUAL WARRANTIES

7-03

In the following detailed analysis of typical warranties it is assumed that the vendors and warrantors are one and the same, that the purchase relates to the shares of a trading company and that the purchaser is a company. The definitions in

para.4-02 are adopted, and defined terms are printed with a capital first letter. Where words are included in square brackets it is assumed, in most cases, that the warranty is prepared by the purchaser's solicitors without those words and that the vendors might wish to add them.

1 Preliminary

1.1 Capacity and authority of the Vendors

7-04

1.1.1 Each of the Vendors has the necessary power and authority to enter into and perform this Agreement and all other documents to be executed by them at or before Completion in accordance with this Agreement which constitutes or will when executed constitute binding and enforceable obligations on each of the Vendors.

Lack of power, authority or capacity, can arise in the case of infants, bankrupts, trustees, persons of unsound mind and companies which do not have appropriate provisions in their articles of association. Where a vendor is a foreign entity, it is standard practice to obtain an opinion letter from a lawyer qualified in the relevant jurisdiction as to the existence of the required capacity.

Where there is a sole vendor who is also the warrantor, the warranty has no function except to operate by way of a reminder to the purchaser's advisers to check the capacity of the vendor, which they should do as a matter of course. If the vendor lacks capacity to enter into the agreement, he/it will also lack capacity to give the warranty, and so it will provide no protection to the purchaser. The provision has legal value in practice only where there are a number of vendors and each vendor accepts responsibility for any incapacity of another vendor, or where the vendors and warrantors differ. If there is any risk attached to this matter, it seems appropriate that it should fall upon the vendors which are, in principle, obtaining the benefit of the sale of the target company rather than the purchaser. The vendors should have no need to amend or seek to resist the warranty and if they do, then the purchaser will need to be careful to ensure that the vendors are in fact entitled to do what they are purporting to do.

1.2 Ownership of Shares

7-05

1.2.1 The Shares are fully paid or credited as fully paid and will, at Completion, constitute the whole of the issued and allotted share capital of the Company.

Issued shares are shares in respect of which an entry has been made in the register of members. Allotted shares are shares which have been allotted by a company and are held on letters of allotment, but have not been registered. Shares are fully paid if they are subscribed for in cash, and are credited as paid. Shares in a private company can be allotted partly or fully paid or nil paid (depending on the provisions of the articles of the relevant company). In the case of a public company, they must be paid-up at least one-quarter of their nominal value and the whole amount of any premium. If shares are not fully paid, there is a contingent liability under the Insolvency Act 1986 s.74 upon holders and certain past holders to pay up the shares on insolvency. The warranty may also have particular relevance in relation to a target company which is a public limited company, as CA 2006 s.586 requires the shares of a public company to be paid-up to the extent of at least one-quarter of their nominal value, together with the whole of any premium on such shares. Again, other

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than where it is not the entire issued share capital of the target company that is being sold (in which circumstances the warranty will need to be amended to refer to the share capital that is in fact being sold), the vendors should not seek any amendment to, or resist giving, the warranty.

7-06 **1.2.2 The Vendors have the right to transfer to the Purchaser (without the consent of any third party) and will on Completion transfer the whole of the legal and beneficial title to the Shares.**

It is only the legal ownership, i.e. the ownership conferred by entry in the register of members of the shares of the target company, that is strictly relevant. This is because the persons entered in the register are defined to be the members of the company (CA 2006 s.112). The subscribers to the memorandum become members on registration of the company, even if their names are not entered in the register of members (CA 2006 s.112(1)). The reference to beneficial ownership will often be inappropriate, for example if the vendors include trustees or the target is a wholly owned subsidiary and one of the vendors is the nominee for the holding company. If for good reason the vendors wish to omit the reference to beneficial ownership, the purchaser should not be concerned. This warranty will be superfluous if the vendors are expressed to sell with full title guarantee (when certain of the implied covenants have been excluded) and free from all encumbrances (see para.4-08) unless the vendors and the warrantors are not the same persons.

7-07 **1.2.3 There is not now existing nor is there any agreement to create any Encumbrance on or affecting the Shares or any unissued shares or securities of the Company.**

"Encumbrance" is defined to include not only those matters that would normally be considered to be encumbrances in the ordinary English meaning of the word, but also more esoteric matters which might arguably, but not ordinarily, amount to an encumbrance. There are minor, and largely irrelevant, differences between the various types of encumbrances in the way that they might apply to shares. If share certificates are handed over for the purpose of securing a debt, the transaction strictly gives rise to a pledge. A lien exists where the certificates are held by a person to whom a debt is owed, such as a banker who happens to be holding the certificates on behalf of a customer indebted to the bank, without a formal charge being created. In relation to a bank, it would appear to be correct to confine the concept of a lien to a right which attaches to documents coming into the bank's possession otherwise than directly in relation to the indebtedness. A lien on the shares held by a vendor may also exist if he is indebted to the target company and its articles of association provide for a lien even where the shares are fully paid.

The 1985 version of Table A of reg.8 provides for a lien over shares that are not fully paid. For companies incorporated under CA 2006, they use the model articles set out in the Companies (Model Articles) Regulations 2008 which presume that shares in a private company will be fully paid (as is most often the case). As such, they do not include provisions relating to liens (or other mechanisms dealing with partly paid shares) as they are not necessary in those circumstances.

If the purchaser is to take free of such a charge of which it did not have actual notice, it must be able to show that the lack of notice was bona fide and this warranty will assist it in doing so. Furthermore, from a practical point of view, the purchaser will wish to ensure that the vendors are reminded to check whether the shares are charged, so that arrangements can be made to deliver the shares, free of encumbrances, at completion. Whilst overlapping with cl.1.1.1 in this regard, this

warranty will also require the vendors to check and confirm to the purchaser that there are no encumbrances, or arrangements to create the same, which might apply in respect of a future issue of unissued shares (or other securities) in the capital of the target company. The vendors cannot reasonably resist the warranty and would, in practice, gain nothing by doing so.

If the shares were the subject of a "chargeable transfer" under IHTA 1984 and tax arising on the transfer remains unpaid, the shares will be subject to a charge to secure the tax (see the comments on cl.29.2 in para.5-100).

The vendors will generally be required to sell their shares with full title guarantee (as defined in the LPMPA 1994 but usually on the basis that s.6(2) is excluded) and free from "encumbrances". Selling with such title implies: that the vendors own the property and are not trying to dispose of something that they do not own; that the vendors can dispose of the property in the way they say they are going to; that the vendors will do all that they reasonably can to give the title that they purport to give (at their own cost); and that the title is free from all charges, encumbrances and adverse rights, other than any which the vendors do not know about or could not reasonably be expected to know about (i.e. free from all known encumbrances). Section 6(2) LPMPA 1994 has the effect, in relation to full title guarantee, that the vendor is not liable for anything within the purchaser's actual knowledge or which is a necessary consequence of facts that are within the purchaser's knowledge. Accordingly, when acting for the purchaser, s.6(2) should be applying to the purchaser. The additional wording relating to freedom from "encumbrances" is added to ensure that the buyer gets a clean title (as it is not subject to knowledge).

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7-08 **1.2.4 None of the Shares were, or represents assets which were, the subject of a transfer at an undervalue (within the meaning of the Insolvency Act 1986 ss.238 or 339) or a preference (within the meaning of the Insolvency Act 1986 ss.239 or 340) within the past five years or a transaction defrauding creditors (within the meaning of s.423 of the Insolvency Act 1986).**

If an asset is transferred at an undervalue "at a relevant time" and the transferor becomes bankrupt, or goes into liquidation or administration, the court may order, amongst other remedies, the asset to be revested in the transferor (Insolvency Act 1986 s.241 in relation to companies and the Insolvency Act 1986 s.342 in relation to individuals).

The "relevant time" for a company is two years prior to the liquidation, the filing of a notice of intention to appoint an administrator or the making of an application to court to appoint an administrator (where an administrator is appointed pursuant to the filing of that notice or application) (Insolvency Act 1986 s.240). The provisions in relation to Insolvency Act 1986 s.238 will not apply if the company transferring the shares was not insolvent at the time it transferred the shares and did not become insolvent as a result of the transfer of the shares. Where the shares were transferred to a "connected party" as defined in the Insolvency Act 1986 ss.249 and 435 insolvency is presumed unless the contrary can be shown.

The relevant time for a bankrupt is five years prior to the date of the bankruptcy petition upon which the bankruptcy order is subsequently made. If the transaction took place between two and five years before the date of the bankruptcy petition, then it is necessary to show insolvency at the time the transaction occurred. However, if the transfer was to an "associate" within the meaning of the Insolvency Act 1986 s.435 it is assumed by the court that the transferor was insolvent unless the contrary can be shown. If the transfer was within two years of the bankruptcy order, then it is not necessary to show that the transferor was insolvent at the time.

The court has the power to make orders against any person, whether or not that person was a direct recipient of the transaction at an undervalue. However, an order cannot be made against an owner of the asset who acquired the asset in good faith and for value. If the purchasers are associates of, or connected with, the person who has made the transfer at an undervalue, then it will be presumed that the transaction was other than in good faith unless the contrary can be shown. A similar presumption arises if the purchaser of property which has been the subject of a transfer at an undervalue knew that the initial transaction was a transaction at an undervalue and that the initial transferor was subject to insolvency proceedings at the time of the second transfer.

There remains a small risk to a purchaser for a period of two years after a transfer has been made (e.g. to trustees or any other person as a gift by an individual) that the transferor may have or will become bankrupt and steps have been taken to set the transfer aside. Purchasers should also be wary of, for example, the target company having been formerly a subsidiary which was then transferred to associated parties of the former shareholder. The purchaser that is genuinely purchasing for value and in good faith is safe if it did not know of both the transaction at an undervalue and of the insolvency proceedings. The warranty helps to demonstrate that it did not have the requisite knowledge if the acquisition should be contested. A purchaser will, however, be vulnerable if, notwithstanding that it is able to show that it did not have actual knowledge of the transaction at an undervalue and the relevant proceedings, there is other evidence that the transaction was not in "good faith". This might be found if, for example, the purchaser was a mere nominee of the initial transferor or transferee or one of its associates and was attempting to put distance between the shares and a possible insolvency appointment. From the point of view of the vendors, there may be some concern about each of them having to accept responsibility in relation to the history of the previous transfers of the shares unless they are all well known to each other. Purchasers should, however, be alert to the fact that as a result of due diligence they may become aware or may be held to be on notice of these issues notwithstanding the warranty.

A preference occurs if, at the "relevant time", a company/individual does something to put a creditor into a better position than that creditor would otherwise have been, provided that the company/individual was influenced by a desire to achieve that effect. The "relevant time" for these purposes is two years prior to the bankruptcy petition, liquidation, the filing of a notice of intention to appoint an administrator or the filing of an application to court to appoint an administrator (as the case may be). However, where the recipient of the preference is not associated with the company/bankrupt, the two-year period is reduced to six months. Where the transaction in question is with a connected person or entity, the requisite desire to prefer will be presumed. The company/bankrupt must also have been insolvent at the time of the transaction, or became insolvent as a result. Typically, this will be an issue for the purchaser if the vendor was a creditor of the previous owner of the shares and, rather than paying for the shares, set-off the value against the debt. If the shares were acquired by the vendor as a result of a preference, the court has similar powers to make orders against third parties as it does for transactions at an undervalue.

A transaction defrauding creditors under the Insolvency Act 1986 s.423 occurs when a company transfers assets at less than value with the purpose of putting assets beyond the reach of creditors or otherwise prejudicing the interests of creditors. There is no need for the company to have been insolvent at the time or even to have subsequently entered into a formal insolvency process. There is also no "relevant time" requirement and so transactions defrauding creditors can potentially be

undone at any time, regardless of solvency. Again, an order made by the court must not prejudice any interest in property acquired in good faith, for value and without notice of the relevant circumstances.

1.2.5 None of the Shares was allotted at a discount. 7-09

Under CA 2006 s.580 there is a prohibition on the allotment of shares at a discount, that is for a consideration of less than par. Allotment at a discount is unlikely to have occurred if the shares were allotted for cash, but if the consideration was the transfer of assets or provision of services, the possibility of a breach is more real. The purchaser will avoid liability to make good any shortfall under CA 2006 s.588 if it is a bona fide purchaser without notice (CA 2006 s.588(2)) and the warranty will help to establish this defence should it be required.

1.3 Share capital

1.3.1 No share or loan capital has been issued or allotted or agreed to be issued or allotted by the Company since the Balance Sheet Date. 7-10

This warranty is designed to elicit disclosure of any share or loan transactions which have occurred since the last annual accounts were prepared, as the purchaser will be basing its assessment of the target company on the position stated in the accounts and will want to know whether the position in them has changed. The warranty brings the position in respect of shares and loan capital up-to-date as at completion.

1.3.2 The Company has not at any time [during the last [.....] years] repaid, redeemed or purchased any of its own shares, reduced its share capital or capitalised any reserves or profits (or agreed to do the same). 7-11

The purchaser will wish to check that prior transactions have been properly undertaken in order to ensure that there is no risk arising from any of them, and that the vendors have good title to the shares they are purporting to sell. For instance, a prior buy-back of shares which was not properly undertaken in accordance with the requirements of CA 1985 or CA 2006 is likely to be void. The consequence of this is that the prior owners of the relevant shares will still be the owners of the shares and the company will have paid out money for no benefit. This can cause significant complications, particularly if the prior owners cannot be located or are not cooperative, as their involvement will invariably be needed in correcting the position and no prudent purchaser will want to enter into a transaction with the vendors unless it is satisfied that they do in fact have good title to sell all of the relevant shares. Where the vendors have not owned the shares since incorporation of the target company, they will prefer to limit the warranty to their period of ownership (by adding the wording in brackets) on the basis that they will not necessarily know what the company did prior to then. The purchaser is unlikely to agree to this and will argue that that is a risk that should fairly lie with the vendors. They would have had the opportunity to obtain confirmation of the position at the time of their acquisition of the shares.

As with all of the warranties relating to the share capital and other constitutional matters, the purchaser will need to be careful to ensure that it is not deemed to have knowledge of illegal buy-backs or other issues (in circumstances where the vendors have not made any disclosures of such matters) by virtue of, for example, accepting the general disclosure of information available in respect of the target company

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at the Companies House Registry. If the purchaser is going to accept general disclosure of relevant searches, it should undertake its own investigations and ask further questions of the vendors in the event of any inconsistency between the results of its investigations and the information provided by the vendors so as to get a clear understanding (so far as possible) of the actual position.

7-12 **1.3.3 The Company has not at any time [during the last [.....] years] provided financial assistance pursuant to CA 1985 ss.151 and 158 or CA 2006 ss.678 or 679.**

Since 1 October 2008 private limited companies have been permitted to give financial assistance without any restrictions being imposed, save for where the company is a subsidiary of a public company and the assistance is being given in connection with an acquisition of the shares in the public company, as a result of the implementation of CA 2006.

The purchaser will wish to ensure that the procedures were properly followed in respect of transactions undertaken prior to 1 October 2008 under CA 1985 (and after that time where the target company has been re-registered from being a public company since 1 October 2008 or has been a subsidiary of a public company during that time), as the consequences of breach or failure to follow the relevant provision will mean that the provision of the financial assistance was unlawful, any agreement or charge given as part of the financial assistance will potentially be void, and the directors of the company may be guilty of a criminal offence. Again, where the vendors have not owned the shares since incorporation of the target company, they will prefer to limit the warranty to their period of ownership by adding the wording in brackets, but this is unlikely to be acceptable to the purchaser for the reasons stated at cl.1.3.2.

1.4 Details of the Company

7-13 **1.4.1 The information relating to the Company in Schedule [.....] is accurate and complete [in respect of the matters dealt with].**

Information which it is appropriate to include in the schedule would be details of the company number, date of incorporation, authorised (if applicable), issued and allotted share capital, registered office, directors, secretary (if applicable), auditors and accounting reference date. Cautious vendors might reasonably object to the statement that the information is "complete", on the ground that it is for the purchaser to specify precisely what particulars are required and should consider including the additional words in brackets which would give them comfort in this regard.

1.5 Directors and shadow directors

7-14 **1.5.1 The Company has no liability to a former member, officer or shadow director or any person nor are there any circumstances in which such liability could arise.**

The vendors should bear in mind that the definition of "director" in CA 2006 s.250 includes a person occupying the position of a director by whatever name called and so is not confined just to people who have been formally appointed as directors of the target company and whose names appear in the register of directors in the company's statutory books and at the Companies House Registry (the so-called de jure directors) but would also include de facto and shadow directors. Shadow directors are discussed at cl.1.5.2. De facto directors were distinguished from shadow directors in *H Laing (Demolition Building Contractors) Ltd, Re* [1998] B.C.C. 561 on the basis that de facto directors are "insiders" of the company, such as shareholders, and senior employees who effectively are directors, whereas shadow directors are often "outsiders", for example those who direct the de facto or de jure directors. It should be noted that the definition of "director" is also relevant for the purposes of the various obligations that are imposed on directors in respect of disclosing interests and other matters under CA 2006.

7-15 **1.5.2 No person is or has been a shadow director (within the meaning of the Companies Acts) of the Company but not treated as one of its directors for all the purposes of the Companies Acts.**

A shadow director of a company is a person who is not a director but in accordance with whose instructions the directors of the company are accustomed to act. Section 251(3) CA 2006 expressly excludes a parent company from falling within the definition for most purposes. In practice, therefore, a shadow directorship is most likely to occur in family companies and, as noted above, the purchaser will wish to be aware of arrangements giving rise to a shadow directorship so that they may be terminated.

1.6 Subsidiaries and branches

7-16 **1.6.1 The Company:**

1.6.1.1 is not the holder or beneficial owner of nor has it agreed to acquire, share or loan capital of a body corporate; and

An agreement to acquire an asset will be relevant if it results in an outstanding liability. In any other case it might be thought that a purchaser will not be concerned if, in the event, the target company has more subsidiaries than were disclosed. However, the purchaser will often be subject to group borrowing restrictions and a heavily geared new subsidiary could have an important impact on the purchaser's gearing ratios. There may also be other cases where such additional companies would be objectionable. Thus, for example, the undisclosed companies might be engaged in activities which are not consistent with other activities of the purchaser, or be in serious financial difficulty so that the purchaser might then face the embarrassment of inadvertently becoming the owner of insolvent companies. Two further examples are where the undisclosed shares are only partly paid or are shares in an unlimited company.

7-17 **1.6.1.2 has not outside the United Kingdom a branch, agency or place of business, or a permanent establishment (as that expression is currently defined in the relevant double taxation relief order).**

The term "permanent establishment" is used in most double tax treaties but the definitions vary. In general, a permanent establishment exists if there is a fixed place of business and will usually include a branch or office or an agency where the agent has, and habitually exercises, power to conclude contracts on behalf of his principal.

This provision is relevant for a number of reasons. Clearly, if the warranty is incorrect, there is a potential taxation liability in the overseas jurisdictions concerned and, if significant activities are involved, it would be prudent to obtain local advice as to the precise implications. However, in addition to taxation mat-

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ters, any overseas branch will involve a consideration of the regulations applying in the overseas jurisdiction to business activities carried on by foreigners, including such matters as registration requirements and work permits. A foreign branch may also be subject to local exchange control restrictions which would prevent or inhibit repatriation of profits (see also cl.4.4.2).

1.7 Options over the Company's capital

7-18 **1.7.1 Apart from this Agreement, there are no agreements or arrangements which provide for the issue, allotment or transfer of, or grant a right (whether conditional or otherwise) to call for the issue, allotment or transfer of share or loan capital of the Company. No claim has been made by any person to be entitled to any of the foregoing.**

It might be thought sufficient to refer to outstanding "agreements" to acquire shares or loan capital, but the purchaser would nevertheless wish to extend the warranty to cover arrangements. This is because unilateral obligations, such as the grant of an option, may be said not to constitute agreements. Equally preemption rights (where shareholders agree to sell shares to each other on a first refusal basis) are often set out in the articles of association of a company and it is not usual to regard the articles as an agreement. Uncertainty in respect of this point could be met by adding reference to "obligations". The warranty expressly excludes the sale agreement, as otherwise the agreement to sell the target company itself would strictly conflict with the warranty, although it is difficult to see how a breach of the warranty in that respect could give rise to a claim for damages.

1.8 Commissions

7-19 **1.8.1 No one is entitled to receive from the Company a finder's fee, brokerage or other commission in connection with the sale and purchase of the Shares under this Agreement.**

Although CA 1985 s.151 has now been repealed (it formerly made it illegal for a company to give financial assistance in connection with the purchase of its own shares or the shares of its holding company), this warranty should be retained as it is relevant in other contexts. For example, in transactions involving local authorities, it is possible that payment of commission could involve corruption and the warranty would minimise any possibility of the purchaser being implicated in that. (Cl. 4.24.1 deals specifically with the issue of "sensitive payments".) This warranty also serves the practical function of reducing the chances of a subsequent dispute as to who is liable for any broker's fees and is quite often extended to cover legal fees to ensure that no personal fees of the shareholders are being met by the target company.

1.9 Elective resolutions

7-20 **1.9.1 The Company has not passed an elective resolution under CA 1985 s.379A which remains in force.**

The purpose of this warranty is to ascertain details of any elective resolutions passed by the target company. This is in order for the purchaser to ensure that they were passed in accordance with the requirements of CA 1985 and to identify

whether any remain in force (as a result of falling under the scope of transitional or saving provisions introduced by the various Commencement Orders brought in following the implementation of CA 2006).

The elective regime under CA 1985 s.379A was intended to deregulate certain aspects of private companies to try and simplify the administrative burden placed upon them. Further simplification has been adopted under CA 2006, as the elective regime is now the default position for private companies.

Prior to the implementation of CA 2006, there were the following five elective resolutions which could be adopted by private companies:

(1) Amending the duration of directors to allot securities (CA 1985 s.80A) (repealed with effect from 1 October 2009).

(The provisions of CA 2006 regarding authority to allot shares did not take effect until 1 October 2009 and therefore the ability to pass an elective resolution under s.80A was retained up until that date. As a result of the Companies Act 2006 (Commencement No.8, Transitional Provisions and Savings) Order 2008 Sch.2 para.45 (Eighth Commencement Order), an authorisation in force prior to 1 October 2009 also has effect on and after that date as if it were passed pursuant to CA 2006 s.551.)

(2) Dispensing with the requirement to present accounts and reports before the members in general meeting (CA 1985 s.252) (repealed with effect from 1 October 2007).

(Following the repeal of CA 1985 s.252, private companies are no longer required to lay their accounts and reports before the general meeting. This therefore rendered the elective regime and elective resolutions passed in this regard prior to 1 October 2007 redundant.)

(3) Dispensing with the requirement to hold annual general meetings (CA 1985 s.366A) (repealed with effect from 1 October 2007).

(4) Although s.366A was repealed on 1 October 2007, this did not affect any provision of a private company's memorandum or articles of association that expressly requires the company to hold an annual general meeting (AGM). If there was an elective resolution under s.366A in force prior to 1 October 2007, however, then this shall remain valid and so the company shall not be treated as one whose articles expressly require it to hold an AGM (the Companies Act 2006 (Commencement No.3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 Sch.3 para.32(4) (Third Commencement Order)) altering the majority required to authorise the holding of a meeting at short notice and the passing of a resolution at short notice to be reduced from 95 per cent to a lower figure but not less than 90 per cent (CA 1985 ss.369(4) and 378(3)) (repealed with effect from 1 October 2007).

(5) If a private company has passed an elective resolution, to specify a percentage of 90 per cent to consent to short notice or specifying a percentage between 90 per cent and 95 per cent, and it remained in force immediately before 1 October 2007, such elective resolution will remain valid (the Companies Act 2006 (Commencement No.6, Saving and Commencement Nos 3 and 5 (Amendment)) Order 2008 Sch.3 para.2(1) and (2) (Sixth Commencement Order)). Any provision of the company's articles of association that specifies a different percentage will be disregarded where such provision(s) of the articles of association were adopted prior to 1 October 2007. This saving provision does not apply in relation to provisions of the company's articles adopted on or after 1 October 2007 dispensing with the

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requirement to appoint auditors annually (CA 1985 s.386) (repealed with effect from 1 October 2007).

Where a private company has passed an elective resolution under CA 1985 s.386, and the election was in force immediately prior to 1 October 2007, such auditors may be deemed re-appointed under CA 2006 (the Companies Act 2006 (Commencement No.3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 Sch.3 para.44). This saving provision takes precedence over CA 2006 s.487(2)(a), which provides that there is no deemed re-appointment of auditors that have been appointed by the directors of the company. In addition to this particular exception, where an elective resolution has been passed under CA 1985 s.390A fixing the remuneration of the company's auditors, and that resolution was expressed as continuing so long as an elective resolution under CA 1985 s.386 was in force, the resolution will continue to have effect after 1 October 2007 notwithstanding the repeal of CA 1985 s.386 (the Companies Act 2006 (Commencement No.3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 Sch.3 para.45).

1.10 Constitutional documents, statutory books and resolutions

7-21 **1.10.1 The copy of the memorandum and articles of association of the Company attached to the Disclosure Letter is accurate and complete and has embodied in it, or attached to it, a copy of every resolution and agreement required to be annexed to or incorporated in these documents by any applicable laws.**

Under CA 2006 s.36, there must be incorporated in or accompanying the articles of association the following documents:

(1) special resolutions;
(2) elective resolutions and resolutions revoking an elective resolution;
(3) resolutions or agreements which have been agreed to by all the members but which, if not so agreed to, would not have been effective unless passed as special or extraordinary resolutions;
(4) a copy of any resolution or agreement relating to the company to which CA 2006 Pt 3A Ch.3 applies;
(5) where the company has been required to give notice to the Companies House Registry under CA 2006 s.34(2) (notice where a company's constitution is altered by enactment), a statement that the enactment in question alters the effect of the company's constitution;
(6) where the company's constitution is altered by special enactment as defined in CA 2006 s.34(4), a copy of the enactment; and
(7) a copy of any order required to be sent to the Companies House Registry under CA 2006 s.35(2)(a) (order of court or other authority altering the company's constitution).

Prior to the implementation of CA 2006 s.36, CA 1985 s.380 required that there must be incorporated in or accompanying the articles of association the following documents:

(1) special resolutions;
(2) extraordinary resolutions;
(3) elective resolutions and resolutions revoking an elective resolution;
(4) resolutions or agreements which have been agreed to by all the members but which, if not so agreed to, would not have been effective unless passed as special or extraordinary resolutions;
(5) resolutions or agreements which have been agreed to by all the members of a class of shareholders but which, if not so agreed to, would not have been effective unless passed by some particular majority or otherwise in some particular manner, and all resolutions that effectively bind all of the members of any class of shareholders although not agreed to by all those members;
(6) a directors' resolution to change the company's name following a direction of the Secretary of State;
(7) resolutions creating, varying, revoking or renewing the authority of directors to allot shares;
(8) a directors' resolution altering the company's memorandum on the company ceasing to be a public company following acquisition of its own shares;
(9) resolutions creating, varying, revoking or renewing a CA 2006 s.166 authority (market purchase of own shares);
(10) resolutions requiring the company to be wound up voluntarily;
(11) resolutions to re-register old public companies; and
(12) directors' resolutions allowing title to a public company's shares to be evidenced and transferred without written instrument.

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The purchaser will normally have made a search at the Companies House Registry against the company but it remains a possibility that the memorandum and articles of association which are shown on the files are not correct. This could be as a result of a failure to file resolutions or arise from the fact that the resolutions do not have to be filed before a lapse of 15 days from the date of passing. There is therefore always the possibility that a company's file at the Companies House Registry will not be up-to-date.

It will be noted that the warranty requires the copies of the memorandum and articles of association to be annexed to the disclosure letter so that there is no question as to the copies which are warranted. If the disclosure letter contains the normal exclusion from the scope of the warranties of matters which appear on the file at the Companies House Registry (see, for example, sub-para.(c) in para.9-18), the first half of this warranty will, for all practical purposes, be rendered inoperative.

In respect of companies incorporated under CA 2006, it will no longer be necessary for a copy of the memorandum of association to be attached to the disclosure letter as the version of it shown on the file will be correct. The new form of memorandum of association is not subject to subsequent change, as it reflects a "snapshot" of the company at the time of incorporation. However, in respect of pre-CA 2006 companies, a copy of the memorandum of association that was in force at the time of implementation of CA 2006 s.28 should be required to be attached to the disclosure letter. This is because, at that time, the provisions in the company's memorandum of association, which are not the kind that are to be contained in the new style memorandum (as in CA 2006 s.8), will be treated as provisions of the company's articles of association and the purchaser will want to know that it has all the correct details of the provisions that are in the articles of association.

7-22 **1.10.2 The register of members, PSC register (as such term is defined in CA 2006 s.790C) and other statutory books of the Company have been properly kept [in accordance with all applicable laws] [in accordance with the Companies Acts] and contain an accurate and complete record of the matters with which they should deal.**

The statutory books of a company are the register of members (CA 2006 s.113, formerly CA 1985 s.352), overseas branch register (if one is kept) (CA 2006 s.131, formerly CA 1985 s.362), index of members where the number of members exceeds 50 (CA 2006 s.115, formerly CA 1985 s.354), register of debenture holders (CA 2006 s.743, formerly CA 1985 s.190) (if one is kept), register of charges (CA 2006 s.876, formerly CA 1985 s.407), register of directors and secretary (if applicable) (CA 2006 s.162, formerly CA 1985 s.288) in respect of directors and CA 2006 s.275 (formerly CA 1985 s.288) in respect of secretaries and register of interests in shares (CA 2006 s.808, formerly CA 1985 s.213) and the PSC register (person with significant control) (CA 2006 Pt 21A). As it is quite possible that minor/irrelevant inaccuracies exist in the statutory books, for example in listing other directorships of a past director, the vendors might wish to qualify the warranty so that immaterial errors are excluded. However, in practice, it is most unlikely that such errors could entitle the purchaser to make a claim and the vendors should therefore be able to leave the warranty unchanged without undue concern. To avoid potential ambiguity, the vendors might wish to remove the wording in brackets "in accordance with all applicable laws" and replace it with the other wording in brackets "in accordance with the Companies Acts", to make it clear that it is only compliance with CA 1985 and CA 2006 requirements that is being warranted and nothing outside of that.

7-23 **1.10.3 No notice or allegation has been received that the statutory books of the Company are incorrect or should be rectified.**

Powers of rectification of the registers of members and charges exist under CA 2006 ss.125 and 873. Although the purchaser is substantially protected by the warranties as to charges and in respect of title to the shares (and, where relevant, ownership of any subsidiaries), it is also of importance to the purchaser that the registered particulars are not in dispute. As the warranty relates to notices or allegations received the vendors should know or be able to easily ascertain the position and so should be relatively comfortable in giving the warranty.

7-24 **1.10.4 Since the Balance Sheet Date, no alteration has been made to the articles of association of the Company and no resolution has been passed by its shareholders.**

The copies of the memorandum and articles of association of the target company whose accuracy is warranted under cl.1.10.1 should reveal most relevant resolutions passed by them and the dates on which they were passed. Nevertheless, the purchaser is entitled to be specifically satisfied that no change has taken place in the articles of association since the last accounts were prepared, as in certain cases a change could affect the treatment of the accounts. It is also possible for an ordinary resolution to have been passed, for example giving approval to substantial property transactions involving directors under CA 2006 s.190, where there is no obligation to file the resolution.

1.10.5 The Company has complied with all statutory requirements relating to any notices pursuant to s.790D (Company's duty to investigate and supply information) and s.790G (Duty to supply information) of the CA 2006 given or received by it and, in the event that it is a registerable relevant legal entity in another company's PSC register (as such term is defined in s.790C of CA 2006) the Company has complied with its duties to update information in accordance with s.790H of CA 2006.

1.10.6 The Company has not been notified that an application has been granted by the Registrar of Companies pursuant to Ch. 5 of Part 21A of the CA 2006.

1.10.7 The Company has not issued or received any warning or restriction notice pursuant to Sch.1B of the CA 2006 and it is not aware of any circumstance which would likely lead to the issue of such a notice.

With effect from 6 April 2016, all UK incorporated companies, UK LLPs and Societates Europaeae (SEs) (other than those companies that are subject to Ch.5 of the Financial Conduct Authority's (FCA's) Disclosure and Transparency Rules and companies with voting shares admitted to trading on a regulated market in the UK or the European Economic Area (EEA) or on specified markets in Switzerland, the USA, Japan and Israel) must maintain a PSC register of individuals or registrable relevant legal entities who satisfy the control or significant influence tests as set out in CA 2006 Pt 21A.

The warranties capture the target company's requirement to maintain a register, including its obligation to find out who should be included on the PSC register, as well as any obligation it may have as a registrable relevant legal entity of another company and any warning or restriction notices which may have been issued, pursuant to CA 2006 Sch.1B, relating to non-compliance with an information request under CA 2006 s.790D or s.790E. Restriction notices will be of particular interest to a purchaser as: (a) any transfer of the shares or voting rights, which are subject to the notice, is void (as is an agreement to make such a transfer); (b) no rights are exercisable in respect of such share or interest; (c) no shares can be issued in right of the interest or in pursuance of an offer made to the interest holder; and (d), except in a liquidation, no payment may be made of sums due from the company in respect of the interest, whether in capital or otherwise.

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1.11 Documents filed

1.11.1 All returns, particulars, resolutions and documents required by CA 2006 [or other legislation] to be filed with the Registrar of Companies [or other authority] in respect of the Company have been [duly] filed and were accurate and complete. 7-25

The filing obligations imposed by CA 2006 are extensive and it is not realistic to attempt to list all of them. While the purchaser is entitled to be satisfied that these obligations have been fully performed, to ensure both freedom from default penalties and that the searches against the target company will be complete, the actual wording of the warranty is quite onerous. It is not unusual for filing of annual returns, confirmation statements and accounts to be late, but the vendors should be able to disclose all recent cases of late filing.

The extension of the warranty to filing obligations under legislation other than CA 2006 and the reference to "other legislation" are so wide in their scope that they are unlikely to be acceptable to the vendors. Indeed, the warranty could be interpreted as applying even to the filing of tax returns. This is a reasonable position for the vendors to take in an effort to achieve certainty as to the scope of the warranty. If the purchaser is concerned about the position in respect of certain other filings then it should include specific warranties in relation to them. Deletion of the word "duly" would remove the need for the vendors to disclose details of late filings. If this is to be accepted, the purchaser should consider the insertion of the following:

"No notice has been received that any such filings were out of time that

CHAPTER 10

Tax Covenant and Tax Limitations

INTRODUCTION

10-01 As indicated in para.1-06, the original idea of indemnities, as distinguished from warranties, was to provide the target company with a means of recovering tax for which it had only a secondary liability without a statutory right of recovery from the person primarily liable.

The clear principle upon which tax deeds were originally based became eroded with the introduction of the corporation tax regime and the development of the practice of adding additional statutory provisions to which the indemnity would expressly relate. Eventually, tax deeds became of inordinate length with a large number of specific provisions set out in the body of them.

The next stage of development of the form of the tax deed was an attempt to shorten the document by having a blanket indemnity against any taxation liability. The scope of the indemnity was spread even further by an increasingly wide definition of the kinds of taxation covered by the indemnity (considered in more detail below). Then came the case of *Zim Properties Ltd v Procter (Inspector of Taxes)* [1985] 58 T.C. 371 after which ESC D33 was issued (as described in paras 3-18 and 3-19).

Following this, as a payment to the target company could be taxable whereas a payment to the purchaser was unlikely to be taxable, the tax deed was redrafted as a deed of covenant under which a covenant was given directly to the purchaser as opposed to an indemnity in favour of the target company. This is the most common approach today, with only the vendors and the purchaser being parties (although the target company is occasionally a party for specific purposes, such as conduct of claims). It is technically inaccurate to refer to this as a tax indemnity, as an indemnity is not given to the target company.

10-02 It has since become the norm to incorporate the provisions that would have been contained in a tax deed in a schedule to the sale agreement. In this form it is known as a tax covenant.

A more recent development has been to put all matters relating to tax—definitions, warranties, covenant, limitation and administrative provisions—in a single schedule within the sale agreement. This approach has the following advantages.

(1) It avoids repetitions and inconsistencies; e.g. "Taxation" would often be defined in both the sale agreement and the tax deed, although not always with the same definition.
(2) It ensures that the same limitations apply to a claim for taxation, whether that claim is brought under the tax deed/covenant or the tax warranties. Previously, tax warranties would usually be subject to the general war-

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ranty limitations, with the result that, for example, there might be different conduct of claims provisions that applied, depending on whether the claim was brought under the tax warranties or the tax deed, with resultant confusion if the claim was brought under both.

(3) On a practical level, it makes negotiation of the tax provisions easier, as the tax advisers can remove a discrete portion of the sale agreement to negotiate between themselves, rather than having to review the whole sale agreement to find the relevant tax bits (with the risk that some tax issues could be overlooked).

Although separate tax deeds or tax covenants are still seen occasionally, the current convention is to have a single schedule dealing with all tax matters. This is the approach adopted in this edition.

The modern tax covenant will generally raise numerous complex and obscure questions. Normally, the purchaser's solicitors will make use of a standard comprehensive form and the vendors' solicitors will face the task of providing amendments which reflect the liabilities which the vendors should reasonably expect to accept. This task has, to some extent, been simplified by the recent trend for first drafts of the tax provisions to be more balanced, with the purchaser's solicitors including many of the amendments which the vendors' solicitors would historically have been expected to make. The tax covenant given here is a reasonably balanced draft, although some of the provisions in favour of the vendors may not be appropriate in every case.

SUMMARY OF TAX SCHEDULE

10-03 The tax schedule is typically divided into four or five parts as follows:

Part 1: Tax definitions
Part 2: Tax warranties
Part 3: Tax covenant
Part 4: Limitations
Part 5: Purchaser's covenant and administrative matters

The tax warranties are discussed in Chapter 5 and are not further considered in this chapter.

SUMMARY OF COVENANT

10-04 The definitions and covenant together reflect the core of the traditional tax deed or covenant.

Before giving detailed consideration to the contents of a typical tax schedule, it is helpful to summarise the main points which will or should be dealt with in the tax covenant. Those that will typically need to be addressed are as follows:

(1) The covenant will generally be in favour of the purchaser for the reasons set out above. If for any reason the covenant is in favour of the target company, this will generally be unacceptable to the vendors.
(2) The covenant will cover unexpected liabilities to taxation which relate to events or transactions prior to completion.
(3) The covenant may cover certain tightly defined liabilities that arise as a result of events or transactions occurring after completion but which the purchaser will not accept liability for.

(4) The covenant may cover the loss of an expected right to a tax repayment, it being a matter for negotiation as to whether the vendors should accept this liability.
(5) The purchaser may seek a covenant against the withdrawal of anticipated tax reliefs. It is, however, a complex matter to determine whether this particular covenant is appropriate and, if so, how the covenant should operate.
(6) Subject to which matters are covered by the covenant, a payment by the vendors will be required:
    (a) when the unexpected liability, or loss of expected relief, results in a payment of tax;
    (b) when the expected repayment would have been received;
    (c) when a payment of tax occurs which would have been avoided if an expected relief had not been withdrawn; and
    (d) when a payment of tax would have occurred but for the availability of other reliefs.
(7) The covenant will not normally extend to liabilities which result in no net loss to the target company, for example because of the availability or otherwise of unclaimed reliefs which could be called upon to shelter the liability.

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DETAILED CONSIDERATION

10-05 A typical form of the tax schedule is set out in Appendix 6 and considered below clause by clause.

As indicated in para.2-20, although the vendors will usually be all the vendors, in special cases—e.g. where the vendors include trustees—some of the vendors may be excluded. The purchaser will usually not object, as long as it has joint and several covenants from a number of vendors who have the means to meet potential claims.

Given the modern structure of a tax covenant, any payment which is made under the tax covenant would not normally be taxable in the hands of the purchaser and with the vendors receiving an adjustment to the amount of the purchase consideration which is brought into account for capital gains tax purposes to the extent of any payments made to the purchaser, whether pursuant to the warranties or under the tax covenant.

Part 1: Taxation definitions

10-06 As noted above, Pt 1 usually comprises definitions. Appendix 6 contains the full definitions. Not all of them have been repeated here, as many of them are self-explanatory. The commentary below discusses only those definitions that have been repeated here and require comment.

10-07 **In this Sch.[3]:**

1.1 Words and expressions defined in the Agreement shall except where otherwise provided or expressly defined below have the same meaning.

It is clearly convenient to adopt the definitions contained in the main body of the sale agreement and the provisions dealing with construction and interpretation without setting them out again in full. The parties must take care to ensure that these provisions and the definitions are equally appropriate for the tax covenant. The comments on the definitions in para.4-02 should be borne in mind.

10-08 **1.3 "Claim for Taxation" includes any notice, demand, assessment, determination, letter or other document issued, or action taken, by or on behalf of a Taxation Authority and whether issued before or after Completion, whereby it appears that the Company is, or may be, subject to a Liability to Taxation (whether or not it is primarily payable by the Company and whether or not the Company has a right of reimbursement).**

Although the basic indemnity (contained in Pt 3, cl.1.1.1) is against any liability to taxation, as defined, Pt 4, cl.1.1.4 contains a covenant relating to the costs of dealing with claims for taxation. Further, the conduct of claims provisions in Pt 4, cl.2 are triggered by a "claim for taxation". Accordingly, the purchaser will wish the definition to be drawn as widely as possible, whereas the vendors will seek to restrict its scope. The parties will therefore need to give particular consideration to the phrase "whereby it appears that the Company is, or may be, subject to a Liability to Taxation", the vendors at the very least preferring "may be" to be replaced by "will be" or "likely to be".

10-09 **1.6 "Event" any event whatsoever, including but not limited to any disposition, action or omission (whether or not the Company or the Purchaser is a party), the earning, accrual or receipt of any income, profits or gains, the declaration, payment or making of any dividend or other distribution (in each case whether actual or deemed) on or before Completion and includes any events which are deemed to have occurred for any Taxation purpose.**

The primary covenant contained in Pt 3, cl.1 operates by reference to events on or before completion. The purchaser will want this definition to be drafted as widely as possible. In practice, this definition is rarely subject to substantial amendment; the main issues tend to occur on the so-called "combined events wording" contained at Pt 1, cl.1.18 (see para.10-17).

10-10 **1.10 "Liability to Taxation" includes:**

1.10.1 any liability of the Company to make an actual payment in respect of or in the nature of Taxation;

1.10.2 the set-off or utilisation of a Pre-Completion Relief or a Purchaser's Relief against a liability of the Company to make an actual payment of or in respect of Taxation where but for the set-off or utilisation a liability would have arisen under paragraph 1.10.1 above;

1.10.3 the loss, disallowance, counteracting or clawing back of a Pre-Completion Relief which would otherwise have been available to the Company other than as set out in paragraph 1.10.2;

1.10.4 the loss, qualifying disallowance cancellation or set-off of a right to repayment of Taxation which would otherwise have been available to the Company; and

1.10.5 any liability of the Company to make a payment under an accelerated payment under Chapter 3 of Part 4 of FA 2014.

This is one of the key definitions, as the primary covenant contained in Pt 3, cl.1.1.1 turns on the definition of "liability to taxation".

One of the principal issues that arises on the definition of "liability to taxation" is the extent to which the vendors will compensate the purchaser for the non-availability of tax reliefs of the target company. The circumstances of the transaction as negotiated between the parties will generally reveal whether or not the consideration paid by the purchaser has been influenced by the expected availability of relief. If, for example, the purchase price reflects the value of carry-forward losses, then the purchaser would expect to have a claim if the losses were not available to the extent anticipated, whether or not this gives rise to an immediate taxation liability. It should be noted that, even in such cases, a fair level of compensation may be less than a full indemnity. If, on the other hand, the purchaser is not paying for expected losses, the vendors can reasonably argue that the purchaser should not be compensated if any reliefs are unavailable.

The definition contained here represents a middle approach which is often adopted. It allows the purchaser to recover certain reliefs which the purchaser might reasonably expect to be available to it.

The three situations in which the loss of a relief may give rise to a liability are:

(1) the use of a purchaser's relief;
(2) the loss or use of a pre-completion relief; and
(3) the loss of a right to repayment of tax. (Although a right to repayment of tax is, strictly speaking, not a relief as normally understood, it is often treated as such for the purposes of the tax schedule.)

Purchaser's reliefs and pre-completion reliefs are dealt with under their respective definitions below and at para.10-12. As regards the right to repayment of taxation (cl.1.10.4), the vendors would usually seek to restrict this to rights of repayment which are contained in the accounts (or completion accounts where completion accounts are to be prepared) on the basis that, if a right to repayment did not appear in the accounts (or completion accounts), the purchaser could not be expecting the repayment, would not have paid for it and so should not be compensated if it is not available.

Accelerated payment notices (APNs) were introduced in FA 2014. In very broad outline, they require a taxpayer who has gained a benefit from a tax avoidance scheme to pay the tax in dispute in advance of a formal determination on whether the scheme works.

The determination of the validity of such schemes can often drag on for a number of years and, until final determination, the taxpayer benefitted from not having to pay the tax even if the scheme was ultimately found not to work. APNs were introduced to counteract this perceived advantage.

There are various requirements before an APN can be issued. A key requirement in most APNs is that the relevant tax avoidance scheme has been notified under the Disclosure of Tax Avoidance Schemes (DOTAS) procedure. Tax warranty 31.1 is designed to force disclosure of any DOTASs in which the company has been involved. Usually, a taxpayer, if not challenging the APN, has 90 days in which to pay the amount demanded. The amount is repaid with interest (although at a minimal rate) if it is subsequently found that the tax is not in fact payable.

Many companies were involved in tax avoidance schemes in recent years, particularly employee benefit trust (EBT)-based schemes and film partnerships. Although the schemes usually pre-dated the introduction of the APN procedure, the APN procedure can apply to such schemes and companies are increasingly finding APNs served on them.

APNs do not sit easily within the framework of "traditional" tax covenants. There is the issue of whether payment under an APN amounts to a liability to tax for the purpose of the tax covenant. It can be argued that it is not a payment of tax, as when an APN is issued, there is no certainty that any tax will be payable. Rather, it is a payment on account of a possible tax liability. Whether payment under an APN amounts to a liability to tax will usually turn on the precise wording of the definition of "taxation" and/or "liability to taxation" contained in the relevant tax

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covenant, both of which will often have been negotiated before the APN procedure was introduced. Problems may also arise in connection with the change of legislation exclusion: see para.10-32.

To avoid these issues, cl.1.10.5 provides that payment under an APN is to be treated as a liability to taxation. This can be deleted as excessive if due diligence and disclosure do not show any evidence of tax avoidance schemes having being used. It is difficult in principle for the vendors to object to such a provision, as any risk in relation to the use of a tax avoidance scheme ought fairly to fall on the vendors. However, as an alternative to this provision, a vendor might request a detailed conduct of claims provision to deal with identified tax avoidance schemes.

10-11 **and the amount of the Liability to Taxation shall be, in the case of:**

1.10.6 paragraph 1.10.1 the amount of Taxation payable;

1.10.7 paragraph 1.10.2 the amount of Taxation which would have been payable but for such set-off or utilisation;

1.10.8 paragraph 1.10.3 the value attributed in the Accounts to the Pre-Completion Relief so lost, counteracted or clawed back; and

1.10.9 paragraph 1.10.4 the amount of repayment which would otherwise have been available.

Although when the liability to taxation constitutes an actual payment of taxation, the amount which the vendors are liable to pay is fairly obvious, it is less clear where the liability to taxation is a loss of a relief and, accordingly, these clauses are necessary.

In the case of a loss of a purchaser's relief or the loss of a pre-completion relief by way of set-off, it is usual for the vendors' liability to be the amount of tax that would have been saved by the use of the purchaser's relief or pre-completion relief. In the case of loss of pre-completion relief in any other circumstances, it is sometimes proposed by the purchaser that the vendors' liability should be the amount of the relief lost. This is difficult because it raises issues such as what rate of corporation tax is to be assumed when putting a value on the relief lost and whether or not it is fair for the vendors to have to pay if, in practice, it is most unlikely that the target company would within a reasonable time be in a position to use the relief. It is also suggested that such an approach is conceptually wrong. The approach that has been adopted in the clause is that it is fair for precompletion losses to be included because they have been given a value in the accounts. If those reliefs are lost, therefore, the appropriate level of compensation is the amount by which the assets of the company would have been less if the loss of the reliefs had been known when the accounts were prepared.

The reference to "Accounts" in cl.1.4.7 will need to be changed to the defined term used in the sale agreement for completion accounts if such accounts are to be prepared.

10-12 **1.11 "Pre-Completion Relief" any Relief which arises as a result of or by reference to any Event occurring on or before Completion and which has either been treated as an asset in the Accounts or is taken into account in computing (and so reducing or eliminating) a provision for deferred taxation which appears in the Accounts or which would have appeared in the Accounts but for the presumed availability of the Relief.**

The concept behind pre-completion reliefs is that it is fair for the vendors to give a covenant in respect of such reliefs since they are reliefs which were taken into account in the balance sheet in the accounts and therefore the purchaser can be assumed to have taken the availability of those reliefs into account in setting the purchase price.

In practice, it is rare for a tax relief to be given a value in the accounts of a company and therefore the first part of the definition will not often be relevant. The position in relation to deferred taxation is more difficult. A provision for deferred taxation may be reduced or eliminated on the basis that when the tax liability becomes actual, there will be available to the company some relief, such as carry-forward losses or capital allowances, to off-set against the tax liability. Alternatively, on the disposal of certain capital assets, it may be possible to roll-over any gain into a replacement asset. If those assumed reliefs prove to be unavailable, the provision for deferred taxation should have been greater and, consequently, the net assets of the company would have been less. The purchaser will seek compensation on that basis. The vendors may argue that it is unreasonable to expect them to compensate the purchaser in respect of a liability that may never arise—deferred taxation is, by its very nature, not an actual liability and may never become an actual liability. If an actual tax liability does subsequently arise, the vendors may argue that the purchaser should recover at that stage either under the tax covenant (if such tax liabilities are covered under the tax covenant) or under an appropriate warranty (e.g. a warranty that adequate provision for tax is made in the accounts).

Again, reference to "Accounts" will need to be changed to the defined term used in the sale agreement for completion accounts if such accounts are to be prepared.

10-13 **1.12 "Purchaser's Relief" any Relief of the Company which arises as a result or by reference to an Event occurring after the Balance Sheet Date [or any Relief of any company within the Purchaser's Group].**

It is usual to exclude from the scope of the tax covenant any tax liabilities arising in the normal course of trading after the balance sheet date (see Pt 4 cl.1.1.2). On that basis, any tax reliefs occurring after the balance sheet date should also be for the benefit of the purchaser. If those reliefs are lost by being used to reduce another tax liability of the target company, then the purchaser should be able to recover from the vendors.

Purchaser's relief also, as here, often refers to reliefs of companies other than the target company, which can include reliefs that are available to companies within the purchaser's group. This is to ensure that if a relief which belonged to the purchaser's group was used to reduce a liability of the target company that should be properly compensated by way of the definition being extended to include the wording in brackets. If the wording in brackets is included, "Purchaser's Group" needs to be separately defined.

10-14 **1.13 "Relief" includes any relief or allowance, exemption, set-off or deduction from or credit available from, against or in relation to Taxation or in the computation of income, profits or gains for a Taxation purpose.**

This definition is of considerable significance if the covenant is extended to cases which, while not giving rise to immediate liability to make a tax payment, involve a loss of relief. The kinds of relief covered are:

(1) relief as such, e.g. group relief or relief from stamp duty;
(2) allowances, such as capital allowances;
(3) exemption, e.g. the exemption from capital gains tax enjoyed by investment trusts;
(4) set-off, which occurs, for example, in relation to set-off of losses in suc-

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ceeding accounting periods under CTA 2010 s.45 and by a claimant company in respect of group relief under CTA 2010 ss.99 and following;

(5) deduction, which arises most commonly in computing taxable profits or gains; and

(6) credit, e.g. under CTA 2010 s.1109, which confers a tax credit for certain recipients of qualifying distributions and credits for foreign tax (although this is repealed from April 2016).

10-15 **1.14 "Saving" a reduction of any liability of the Company to Taxation by virtue of the set-off against the liability or against any income, profits or gains of any Relief arising as a result of a Liability to Taxation in respect of which the Vendors have made a payment under Part 3 of this Schedule [.....].**

Sometimes, a liability to taxation can give rise to a corresponding saving in taxation of the target company. This can arise because of timing issues. For example, if a deduction has been claimed in one tax period which should have been claimed for a later tax period, there will be a liability to taxation in respect of the earlier period. However, the taxation for the later period may be reduced, as the deduction is allowable for the later period. Therefore, the only loss the target company suffers is in respect of penalties and interest for having claimed the deduction in the wrong period. In other cases, payment of one form of taxation may lead to a deduction in payment of another form of taxation. For example, stamp duty may be deductible when calculating chargeable gains. Where there is a group of companies, deductions may sometimes be claimed in the wrong company, with the result that the tax liability of one group company increases, but the tax liability of the group company in which the deduction should properly have been claimed is reduced. These matters are dealt with in Pt 4 para.5.

10-16 **1.15 "Taxation" shall have the meaning as in clause [.....] of the Agreement.**

As noted above, it is preferable to avoid having two possibly conflicting definitions of "taxation" in the sale agreement. The definition is better left in the main definition provisions, as the term "taxation" will usually be used more widely than the tax schedule. However, this definition is included here to remind the tax specialists reviewing the tax provisions to check the definition.

The definition in para.4-08 is very wide. Nonetheless, a wide definition is usually accepted by the vendors. However, issues do sometimes arise, particularly in relation to the following matters.

(1) Rates: it is often argued that rates should not be covered by the tax covenant. They will, in any case, normally be dealt with fully under the non-taxation warranties.

(2) National Insurance contributions: these are not, strictly speaking, tax. However, it is usual to treat them in the same way as tax.

(3) Stamp duty, stamp duty reserve tax and stamp duty land tax (SDLT): including stamp duty within the tax covenant. These can cause problems, particularly as stamp duty (unlike stamp duty reserve tax or SDLT) is effectively an optional tax. Further, an indemnity against stamp duty may be ineffective under the Stamp Act 1891 s.117. Such considerations do not apply in relation to stamp duty reserve tax and SDLT because of their compulsory nature. A specific provision is sometimes included providing that if any document requires stamping, the stamp duty shall be treated as a liability to taxation.

It is often found in practice that the definition of "taxation" includes taxes which are almost certainly of historical interest only but which, if there has been fraudulent evasion of a tax assessment, may remain a theoretical possibility indefinitely. A note of certain taxes which are no longer in force (and of some taxes which are of limited relevance) is included in para.5-106. The vendors will find it difficult to insist on the deletion of specific taxes on the grounds of irrelevance, since the purchaser may reasonably argue that any risk of a liability, however slight, should fall on the vendors.

10-17 **1.18 References to any Event occurring on or before Completion include a combination of two or more Events the first of which occurred or is deemed to have occurred on or before Completion.**

This is often a controversial provision. The purchaser will not want its claim defeated on the basis that some part of the event which gave rise to the claim arose after completion of the sale. For example, if there was a contract which had been largely performed prior to completion, the fact that payment was received after completion should not prevent a claim. Secondly, there are a number of specific tax situations where a later act combined with an earlier act can give rise to a tax charge, for example a charge under TCGA 1992 s.179 (see para.5-62) or a claw-back of stamp duty or SDLT relief (see para.5-101). However, the vendors will argue that the clause as drafted is far too wide; for example, this wording may leave the vendors liable for capital gains tax in respect of a disposal of an asset acquired before completion if that acquisition is combined with the subsequent disposal. This clause also does not address the position where there has been something "unusual" in tax terms about the original acquisition, for example where the asset was not acquired on arm's length terms, or an earlier gain was rolled over into the asset. The vendors will therefore usually try to either delete this clause or qualify it by wording such as:

> **"... provided that the Event occurring on or before Completion occurred outside the ordinary course of business of the Company and the Event occurring after Completion occurred in the ordinary course of business of the Company."**

Alternative wording which favours the purchaser more is:

> **"... provided that the Event occurring after Completion occurred either (a) pursuant to a binding contract entered into on or before Completion or (b) in the ordinary course of business after Completion."**

Part 2: Taxation warranties

10-18 These are discussed in detail in Chapter 5 and not repeated here.

Part 3: Taxation covenant

10-19 **1.1 Subject as provided below, the Vendors jointly and severally covenant to pay to the Purchaser an amount equal to the amount of:**

The vendors will normally be required to accept joint and several liability and, in the absence of express contrary provision, they will ultimately bear the liability amongst themselves in proportion to their rights in the total consideration. For further discussion of this point see para.3-15.

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10-20 **1.1.1 any Liability to Taxation which has arisen or arises as a result of or in connection with an Event which occurred on or before Completion whether or not such liability has been discharged on or before Completion;**

This is the basic covenant, the scope of which depends, to a large extent, on the definition of "liability to taxation".

10-21 **1.1.2 any Liability to Taxation which arises on, before or after Completion as a result of the non-payment of Taxation by a Vendor or any person (other than the Company) which is or has been connected (within the meaning of ITA 2007 ss.993 and 994) with a Vendor and for which that person is primarily liable;**

A company may sometimes be secondarily liable when a connected party, such as another group company or a controlling shareholder, fails to pay a tax liability, for example for capital gains under TCGA 1992 s.190. In such cases, it could be argued that the event which gives rise to the company's liability is the failure to pay by the connected party which is primarily liable. If that event occurs after completion it would not be caught by the general indemnity in cl.1.1.1. This clause makes it clear that such a liability is covered.

10-22 **1.1.3 any liability of the Company to make a payment in respect of Taxation under any indemnity, covenant, guarantee or charge (including any payment in respect of a surrender of group relief) entered into on or before Completion;**

This is potentially wide-ranging and the vendors need to consider the matter carefully before they give the covenant. It covers not only situations where there is a statutory right of reimbursement (see the examples set out at para.5-23) but also where there is a contractual right. For example, if the target company had previously sold a subsidiary, it could cover any continuing liability under the tax covenant given at that time. The vendors may want to argue that it is inappropriate that those types of arrangements are dealt with in the tax covenant.

The clause also covers payments for the surrender of group relief. As noted at para.5-58, a company to whom group relief is surrendered normally pays to the surrendering company an amount equal to the tax saved. The purchaser can argue, therefore, that a payment made in order to reduce the tax liability of the target company should be treated in the same way as a tax liability. The wording in brackets will clearly be of relevance only where the target company is or has been a member of a group.

10-23 **1.1.4 the costs and expenses reasonably incurred by the Company or the Purchaser in respect of any Liability to Taxation or Claim for Taxation arising as a result of or in connection with an Event which occurred on or before Completion or in taking or defending any action under this Part 3 of Schedule [.....];**

The purchaser will normally wish to ensure that the covenant to pay costs covers not only liabilities to tax in respect of which the vendors are liable but also all claims for taxation, even if the relevant tax authority's claim is subsequently found to be groundless. The justification for this is that any claim for tax will arise as a result of a problem created by the vendors and therefore they should be responsible for the costs of dealing with it.

The vendors should ensure that this clause relates only to liabilities to taxation and claims for tax to the extent that they arise from events on or before completion. The vendors may also want to seek to limit the clause to liabilities and claims for which they are liable.

1.1.5 any depletion in or reduction of value of the assets of the Company or an increase in its liabilities as a result of inheritance tax which: 10-24

1.1.5.1 is at Completion a charge on any of the Shares or the assets of the Company or gives rise to a power to sell, mortgage or charge any of the Shares or the assets of the Company; or

1.1.5.2 after Completion becomes a charge on or gives rise to a power to sell, mortgage or charge any of the Shares or the assets of the Company which arises as a result of a transfer of value occurring or being deemed to occur on or before Completion (whether or not in conjunction with the death of any person whenever occurring);

provided that any right to pay by instalments shall be disregarded and the provisions of IHTA 1984 s.213 shall not apply to payments to be made under this Covenant;

As set out in para.5-100, in certain circumstances a charge can arise over the shares in, or the assets of, the target company in respect of unpaid inheritance tax. It is reasonable for the vendors to give this covenant.

1.1.6 any liability which arises at any time of the Company to account for income tax or National Insurance contributions in respect of an option or other right to acquire securities granted prior to Completion by the Company or by any other person (other than the Purchaser or any person connected with the Purchaser or acting on its behalf) or in respect of the exercise of such option or right or in respect of any acquisition, disposal or any other event in relation to employment-related securities (as defined for the purposes of Pt 7 IT(EP)A): 10-25

1.1.6.1 acquired at any time on or before Completion or at any time after Completion pursuant to the exercise of any right or option (in either case whether conditional or otherwise) granted on or before Completion [but for the avoidance of doubt not including the consideration shares]; or

1.1.6.2 acquired (before Completion) in replacement or exchange for or derived from any employment-related securities (as defined for the purposes of Pt 7 IT(EP)A) acquired as mentioned in paragraph 1.1.6.1 above;

If shares and/or options have been granted to employees before completion and the shares/options survive completion, events after completion may give rise to tax for which the target company may be liable to account under PAYE and pay National Insurance contributions. In most cases, employee share schemes or options will not survive completion so this is unnecessary. However, care may need to be taken with options, as sometimes these are not technically capable of exercise until after completion. This type of provision is now reasonably standard.

1.1.7 any Liability for Taxation of the Company that arises at any time under 10-26

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Pt 7A of IT(EP)A 2003 including any liability arising as a consequence of any payments or loans made to any assets made available or transferred to, or any assets earmarked, however informally, for the benefit of, any employee or former employee of the Company, or for the benefit of any relevant person, by an employee benefit trust or another third party where the arrangement giving rise to the charge was entered into at a time when the third party was acting on the instructions of, or for the benefit of, the Vendors or an associate of any of the Vendors;

Since the introduction of IT(EP)A 2003 Pt 7A in April 2011, this covenant has become increasingly common. As explained above, Pt 7A imposes an income tax charge where assets held by third parties are "earmarked" for the benefit of employees. If, for example, an EBT makes a loan after completion to a vendor, that could give rise to an income tax and National Insurance charge for which the company is liable under PAYE. As the event triggering the liability, the loan, occurs after completion, it may not be covered by the principal tax indemnity in cl.1.1.1 (although it may arguably be covered if "combined events" wording has been included).

The indemnity as drafted covers only situations where a vendor benefits from the arrangements. In this form, it is difficult for the vendors to argue against it. The indemnity could be extended to cover situations where any employee benefits, but the vendors may argue that these are ordinary course of business liabilities which the purchaser should be expected to bear.

10-27 **1.1.8 any Liability to Taxation of the Company that arises at any time as a result of or in connection with any payment to the Vendors under this Agreement.**

Again, this is becoming an increasingly common covenant, given HMRC's focus on the avoidance of income tax on payments to employees.

Usually, it will be clear that any payment made to the vendors on completion is a capital payment for the vendors' shares (although even then, there may be issues under the restricted securities legislation in IT(EP)A 2003 Pt 7). However, the position may be less clear when there is an earn-out.

In certain circumstances, it is possible for HMRC to argue that the payment of an earn-out is not a payment for the shares but a payment in respect of the vendors' continued employment with the company. If that argument was successful, the payment of the earn-out would be treated as employment income and the company would be liable for PAYE and National Insurance contributions in respect of the payment.

Factors which particularly indicate the possibility of the payment being treated as employment income are where the payment of the earn-out is linked to continued employment, where the amount of the payment is calculated by reference to individual targets rather than company performance, and where the vendor is not otherwise properly remunerated for his continuing role.

The covenant may be irrelevant where there is no earn-out and the vendors should delete it in such circumstances. Otherwise, it will be a matter for negotiation in each case whether this indemnity should be given. In particular the vendor may be reluctant to give the covenant where, for example, the purchaser insists on some feature, such as a link to continued employment, which increases the risk of the payment being treated as employment income.

Other covenants may sometimes be included in Pt 3. Examples include the following.

(1) Specific covenants against identified issues. Although any such issues are usually covered by the general wording in cl.1.1.1 in any event, they may be included both to avoid any doubt as to whether they are intended to be covered and because the purchaser may adopt the approach that certain limitations should not apply to known problems.
(2) As noted at para.10-28, it is usual to include an indemnity against liability in respect of shares and options in the target company issued or granted prior to completion.
(3) Where property and/or shares are major assets of the target company, covenants relating to stamp duty and SDLT. In the case of stamp duty, this is to avoid arguments on share acquisitions and pre-SDLT land acquisitions that stamp duty is a "voluntary tax" and therefore never payable. In the case of land transactions to which SDLT applies, events occurring after completion may give rise to the requirement to file a further SDLT return and pay additional SDLT.

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Part 4: Limitations

1. Limitations on claims

10-28 In a tax covenant, the limitations have two roles:

(a) To establish what the true loss is. Like with an indemnity, there is no need to establish loss under a tax covenant. For example, if the purchaser can show that there is a liability to taxation as defined, it can, in the absence of limitations, recover that amount from the vendors even if the purchaser or the target company has already recovered an amount in respect of such liabilities, whether, for example, from the vendors under a different provision of the sale agreement or from a third party such as an employee.
(b) To apportion risk. For example, is the risk of a change in law one which the vendors or the purchaser should properly bear?

This distinction should be borne in mind in considering the limitations. It may be perfectly proper to argue which party should bear a particular risk, but it will usually not be reasonable for a purchaser to argue against a limitation designed to prevent double recovery.

10-29 **1.1 The Tax Covenant and any claim under the Tax Warranties shall not apply to any Liability to Taxation:**

As noted above, the limitations apply to both the covenant and the tax warranties to ensure consistent treatment.

10-30 **1.1.1 to the extent that specific provision or reserve or allowance in respect thereof has been made in the Accounts;**

If the vendors have provided management accounts for periods subsequent to the balance sheet date which contain provisions for taxation on the profits shown, the clause should extend to also include those accounts. If there are to be completion accounts, this clause should refer to the completion accounts rather than the last statutory accounts.

The purchaser cannot fairly complain about a liability which arises after comple-

tion where a specific provision or reserve was made in the accounts, although a note in the accounts may not of itself provide a quantification of the anticipated liability.

Deferred taxation needs careful consideration. If no reference is made to deferred taxation, the vendors will normally not be liable if it becomes an actual liability, as this will be the result of post-completion events (although there may be liability if the adequacy of the deferred taxation is as a result of the loss of a pre-completion relief). The purchaser should specifically consider the nature of any deferred tax provision to see whether it is acceptable for the liability, if it arises, to be outside the scope of the tax covenant. It is not unusual for the purchaser to seek to exclude provisions for deferred tax from this exclusion.

The vendors will often seek to delete "specific" on the grounds that if the provision or reserve for tax is sufficient in aggregate to cover all the tax liabilities, it should not matter whether the provision or reserve has been allocated to a specific liability.

10-31 **1.1.2 for which the Company is, or may become, liable wholly or primarily as a result of transactions in the usual course of its business after the Balance Sheet Date;**

A general exclusion for liabilities arising from transactions in the usual course of the company's business is fair having regard to the broad principle that the indemnities should relate to unexpected liabilities and that the purchaser is effectively getting the benefit of profits earned in that period. Furthermore, the purchaser has the protection of the warranties. This exclusion is not appropriate if there are to be completion accounts and cl.1.1.1 has been amended to include reference to completion accounts, as any liability should be picked up by way of provision in the completion accounts. The purchaser may want clarification on what is and is not usual course of business. For example, distributions should be excluded.

10-32 **1.1.3 to the extent that it would not have arisen or been increased but for a change in the rate of Taxation or change in legislation or published administrative practice made after Completion, or change after Completion in any extra statutory concession or published practice previously made by any Taxation Authority with retrospective effect;**

It has become established practice for the purchaser to accept the risk of an increased liability and, conversely, for the vendors to allow the purchaser the benefit of a reduction in the tax rate (although, in practice, retrospective changes of this nature are unlikely).

The part of this clause relating to changes in the law will not be necessary if the definition of relevant statutory provisions is limited to those which are in force at the date of the sale agreement or result from a mere consolidation. However, if the definition allows for future changes in the law, then it is a matter for negotiation between the parties as to whether a retrospective liability imposed upon the target company should be borne by the vendors or by the purchaser. The purchaser should bear in mind that provisions in Finance Acts are often retrospective, at least to the date of the Budget speech. Where taxation avoidance is involved, for example in relation to employee remuneration, the Government has indicated that it may impose retrospective legislation. The purchaser may want to consider whether this limitation is appropriate if the target company has been involved in matters which run a greater risk of retrospective legislation, such as aggressive tax avoidance.

Indeed, it is becoming more common for purchases to exclude from the scope of this limitation any tax avoidance arrangements.

The vendors may wish to try to extend the exclusion to avoid a liability which results, for example, from a recognised interpretation of the law being reversed by the ruling of a higher court.

1.1.4 to the extent that the Liability to Taxation arises as the result of the change after Completion in any accounting policy, any Taxation or accounting practice or the length of any accounting period for tax purposes of the Company; 10-33

If a change in accounting policy after the purchaser acquires control of the target company gives rise retrospectively to a taxation liability which would not otherwise relate to the pre-completion period, the vendors might reasonably consider that they should not be required to meet that liability. For example, treatment of an asset as a fixed asset rather than trading stock could affect the deductibility of expenditure incurred on the asset.

There is a considerable subjective element involved in quantifying timing differences and the vendors should not be penalised if a change of treatment taking place after the sale of the target company results in an unexpected liability.

A purchaser will often qualify this exclusion to exclude changes in accounting policy that are necessary because the target company's accounts have not previously been prepared in accordance with accounting standards. The vendors cannot reasonably object to this.

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1.1.5 to the extent of any recovery by the Purchaser under the "Non-Taxation Warranties" in respect of, or arising from, the same Liability to Taxation; 10-34

This clause adopts the definition of "non-taxation warranties" which appears in the sale agreement (see para.4-02). In principle, it should not be objectionable, as its aim is to avoid double recovery. The purchaser will generally want to bring a claim under the tax covenant to the extent that it is able to give a better basis for recovery unless warranty claims are to be quantified on an indemnity basis, as discussed in para.3-06.

1.1.6 to the extent that a Relief other than a Pre-Completion Relief or a Purchaser's Relief is available to reduce such Liability to Taxation; 10-35

As discussed at para.10-10, the position adopted in this tax covenant is that the purchaser should be entitled to the benefit of reliefs only if the availability of those reliefs was assumed in deciding the purchase price. If the availability or otherwise of such reliefs is not reflected in the purchase price, then it is fair that the vendors should have the benefit of them to reduce any potential claim under the tax covenant. This exclusion would cover a situation where, for example, there was a liability to taxation but there were carry-forward losses to offset against that liability.

The purchaser may want to limit this to reliefs that are actually used, rather than just being available.

1.1.7 if it results from the cessation of the trade of the Company after Completion; 10-36