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Representations and warranties: What happens if a notice of claim is untimely filed with the seller?

When the shares of a company are transferred from one party to another, the purchaser usually makes representations and warranties that are designed to cover any post-transfer increase in liabilities or decrease in assets, provided that the cause or the origin of this increase or decrease dates back to the period prior to the transfer.

These representations and warranties are either included in the share purchase agreement or set forth in a separated agreement called "Garantie d'actifs et de passif" (literally "Asset and liability warranty", also known by the acronym "GAP") under French law.

Whichever option is chosen, the share purchase agreement usually stipulates that any warranty claim must be notified according to a specific procedure to enable the seller to take any useful action to limit the sums that he might be bound to pay under such claim.

So, what happens if the purchaser does not comply with the claim notification requirements set forth in the share purchase agreement?

On January 19, 2007, spouses A sold to company B all of the shares they held in company C which itself held almost the entirety of the shares making up the capital of company D, and entered with company B into a warranty agreement according to which they would, as a form of price reduction, hold company B harmless from and against any loss it would suffer in connection with any additional or excess liabilities resulting from

facts originating in the period prior to the sale. This agreement stipulated *inter alia* that any claim, fact or event likely to trigger the enforcement of the warranty ought to be notified to spouses A by company B within a maximum period of 20 days as from the date on which company B becomes aware of such claim, fact or event.

Disputes arose throughout the performance of this warranty agreement and companies B and C subsequently summoned spouses A to appear before the First Instance Court of Metz and asked the Court to order spouses A to hold them harmless from and against the liabilities that appeared after the sale.

On January 23, 2013, the Commercial Chamber of the First Instance Court of Metz ordered spouses A to indemnify companies B and D.

On February 11, 2013, spouses A lodged an appeal against this judgment and argued that the warranty had been forfeited because of company B's failure to notify the claim within the required timeline.

The Court of Appeals of Metz found that company B had indeed failed to give notice of the claim within the prescribed 20-day period but, given the fact that the agreement did not expressly provide for any sanction for non-compliance with the timeline for giving notice, it did not acknowledge the forfeiture of the warranty and replaced it by the payment of a lump-sum compensation, as per former Article 1142 of the French Civil Code[1], provided that spouses A be able to establish that the delay in notifying the claim had caused them a loss[2].

Asked to rule on the appeal lodged against the judgment of the Court of Appeals of Metz, the *Cour de Cassation* (French Supreme Court) upheld such judgment considering that: "*when exercising its discretion to assess the will of the parties, which was made necessary because of the vagueness of the agreement, the Court of Appeals ruled that, in the absence of any sanction for failure to comply with the prescribed timeline for giving notice, non-performance by the purchaser of its obligation to inform the sellers, within the prescribed timeline, of any claim, fact or event likely to trigger the enforcement of the warranty was not alone sufficient to deprive the purchaser of the benefit of the application of such warranty, and could only give rise to damages in compensation for the loss that the delay in notifying the claim may have caused to the sellers*"[3].

In practice, in order for representations and warranties to serve any useful purpose, it is therefore critical to clearly define the procedure for notifying claims and to specify applicable sanctions for non-compliance therewith. As such, the agreement may provide that if a claim is notified belatedly or if the notification requirements are not complied with, the right of the party seeking enforcement of the warranty will be forfeited or, alternatively, that the sums due by the sellers under the relevant warranty will be reduced in proportion to the loss suffered as a result of non-compliance with the contractually agreed notification procedure.

[1] "*Any obligation to do or not to do resolves itself in damages in case of non-performance on the part of the debtor*" (as in force prior to October 1, 2016)

[2] Court of Appeals of Metz, February 26, 2015

[3] Commercial Chamber of the *Cour de Cassation*, January 25, 2017, n° 15-17137 and 15-18246.