

Warranties and Indemnities Update - October 2023

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Insurers prevail in W&I claim by baked goods company after purchase turns sour due to lack of due diligence.

In **Finsbury Food Group PLC v Axis Corporate Capital UK Limited & Others [2023] EWHC 1559** (comm), the Commercial Court found in favour of insurers in respect of a claim under a warranty and indemnity ("W&I") policy following allegations by the buyers of a baked goods company that allegedly unknown price reductions and a change in recipe had resulted in a reduction in the purchased company's profits.

After criticising the insured's witnesses as being 'untruthful', the Judge found that there was no breach of the warranty; the insured had been provided with sufficient information – even if it did not pay proper attention to it – and, in any event, the information would not have prevented the sale from proceeding at the agreed price.

It is unusual for W&I claims to proceed all the way to judgment and this case provides an interesting insight into how judges will interpret W&I policies including the steps taken by each side during the course of negotiations.

Background

Finsbury Food Group Plc ("Finsbury") was a group of food manufacturing companies. Ultrapharm Limited ("Ultrapharm") was a specialist manufacturer of Gluten Free ("GF") baked goods, with its chief business in the UK and Poland being the supply of GF goods to Marks and Spencer plc ("M&S").

Following the ever-increasing demand for GF bread and other 'free-from' products, Finsbury engaged a firm of investment consultants that advised them it would be of significant benefit to enter the GF market. Ultrapharm was deemed the best target and it was considered that the acquisition of their sites, including their recipes and know-how, would be of extreme benefit to Finsbury. Ultrapharm was a family-run business and the owners were at times reluctant to sell. A price of £20m was agreed.

The parties entered into a Sale and Purchase Agreement ("SPA") on 31 August 2018 which contained the following **Trading Conditions Warranty** ("TCW"):

1. There had been no material adverse change in the trading position of Ultrapharm or in its turnover; and
2. There had been no loss of a customer representing more than 20% of Ultrapharm's total sales.

There was a separate **Price Reduction Warranty** ("PRW") that Ultrapharm had not offered or agreed to offer ongoing price reductions or discounts which would be reasonably expected to materially affect the profitability of the company.

The SPA also contained a knowledge exception exclusion such that there would be no liability under the warranties if the buyer had actual knowledge of the circumstances of a warranty claim and was actually aware that such circumstances would be reasonably likely to give rise to a claim under the warranty ("**the Knowledge Exception**").

Alleged breaches of the Warranty

During 2017, Ultrapharm agreed recipe changes and price reductions with Marks & Spencer ("M&S") which were implemented in early 2018.

By April 2018, it was clear that Ultrapharm was less interested in the acquisition process whilst Finsbury was still very keen to continue. To keep Ultrapharm interested, Finsbury reduced the due diligence process to only looking at the 2017 audited accounts. They also agreed that they would do as much as they could from their side to reduce the amount required of Ultrapharm.

By July 2018, the limited financial due diligence showed that the UK side of the Ultrapharm business was underperforming. This was explained by Ultrapharm as being due to a change in shift patterns, high levels of waste and increased wages. To allay any concerns, Finsbury sent two employees to the Ultrapharm UK site to review the plan to turn the site around. They attended the site for two days in August 2018. During their visit, the individuals were provided with full access to the accounts and were provided a spreadsheet showing the price reductions that had been agreed. At trial, Finsbury could not recall seeing a copy of the spreadsheet.

The acquisition completed on 31 August 2018. It was met with a negative reception from the City and there was no immediate improvement in sentiment around Finsbury. Finsbury was therefore concerned to ensure that Ultrapharm profits post-acquisition were strong. Improving the UK site was proving difficult and around November 2018 Finsbury had concerns about the price reductions and the impact these had had on profits. On 22 January 2019, Finsbury notified insurers of a claim alleging breaches of the TCW and PRW.

Commercial Court decision

Breach of Warranty

Finsbury alleged there had been two material breaches of the warranties:

1. The change in recipe that was agreed with M&S had had a material impact on profitability (in breach of the TCW); and
2. The price reduction was a breach of the PRW.

On the first issue (the TCW), the Judge found that the change in recipe was not a 'materially adverse change' for three reasons: first, it was agreed and came into effect before the Accounts Date (defined as 31 December 2017); secondly, it was not a material adverse change as it would have had only a minimal impact on profits; and, thirdly, the Judge agreed with insurers that recipe changes are in the usual course of a bakery's business and do not fall within the ambit of a TCW.

In relation to the second issue (the PRW), Finsbury argued that although the price changes were agreed in October 2017, the effect of those changes was not seen in the figures until after the Accounts Date of 31 December 2017 and so it fell within the PRW. The Judge disagreed and found that the date on which the price change had been agreed was the date it took effect so there had been no breach.

Although these findings were sufficient to dispose of Finsbury's claim, the Judge went on to consider whether the Knowledge Exception applied. The Judge was satisfied that, in being provided with access to the accounts and being sent a spreadsheet containing information about the price reductions, Finsbury had been provided with sufficient information and data for the Knowledge Exception to apply. Even though Finsbury personnel did not express awareness of the information at the time, the Judge concluded that they would have done, or should have done, had they given it the proper thought.

Causation

The Judge also went on to consider causation and found that, even if there had been a breach of the warranty and Finsbury had been made aware of the material accounting information, they still would have proceeded with the purchase price of £20m. They knew that Ultrapharm was less interested in the acquisition and required £20m to sell. Further, the profitability of the company was not of determinative importance to the deal. As such, Finsbury had failed to show that it had suffered any loss.

Comment

Although the express terms of warranties are always going to be specific to the facts of the transaction, this is a reminder that W&I policies are not there to protect buyers where they have not carried out sufficient due diligence or where the transaction has not been as successful as they had anticipated.

It also serves as a warning that the court will not allow a party to plead ignorance where they have been provided the relevant data but did not pay proper attention to the significance of the information they were being shown.

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