The correct measure of damages in a claim for breach of warranty and deceit in the context of a share sale

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***MDW Holdings Limited v James Robert Norvill and Ors* [2022] EWCA Civ 883**

Dispute Resolution analysis

The Court of Appeal has considered how damages should be assessed under a share warranty agreement, where the seller breaches contractual warranties and commits a fraudulent misrepresentation. When assessing damages for the breach of warranty, should hindsight be used to clarify any uncertainties upon which the share purchase price was based (answer: usually no)? When damages are assessed for deceit, can the defendant assert that the purchaser would have entered into the contract in any event, but on different terms (answer: generally yes).

What are the practical implications of this case?

This case provides important clarification, and a clear and robust summary, of the principles applicable to the assessment of damages for breach of warranty and deceit in the context of a share sale.

(1) Contractual damages and hindsight

On the seller's appeal, the issue was whether the trial judge should, when assessing damages for breach of warranty at the date of breach, have taken into account actual events that had occurred *since* that date. Those events (concerning reputational harm to the company) had been material uncertainties upon which the share price had been fixed, but were known by the date of trial not to have eventuated.

First, the Court of Appeal drew a clear distinction between the assessment of damages for *anticipatory* breach, and the assessment of damages for an *actual* breach. In each case the court is attempting to value the contractual performance that has been lost by the breach of contract. But where the breach is anticipatory, performance will fall due in the future and may be subject to uncertainties or contingencies that need to be taken into account. It may therefore be appropriate to take into account subsequent events when valuing what the innocent party has lost. By contrast, where the breach is an *actual* one, the value of the performance is simply the present value of the goods or services that should then have been provided. (The relevant events can be of *evidential* use, casting light on a contingency or event that had already occurred at the time of the sale.) Thus, in a share sale, any contingencies used by the parties to set the price, even if they do not subsequently occur "*will not retrospectively change the value of the shares at an earlier date*" (at [49(iv)]).

Secondly, and consequently, it will only in a rare case be necessary to take account of subsequent events, and only in order to give effect to the overarching compensatory principle. The mere fact that the shares have increased in value is not enough, and any contractual allocation of risk (for example, the absence of a post-completion share price adjustment) cannot be disturbed.

Practitioners need to be mindful of this distinction, so they can advise their clients properly when considering the risks associated with the sale of shares.

<u>(2) Deceit damages where the transaction would have been renegotiated</u>

The buyer's cross-appeal related to the alternative claim in deceit. The Court of Appeal's judgment contains a clear and helpful summary of the general principles (at [71]-[73]). A successful claimant may claim all losses (irrespective of foreseeability) that were directly caused by his entry into the transaction, and is entitled also to claim consequential losses.

Of particular interest, the Court of Appeal settled an academic debate: what if the claimant, had he known the truth, would have gone ahead with the transaction but on renegotiated terms? Despite policy reasons for imposing more extensive liability on intentional wrongdoers, damages then should be assessed by reference to the difference between what the claimant *would have paid* and what he did pay (at [74]-[77]). The decision is also notable for its conclusion that, while the claimant must give credit for benefits received under the transaction, policy reasons justify limiting those to direct benefits, so as to avoid rewarding the wrongdoer "*for the fruits of his own deceit*" (at [85]).

What was the background?

In 2015 MDW Holding Limited ('MDW') bought the entire issued capital of G.D Environmental Services Limited ('GDE') from the Appellants, James, Jane, and Stephen Norvill for £3,584,224 pursuant to a share purchase agreement ('SPA'). The SPA contained a number of warranties – guaranteed by the Appellants to be true and accurate at the date of the agreement except as disclosed by a disclosure letter. Among other things, the Appellants warranted that GDE had conducted its business in accordance with all applicable laws and regulations, it held the requisite consents and was not in breach of any of their terms, no proceedings against GDE had been threatened and there were no circumstances likely to give rise to such proceedings, GDE's accounts showed a true and fair view, and that GDE had complied with environmental laws and permits.

GDE was in the business of collecting, processing and disposing waste, including leachate. The operation of GDE was contingent on consents and permits from environmental regulators. GDE held an environmental permit issued on 3rd July 2012, and had also been granted a consent to discharge effluent into the public sewers of Dwr Cymru Welsh Waters ('DCWW'), subject to certain conditions set out in a variation issued in 2012 ('the 2012 Consent'). In his judgment, HHJ Keyser QC identified a number of occasions on which the regulators had been supplied with false information prior to the date of the SPA. The Judge held that the Appellants had breached the relevant warranties contained in the SPA (§10) based on the following findings:

(i) GDE had repeatedly and persistently breached the 2012 Consent in relation to the discharge of leachates (§6);

(ii) GDE had improperly discharged cess waste directly into a power sewer (§7);

(iii) Hard solids had occasionally been dug out of the very bottom of separator tanks and disposed of as 'dry' waste (§8);

(iv) The Appellants had also been responsible for untrue representations which MDW had relied on (§9).

As a result of the above, the Judge below concluded that the Appellants had been in breach of the various warranties mentioned above. On quantum, the Judge held that the measure of damages for breach of warranty was the difference between (i) the value of GDE on the

basis that the warranties were true ('Warranty True') and (ii) the actual value of GDE given that the warranties were false ('Warranty False') (§11). On this aspect of the case, the Judge was assisted by expert evidence from two forensic accountants. Both experts agreed that the method of valuation most commonly used by professional valuers was the 'EV/EBITDA' method, which involved a three-stage approach to valuation: first, calculation of the level of maintainable EBITDA[1] ('the multiplicand') which could reasonably be expected to be achieved over the course of an average year. Second, application of a suitable multiple, so as to calculate capitalised earnings, giving what is referred to as the Enterprise Value ('EV') of the business, and finally, the deduction of net debt from the EV.

The Judge below reached the following conclusions:

(i) The 'Warranty True' value of GDE was £3,341,276. The price paid was no more than a guide; applying the 'EV/EBITDA' multiplier approach, it was appropriate to adopt a multiplicand of £1,153,000 and a multiplier of 4.2 (§13). The figures used were taken from the report of one of the experts, Mr Mesher, who had considered the appropriate multiplier to be used in the valuation to have been around 4.2 (§14).

(ii) In respect of the 'Warranty False' valuation, the Judge concluded that for reasons given by Mr Mesher, the appropriate multiplicand was £1,115,000. This figure reflected the additional costs that would have been incurred in the lawful leachate processing operations at the site, and the reduced profits (§15).

(iii) Regarding the multiplier, the Judge concluded that it should be reduced from 4.2 to 4; some reduction was considered appropriate to reflect the reputational damage that the breaches were liable to cause to the company (§16). Such a reduction was justifiable and would properly relate only to the risks to the ongoing wet waste division, over and above the reduction in the leachate business. It would not, however, be justifiable to value a business on the basis of *possible* concealed breaches for which there was no evidence. In addition, Mr Mesher considered that the appropriate range was between 3.8 – 4.5, and even though the specific figures at each end were suggested by a fairly limited examination of comparables, the Judge accepted the expert's opinion as to range (§16).

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[1] EBITDA is a shorthand for 'Earnings Before Interest, Tax, Depreciation BS Amortisation'

(iv) Based on the above, the difference between the 'Warranty True' valuation and the 'Warranty False' valuation was found to be £382,600, or about 11.5% of the purchase price (§17).

What did the court decide?

Both sides challenged the Judge's assessment of damages, as summarised above. The Appellants challenged the Judge's reduction in the multiplier when calculating the 'Warranty False' value. It was argued that the Judge reduced the value of the multiplier by improperly taking into account a risk which, by the time of the trial, was known not to have materialised (§19, 20). MDW, on the other hand, maintained by its cross-appeal that it should have been awarded a larger sum to account for the fraudulent misrepresentation.

After summarising the applicable legal principles (which were extracted mostly from authorities dealing with contracts for the sale of goods) (§23 - §46) the Court of Appeal reached the following conclusions:

(a) Where damages fell to be assessed in respect of an anticipatory breach of contract which had been accepted, it would be appropriate to consider what *would have happened* if the breach had not occurred and, *in that context,* events subsequent to the breach *may* be relevant (§49).

(b) The above principle has no application where a party to a contract has committed an *actual* rather than an anticipatory breach (§49).

(c) The principles above should, in general at least, apply to breach of warranty cases in the context of a share sale. Events subsequent to the purchase of the relevant shares cannot affect the value *at the time of the transaction* (§49).

(d) If there were to be cases in which account can be taken of subsequent events as regards a contingency which existed on the date of damages assessment, such cases must be rare, and would no doubt involve situations in which the buyer might be said to have gained a 'windfall'. The mere fact that the value of shares has increased since the date of assessment, cannot demonstrate a 'windfall' (§49).

(e) There is no similar bar on using events subsequent to the date of assessment to cast a light on events which *had happened* by that date (§49).

(f) Based on the above, the Judge was fully justified in lowering the multiplicand and the multiplier (§53 - §57). The fact that, as matters turned out, GDE did not experience reputational damage does not mean that the value of the company was not reduced in the way the Judge found as *at the date of the SPA* (§53). The use of matters subsequent to the date of assessment to cast light on events which had happened earlier was legitimate (§55).

(g) In conclusion, the Judge's reduction in the multiplier was not arbitrary, unreasoned, and unjustified. The Judge was fully entitled to reduce the multiplier in the manner that he did, and he explained the basis for doing so adequately (§59).

Regarding the cross-appeal, the court held that it was open to MDW to contend for a higher sum based on an application of the tortious measure of damages (§68, §69).

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