

Guide to: Disclosure Letters

Disclosure Letters are an important document for both the buyer and the seller in the sale of a business (whether it is a share or asset deal).

It provides the seller the opportunity to make disclosures against the warranties which, provided the disclosures give sufficient detail, protect the seller against breach of warranty claims. A buyer on the other hand, wants to know as much as possible about the business it is purchasing and as the disclosure letter encourages full disclosure by the seller, the buyer benefits from receiving this information. The buyer can then determine whether or not it is paying a fair price for the business or whether specific protection should be sought to cover any disclosed areas of risk before entering into the deal.

So, we know that the disclosure letter is important, but what exactly is a disclosure letter?

The disclosure letter and the warranties

Warranties are statements of fact given by a seller about the business as at completion which will be contained in the negotiated sale agreement. If a warranty is misleading or not true, then the seller could use the disclosure letter to disclose against this particular warranty and, provided that the disclosure provided sufficient information, the buyer would not be able to bring a successful breach of warranty claim in relation to that warranty. For example, if a warranty stated that the business had no ongoing disputes with its customers and there was in fact a current dispute, the seller should provide details in the disclosure letter together with any relevant documents in order to fully inform the buyer (otherwise there is a risk the buyer could bring a warranty claim). This would usually defeat any attempt by the buyer to bring a claim based on the fact that the warranty was untrue.

The disclosure letter and the disclosure bundle

The disclosure letter is prepared by the seller's solicitors and is usually split into two sections: general and specific disclosures. Ancillary to the letter is the disclosure bundle, which contains the supply documentation to the disclosures contained in the letter.

The general disclosures usually cover information in the public domain and/or information which the buyer ought to be aware of as a result of its due diligence or the standard searches a buyer would normally make when purchasing a business. A seller would want the general disclosures to be as wide as possible in order to capture as much information as possible, but the buyer will want to narrow this to ensure that they are fully aware of anything being generally disclosed.

The specific disclosures are the disclosures against specific warranties as mentioned above. These would often be supported by relevant documents which provide more information about the disclosure e.g. correspondence, contracts etc. and these documents would form the disclosure bundle. The disclosure bundle can often be quite substantial and will need a detailed review to ensure the buyer is fully aware of what is being disclosed to it.

The seller's approach to preparing the disclosure letter

The seller should seek to include everything that is relevant. If a seller is unsure whether something should be disclosed, then the prudent approach would be to include this. In order for a seller to benefit from its disclosure, the information provided must at least provide sufficient detail for the buyer to fully understand the matter being disclosed. If necessary, the seller should contact all key personnel and advisors to ensure that they have all information necessary to make full and accurate disclosures. Those people may even know things that the seller does not, further assisting in the disclosure process.

The buyer's approach to reviewing the disclosure letter

The buyer should request that the disclosure letter is provided as soon as possible following negotiation of the warranties to ensure that any issues are discovered early on.

If a disclosure reveals previously unknown information then this provides an opportunity prior to completion for the buyer to renegotiate or walk away from the transaction. Therefore, it is vital that the information is properly considered and the buyer should avoid accepting last minute disclosures before they are fully considered.

The buyer can also request that the seller qualifies disclosures if they are broad or insufficiently clear. This will minimise the protection afforded to the seller and provide scope for a breach of warranty claim to be brought if the disclosure is not sufficient to allow the buyer to understand the nature and scope of it.

Where the buyer has knowledge of a breach of warranty that has not been disclosed, then the buyer will not be able to bring a breach of warranty claim because of their actual knowledge. Therefore, if the buyer has knowledge of a breach not disclosed, then they should seek an indemnity from the seller or a reduction in the consideration provided.

Advice on a disclosure letter

A disclosure letter needs to be properly prepared and advised on to avoid unforeseen complications. If a seller is not properly advised, then they could potentially be forced to repay some of the purchase price. If a buyer is not properly advised, then the business it bought could be worth less than they envisaged and they wouldn't have any recourse against the seller.

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