Top secret cheat sheet

WARRANTIES AND DISCLOSURE IN BUSINESS ACQUISITIONS

What are warranties?

A form of enforceable promise that a seller is often asked to give to a buyer in respect of the business or asset being sold.

What do warranties do?

Warranties offer a way of reducing the risk in a transaction by asking the seller to provide assurances as to the state of the business or the asset(s) at the time they are being acquired.

The negotiation of warranties is often extensive as they offer protection to both parties, whether by allowing a buyer to claim for unexpected and undisclosed liabilities arising after the purchase or by allowing a seller to clearly define what matters they are – and what they are not – liable for. Disclosing against warranties allows the buyer to take a deeper dive into what it sees as key areas of risk for a business while also providing the seller with an opportunity to place the buyer on notice of certain liabilities which may arise after the sale is completed.

What is a disclosure letter?

This letter from the seller to the buyer sets out any matters which may contravene the warranties being provided by the seller (specific disclosures), while also confirming the more general, often public information regarding the business or assets that the buyer is considered to be aware of (general disclosures).

When is something "disclosed"?

Warranty disclosures are subject to an agreed standard of disclosure, which ensures that the parties to an agreement have an acceptable benchmark of information to be provided before a disclosure can be accepted. Regardless, it is essential for disclosures made by a seller to be complete and precise in the matters they seek to identify as failing to do so can mean that the disclosure is worthless in the event of a claim from the buyer for breaching a warranty.

What happens if I don't make a disclosure?

While the obvious result of failing to make a disclosure is that the buyer could bring a claim for breach of a warranty if the matter leads to a liability for the buyer post-completion, there is also the risk of further civil liabilities for misrepresentation and potential criminal liability for using false information to entice a party into an investment agreement (such as a share purchase agreement) – none of which are good news for a prospective seller.

Although making disclosures can lead to renewed discussions over the value of a business or asset, however, it is often much better to have those conversations in a boardroom as opposed to a court room.

The disclosure process is usually a more tightly focussed version of the due diligence process many businesses and entrepreneurs are used to when considering entry into important transactions, nevertheless it is important to remember that significant liabilities can arise as a result of failing to take proper care in the process (as a buyer or seller).

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