# Disclosure

This section considers how the disclosure process works to limit the potential liability of the seller

# Introduction to disclosure

The seller can seek to avoid liability for breach of warranty by making disclosures against the warranties. Disclosures essentially have the effect of **qualifying** the warranties. Warranties and disclosures must therefore be considered together. Everything formally disclosed should be recorded in the **disclosure letter**.

The disclosure letter is a letter written by the seller and addressed to the buyer. In that letter, the seller sets out the details of any matters which make the statements of fact - given in the form of the warranties - untrue.

It can therefore be seen that, apart from providing the buyer with contractual protection, **warranties serve another purpose**. To avoid liability for breach of warranty, the seller must make disclosures against the warranties. The warranties therefore have the **effect of** **eliciting further information** from the seller in relation to the target - and flushing out any problems relating to the target.

# Introduction to disclosure

An acquisition agreement on a share sale contains a warranty that the company is not involved in any litigation. Assume, however, that the company is in fact the claimant in an action for a small debt. In order for the seller to ensure that it is not in breach of warranty, it will need to disclose the details of the litigation in the disclosure letter. In doing this, the seller is saying that **the warranty is true 'but for' the litigation**, details of which have been set out in the disclosure letter. By making the disclosure, the seller ensures that it cannot be sued for breach of warranty by the buyer post completion in relation to the matter disclosed. The result of this, though, is that the buyer will be alerted to the litigation and may ask the seller for an indemnity or a reduction in the purchase price to take account of the risk/s identified.

# Types of disclosure

There are effectively two types of disclosure that can be found in a disclosure letter.

* General disclosures
* Specific disclosures

**Specific disclosures** are the disclosures usually found in the latter part of the disclosure letter (usually referred to as the ‘**back-end’** of the disclosure letter).

The specific disclosures are those that relate to the specific warranties given – as in the example on the previous page.

**General disclosures** are disclosures which are usually found at the beginning of the disclosure letter (often referred to as the ‘**front-end’** of the disclosure letter).

General disclosures usually relate to searches of public registers that the buyer should complete prior to completion, such as searches of the Register of Companies and the Land Registry.

The seller will usually seek to ensure that anything that the buyer could have found out by conducting such searches is deemed to have been disclosed. The buyer may seek to resist such general disclosures or may seek to make them as narrow as possible.

It is also increasingly the case that the seller seeks to ensure that the full data room is deemed to be disclosed and for a buyer to accept this.

# The disclosure letter

* Copies of all relevant documents relating to the disclosures (such as contracts, title documents, accounts and litigation papers) will be provided to the buyer.  They may be annexed to the disclosure letter or, more commonly, provided electronically (for example by way of DVD, USB or other electronic exchange). The documentation provided, in whatever form, is referred to as the **disclosure bundle**.
* In terms of timing, the seller will send a draft(s) of the disclosure letter to the buyer **prior to signing** of the transaction. This gives the buyer time to review and evaluate the disclosures. The disclosure letter will be finalised at signing (if split signing and completion) with two copies of the bundle being prepared - one for the seller and one for the buyer.
* Historically, it was thought that disclosure had to be **fair** in order to qualify warranties. More recent case law makes it clear, however, that the level of disclosure necessary to qualify the warranties depends on the precise wording of the acquisition agreement.  
  There does not**, therefore, appear to be an objective standard for disclosure** which will always apply. This brings uncertainty.
* We will now consider case law which provides guidance on the concept of ‘fair disclosure’.

# What is ‘fair’ disclosure?

*“Merely making known the means of knowledge which may enable the other party to work out certain facts and conclusions will be insufficient.”*

**Levison & Others v Farin & Others** : This judgment makes it clear that specific notice of the matter the seller wants to disclose must be given to the buyer. The case involved the sale of a fashion business where the head designer was ill. In the agreement, the seller warranted that there had been no material adverse change in the overall value of the business. In fact, the value of the business had decreased as a result of the head designer’s illness; he had not been producing collections. The Court held that there was a breach of warranty. The seller argued that the buyer had been made aware of the designer’s illness before completion, but the Court held that merely disclosing the designer’s illness did not constitute fair disclosure; that was merely disclosing a “possible cause of loss”. What the seller should have disclosed was that there had been an actual drop in the net asset value of the business. In this case, there was no stated standard for the disclosures and the Court implied a standard.

*“Fair disclosure requires some positive statement of the true position and not just a fortuitous omission from which the buyer may be expected to infer matters of significance.”*

**Daniel Reeds Limited v EM ESS Chemists:** In this case, the seller of a medical products company discovered before completion that an important licence - to sell and supply paracetemol in the UK – had expired. In the acquisition agreement, the seller warranted that the target company had all the necessary licences to enable it to carry on its business effectively. Then, by way of disclosure against the warranty, the seller produced a list of all the existing product licences – and simply left off that list the licence for the supply and sale of paracetemol that had expired. The Court held that listing the valid product licences was not a sufficiently clear statement of the position regarding the lapsed paracetemol licence. It would not, therefore, amount to a fair disclosure. Here, the agreement required fair disclosure – and so the Court was interpreting the terms of the agreement.

**New Hearts Limited v Cosmopolitan Investments Limited:** Here, the seller tried to disclose all matters “set out or referred to” in a complex document, but it was held that simply referring to a complex body of information would not be a fair disclosure even if a diligent reader may be able to identify the relevant information.

“*Mere reference to a source of information, which is in itself a complex document, within which the diligent enquirer might find the relevant information, would not satisfy the requirements of a clause providing disclosure.”*

**Curtis & Anor v Lockheed Martin UK Holdings Limited**: Here, it was commented in relation to the meaning of “fairly disclosed” that:

“*Fairness, in this context, requires more than clues which enable a purchaser to start a paper chase for matters which should be fairly disclosed”.*

# What happens if the acquisition agreement does not specify that disclosure must be fair?

* The cases of **Infiniteland Limited v Artisan Contracting Limited1 BCLC 632** and **MAN Nutzfahrzeuge AG and others v Freightliner Ltd** make it clear that the question of whether or not disclosure effectively qualifies the warranties in any acquisition agreement will depend upon the level of disclosure that the **buyer has agreed to accept.**
* For example, the buyer may agree to accept that the warranties are qualified by “all the matters contained in or referred to in the disclosure letter and its accompanying documents”. Due to the **vague nature of this qualification** wording, the buyer cannot later complain that an issue had not been properly disclosed because the consequences of the matter were not fully explained in the disclosure letter.
* It is clear from all of these cases that a properly advised buyer will seek to ensure that the acquisition agreement specifies that warranties **will be qualified only by** matters fairly disclosed.  (Note that whilst case law will assist in establishing what is ‘fair’ disclosure, the parties will often also include a definition of ‘fair disclosure’ in the acquisition agreement).
* Sellers should, therefore, be advised to **make disclosures in the disclosure letter as fair** as possible to try to ensure that they will be effective.

# What if the buyer knows before completion about facts that amount to a breach of warranty?

* Whether a buyer can pursue a claim for breach of warranty where it knew before completion that the warranty in question was untrue, even though the information that has made it untrue had not been formally disclosed by the seller, has been considered in **Eurocopy plc v Teesdale and Others** [1992] BCLC 1067 (an interlocutory application) and, later, in Infiniteland (although this was obiter).
* Following Infiniteland, it appears that the position will depend on the wording of the acquisition agreement. However, it remains unclear if a court will allow a buyer to recover in respect of a breach it had actual awareness of, even if the contract provides that they may claim.
* In any event it is likely that the buyer will have taken into account the breach when determining the purchase price and so even if the buyer could bring a claim its losses are likely to be minimal.

# What if the seller does not wish to disclose something?

A seller who fails to disclose a relevant matter in relation to the warranties may have a claim made against it by the buyer for breach of warranty.

A claim for misrepresentation is also a possibility.

We will consider the buyer’s remedies later in this Topic.

A seller who fails to disclose relevant matters in connection with a sale of shares may also be criminally liable under s.89 Financial Services Act 2012.

The seller may also, in this situation, have to consider the provisions of the **Fraud Act** 2006. This could be relevant if:

* a representation is made, which is false; and
* the seller has made such representation dishonestly, intending to make a gain for itself and/or cause loss to the buyer.

This may constitute the **criminal offence of fraud** which is punishable by up to 10 years’ imprisonment and/or a fine.

Further, liability for fraud cannot be limited under contract law so any liability arise from a fraudulent misstatement or withholding of information may give rise to further liability.

**Summary**

* In order to avoid liability for breach of warranty, the seller will **disclose**, in a **disclosure letter**, issues which would otherwise make certain warranties untrue.
* Whether a **disclosure is effective** will depend on what the **parties have agreed** about disclosure, looking at the precise wording of the acquisition documentation. For example, if the acquisition agreement simply states “*Warranties are subject to matters disclosed”* it is possible that even very vague/wide disclosure could qualify the warranties.
* But, if the acquisition agreement states “*Warranties are subject to matters fairly disclosed*”, then a higher standard will be imposed. Disclosure will only be effective if “fair”.
* We can use case law to help determine what might or might not be considered “fair”. For example, being sufficiently precise and not just information from which the buyer could work out certain facts and conclusions for itself; a positive statement and not an omission; clearly flagged not a mere reference to a complex source of information.  However well advised parties will often also include a definition in the acquisition agreement of what constitutes ‘fair disclosure’