

## Briefing Note: The Disclosure Letter Explained

### Introduction

The Disclosure Letter is a key document in any company sale or purchase. It is the seller's opportunity to make 'disclosures' against the warranties which the buyer will require the seller to give. If a seller makes inadequate disclosures, it may face breach of warranty claims, which could allow the buyer to recoup some or even all of the purchase price.

This guide should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

### Warranties and the Disclosure Letter

Warranties and disclosures must be considered together. Please see our note on [Warranties and Tax Covenants in Share Sales](#) for a more in-depth explanation of the purpose of warranties. If a warranted fact turns out to be untrue or misleading, the buyer is likely to make a claim to recover its losses, regardless of whether it relied on the warranty concerned. However, such a claim will fail if the facts which gave rise to the breach were disclosed.

A full and proper disclosure exercise is in both parties' interests. For the seller, it may provide protection against a breach of warranty claim or at least may provide a successful defence to such a claim. For the buyer, it supplements the due diligence exercise in giving the buyer the fullest picture of the target company or business.

### The Disclosure Letter and Disclosure Bundle

The Disclosure Letter usually takes the form of a letter from the seller to the buyer. It is prepared by the seller's solicitors. It is usually divided into two parts: general disclosures and specific disclosures and will have attached to it copies of the documents being disclosed to the buyer (the disclosure bundle).

*General* disclosures cover certain matters that appear in public records and/or of which the buyer ought to be aware on the basis of pre-contract enquiries or searches actually made, or which a buyer would normally make. The general disclosures are often the subject of substantial negotiation between the buyer and the seller's solicitors. Whilst it is in the seller's interest for these general disclosures to be as comprehensive as possible, the buyer's solicitors will seek to limit them.

*Specific* disclosures are the seller's opportunity to specifically disclose actual matters which, if not disclosed, would constitute a breach of warranty. The specific disclosures are made by reference to the warranties themselves. For example, if there is a warranty within the sale agreement that the target company is not a party to any litigation, the seller would need to disclose full details of any current litigation affecting the company. Also, certain warranties may require specific information to be listed in the Disclosure Letter or included in the disclosure bundle (such as material contracts, pension schemes, etc).

The disclosure bundle can often be voluminous and should contain all documents referred to in the warranties and/or the specific disclosures. Two copies of the bundle will need to be prepared: one each for the buyer and seller.

**Briefing Note**  
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### Seller's approach

The golden rule in preparing the Disclosure Letter is to ensure that everything that is relevant is disclosed in as much detail as possible, even if the buyer is already aware of a particular matter. If the seller has any doubts as to whether something should be included, the prudent approach is to include it.

Depending on the definition of 'disclosed' that is negotiated between the parties and included in the sale agreement, invariably, to be valid, any specific disclosures must be full and fair and provide sufficient detail for the buyer to understand the nature and scope of the matter purportedly disclosed. If a disclosure is not specific and precise, the seller runs the risk that a court may find that disclosure insufficient to preclude a claim for breach of warranty.

The seller should ensure that enquiries are made of all relevant personnel to ensure the disclosures provided are as accurate and full as possible. Revisions and updates to the Disclosure Letter often take place right up to completion.

When approaching disclosures, the seller must go through each warranty in turn and consider whether it is true and accurate. Any inaccuracies should be noted in full (and supporting documents located and copied) as the basis of a specific disclosure against that warranty. Key personnel and professional advisors (such as accountants) are essential to this exercise. Each and every warranty must be addressed in this way to ensure the disclosures are as comprehensive as possible. Where possible the seller should explain the breach fully, quantify the consequences and identify all warranties affected. It is not sufficient simply to provide the buyer with the bald facts of the disclosure; it must be 'spelled out' in terms of detail, effect and the warranties cross-referenced.

### Buyer's approach

No matter how thorough the buyer is in its due diligence process, the first draft of the Disclosure Letter nearly always throws up previously undiscovered problems. It is important that the buyer raises enquiries in relation to the drafts of the Disclosure Letter, and associated disclosure documents, to ensure that the disclosures are clear and unambiguous and that it fully understands the consequences of accepting them. It is best for the buyer to expose any problems at the negotiation stage of the deal rather than having to cope with them after completion.

The problems may be so significant that the buyer decides not to proceed with the transaction or it may seek to renegotiate the price or indemnities. Accordingly, a buyer should require the seller to disclose all possible issues as early as possible within the process.

### Conclusion

**The Disclosure Letter is just one example of the absolute requirement for the parties to a business sale to have expert legal representation in the process. Poorly drafted documentation can result in the seller being forced to repay some or all of the sale price or the buyer having no recourse despite being misled as to the true value of the business.**

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If you would like to know more about this topic or our legal services, please contact Mark Williams on 01323 435955 or [mew@gabyhardwicke.co.uk](mailto:mew@gabyhardwicke.co.uk)

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