



The Disclosure Letter

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The Disclosure Letter is Very Important

The Disclosure Letter is a very important part of the company share or asset sale and purchase process. However, it is often misunderstood, and even regarded as an unnecessary step. In fact, the Disclosure Letter is a key document in defining what is really being sold and the true value of the shares/ asset.



Warranty and Disclosure

In a company share sale or asset sale, the sale and purchase agreement ("SPA") usually contains various warranties by which the vendor confirms various facts (and sometimes opinions) to be true and accurate. Each warranty is a statement of fact (sometimes opinion).

A typical SPA (especially when the purchaser has stronger bargaining power) contains many "standard warranties". A classic example is what is sometimes very conveniently drafted by the purchaser's lawyer apparently without true regard to reality: "The Vendor warrants that all intellectual property rights owned by it have been registered." No company can register all of its intellectual property rights (eg the copyright relating to the advertising materials for its products). A properly draft SPA should not leave the parties to argue about the true meaning of such warranties only when disputes arise.

If a warranty is untrue or inaccurate, the purchaser may have a claim for damages against the vendor for breach of warranties. The SPA usually provides that the damages will be such compensation as is required to place the purchaser in the position



it would have been has there not been a breach of the warranty. This may mean a commercial nightmare for the vendor especially when part of the purchase price is retained for a period of time after the sale pending any breach of warranty claim by the purchaser.

How does it work?

The Disclosure Letter is issued by the vendor or the vendor's lawyers on its behalf prior to the completion of the sale (usually upon signing of the SPA). By the Disclosure Letter, the vendor makes a disclosure against (i.e. qualifying) the warranties given in the SPA. It serves to protect the vendor from claims by the purchaser under the warranties given in the SPA by stating which warranties are untrue or inaccurate and what the true situation is in relation to each of such warranties.

For the purchaser, the Disclosure Letter serves to reveal facts and opinion that are not shown or noticeable during the due diligence process. In some deals, the disclosures may lead to the purchaser's request to re-negotiate the purchase price or require an indemnity (or further indemnities) from the vendor.



Its Contents

A Disclosure Letter usually comprises two parts. The first part contains general disclosures and the second part contains specific disclosures.

For a share sale, the general disclosures typically contain:

- a general disclosure of the company's/ group companies' management accounts;
- a general disclosure of information filed with the relevant companies registry(ies);
- a general disclosure of properties owned or leased by the company/ group companies; and
- a general disclosure of intellectual property rights owned by or licensed to the company/ group companies.



The specific disclosures may include (a) matters that will be a breach of warranty if they are not disclosed; and (b) information which is required to be included by the warranties given in the SPA.

A Disclosure Letter is usually accompanied by a Disclosure Bundle. Depending on the contents of the Disclosure Letter, the Disclosure Bundle may include copies of documents disclosed to the purchaser during the due diligence process and documents referred to in the specific disclosures.

The vendor should prepare or enable its lawyers to prepare the Disclosure Letter with great care. Instructions and documents given to its lawyers must be complete and accurate.

Due Diligence and the Disclosure Letter

A common misunderstanding is that the due diligence process serves the purposes of the Disclosure Letter. Due diligence is conducted by the purchaser for its own information and evaluation. The process does not automatically release the vendor from liabilities for breach of warranties.

In some cases, additional liabilities for misrepresentation may arise out of misrepresentations made by the vendor in the due diligence process.

In practical terms, negotiating the warranties and the Disclosure Letter may be viewed as one and the same process. The warranties in the SPA take effect as limited/ qualified by the Disclosure Letter. The due diligence process does not automatically give such limitation/ qualification.

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