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Briefing note

Warranties, Indemnities & Disclosure

One could be forgiven for thinking that a thorough due diligence process is sufficient risk management for a buyer. However, it is quite common for future risk to be balanced between the parties, with the help of warranties and indemnities.

- Warranties and indemnities should not be seen as a substitute for due diligence, as the two are complementary.
- A warranty is a contractual statement made by the seller about the condition of the target company. They are usually contained in the acquisition agreement.
- It is sensible for the seller to try to limit their liability under the warranties to the total consideration and to limit the period for which a breach of warranty is actionable to twelve months or less.
- In order to successfully claim damages for a seller's breach of warranty, the buyer would need to prove that the warranty was breached and that they suffered a loss resulting from the breach.
- Disclosure is the process of highlighting differences between the buyers' expectations (the warranties) and the sellers' understanding of reality. The disclosure letter is a key document prepared by the seller. The buyer will usually agree that the seller will not be liable for a breach of warranty where the matter was disclosed in the disclosure letter.
- An indemnity is a commitment by the seller to compensate the buyer in respect of a particular type of liability, should it arise.

Do

- Negotiate the wording of warranties and indemnities proposed by the buyer in their first draft of the acquisition agreement.
- Try to limit the liability under the warranty claims.
- Try to limit the number of indemnities and the period for which they apply.

Don't

- Gloss over the warranties when preparing disclosure.
- Leave any areas of concern until disclosure is required (this could reveal a deal-breaker at the end).
- Underestimate the power of warranties and indemnities.

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