RUSSELL-COOKE | SOLICITORS

Seller beware?
The dangers of withholding information

Conducting a due diligence and disclosure exercise can be a frustrating experience for sellers. Frequently it will suck significant amounts of senior management time and attention away from the business itself. It can also throw up difficult issues, sometimes late in the process, which the seller would rather not let the buyer know about.

The recent case of *Erlson Precision Holdings Limited (formerly GG132 Limited) v Hampson Industries plc* however highlights the importance of effectively managing the disclosure process on a business or share sale and the dangers of concealing material information.

The Facts

Hampson Industries plc (the "Seller") and GG132 Limited (the "Buyer") entered into an agreement for the Buyer to acquire ownership of the shares in Hampson Precision Automotive Limited ("HPA") on 23 June 2010.

As part of the negotiation process, the Buyer and its parent had been provided with large amounts of information about HPA, including accounting information which contained projected income figures – these financials included a breakdown of historic and forecast sales by customer.

On 30 April 2010 HPA's second largest customer had confirmed unequivocally to the CEO of the Seller (also a director of HPA) that it wished to withdraw from its relationship with HPA.

The CEO had asked the customer to keep this information confidential whilst he dealt with this internally, given the risk of prospective redundancies etc. At no time before completion however did the CEO let the individuals conducting negotiations with the Buyer know about the customer's decision.

The Buyer only found out about the customer's decision when a formal written notice terminating its relationship with HPA was circulated to it shortly after completion.

The Consequences

The court held that there had been a fraudulent misrepresentation by the Seller, in that it had presented financial information to the Buyer which had induced the Buyer to enter into the sale agreement and which the Buyer had relied on when doing so.

In all the circumstances the Seller was under a duty to let the Buyer know when it became aware that the financial information presented had become inaccurate as a result of subsequent events.

The precise details of the award which will be made in favour of the Buyer remain to be decided at a future date, but the remedies for fraudulent misrepresentation can include both rescission (essentially, treating the contract as if it had never occurred and putting the Buyer and the Seller back in their pre-contractual position) and damages.

Given the element of dishonesty involved the damages claimed can be wider than for a standard breach of contract claim and in this case the award could be substantial.

The Lesson

It appears that the sale agreement had been well drafted on behalf of the Seller. The financial information central to the case was not the subject of any general or specific warranties. The agreement also included an “entire agreement” clause, effectively providing that all terms of the deal between the parties were reflected in the agreement and that the Buyer had not relied on any other representations when entering into the agreement. However, none of these provisions were sufficient to defeat a claim for fraudulent misrepresentation.

It is not unusual for issues to arise, often at a late stage in negotiations, which are likely to be material to a buyer and which a buyer would expect to be disclosed. A seller will therefore face a difficult decision as to whether and how to disclose this information.

There is no general contractual duty on a seller to disclose all relevant facts to a buyer. A seller might therefore feel comfortable not disclosing material information where it is confident that this information would not contradict or distort other information or confirmations it has provided (whether explicitly in a warranty or not). (If a seller was taking such a view it would also need to consider its position under s.397 of the Financial Services and Markets Act 2000, and the Fraud Act 2006.)

In the vast majority of cases though a disclosure will be necessary and even if it is not strictly necessary from a general legal perspective the seller may wish to disclose information to prevent claims arising after completion. (One can imagine that, even if there was no possibility of arguing fraudulent misrepresentation in this case, the Buyer would have been keenly investigating the possibility of bringing any possible claim against the Seller given it had acquired a company which had just lost its second biggest customer.)

Certainly in this situation there will generally be scope for an element of damage limitation by using an appropriate strategy to communicate the information to the buyer and its advisers. It may also be possible to take action once a problem has been identified to remedy, or at least mitigate, its effects. However, as this case illustrates, trying to conceal important matters rarely works out successfully in practice and can be extremely costly.

For more information, please contact:

David Webster
Solicitor
020 7440 4825
David.Webster@russell-cooke.co.uk