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Warranties and disclosure

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On every venture capital investment, whether early-stage or follow-on funding, we would expect warranties to be given by the company and potentially also by certain key people (usually the founder(s) and other key management) known as the 'warrantors'. The identity of the warrantors should be agreed at term sheet stage. The new BVCA documents have moved away from founders giving warranties. Whilst this has been accepted by many venture capital investors (particularly on larger and later stage VC deals), some investors still require warranties to be given by founders on seed/Series A stage investments, particularly if no institutional money has previously been invested.

Warranties are certain statements relating to the company which are given as being true as at completion.

The warranties are usually relatively lengthy and are provided in a schedule to the subscription agreement. The BVCA form of subscription agreement includes a standard set of warranties, which have been widely adopted by venture capital investors and are generally seen as a fair starting point. The extent of the warranties will depend on the company being invested in, but typical areas covered including some examples are as follows:

- the business plan (i.e. the business plan contains no material inaccuracies);
- shares and corporate structure (i.e the share capital table is accurate);
- contracts and trading (i.e. the company is not a party to any contract which contains onerous terms);
- employees (i.e. the company does not have any outstanding obligations to former employees);
- intellectual property (i.e. the company owns its key intellectual property and is not infringing any third-party intellectual property); and
- litigation (i.e. the company is not at present engaged in any dispute or legal action).

The purpose of the warranties is two-fold; firstly, to provide relevant information to the investors and secondly, to give the investors a contractual right to bring a claim against the warrantors in the event that any of the warranties are untrue, subject to such matter giving rise to a claim being disclosed.

The warrantors can qualify the accuracy of warranties by way of 'specific disclosures' in the disclosure letter, subject to the agreed standard of 'disclosed' being met (such standard often being that the disclosure made must be fair with sufficient detail to enable the investor to reasonably understand the nature and scope of the fact or matter being disclosed). By way of example, if a warranty provides that the company has not been involved in any litigation but the company has been involved in a dispute with HMRC, the warrantors can include details of this dispute in the disclosure letter to prevent a claim being brought by the investors for breach of warranty, subject to various limitations.

The disclosure letter will also contain 'general disclosures' which will, subject to meeting the agreed standard of 'disclosed', qualify any warranty to which they reasonable relate. General disclosures tend to cover items such as the following:

- accounts;
- intellectual property searches; and
- filings at Companies House.

Whilst warranty claims are extremely rare, given that disclosures are key in limiting any potential claims against the warrantors, it is crucial that the disclosure exercise is treated very seriously and lawyers closely involved in the negotiation of the warranties and the disclosure process.

Claims against the warrantors will be subject to various limitations as set out and agreed in the subscription agreement (save in relation to claims arising from fraud, misrepresentation or wilful non-disclosure by the warrantors). Some of the typical limitations that we would expect to see are:

- **time limitations** – an investor can only make a claim within a certain period from completion, usually between 12 and 18 months;
- **quantum** – an investor can only make a claim if the quantum of the claim exceeds the agreed thresholds, usually 0.1% of the total investment for each individual claim and 1% for aggregated claims;
- **overall caps on liability** – the total liability of each warrantor will be limited, which is usually the total investment amount in respect of the Company and a multiple of salary (usually 1x) in respect of the founder(s) and other key management where they are giving warranties;
- **no double recovery** – an investor cannot recover more than once in respect of the same damages; and
- **changes in law** – the warrantors shall have no liability to the extent that the claim would not have arisen but for any change in law.

In the event that a successful claim is made for breach of warranty, the investors can seek damages from the warrantors. Such damages will be calculated on the basis of the loss suffered by the investor due to the warranty not being true but shall not exceed the cap on liability of each relevant warrantor.

Specific investment funder might have some additional warranty coverage they need. For example, VCT investors require additional warranties to be given in relation to how the funds invested will be used, so as to not affect the relevant investor's VCT status.