

CROSS BORDER M&A – UIA NY 2017

# REPRESENTATIONS AND WARRANTIES INSURANCE

## THE EUROPEAN PERSPECTIVE

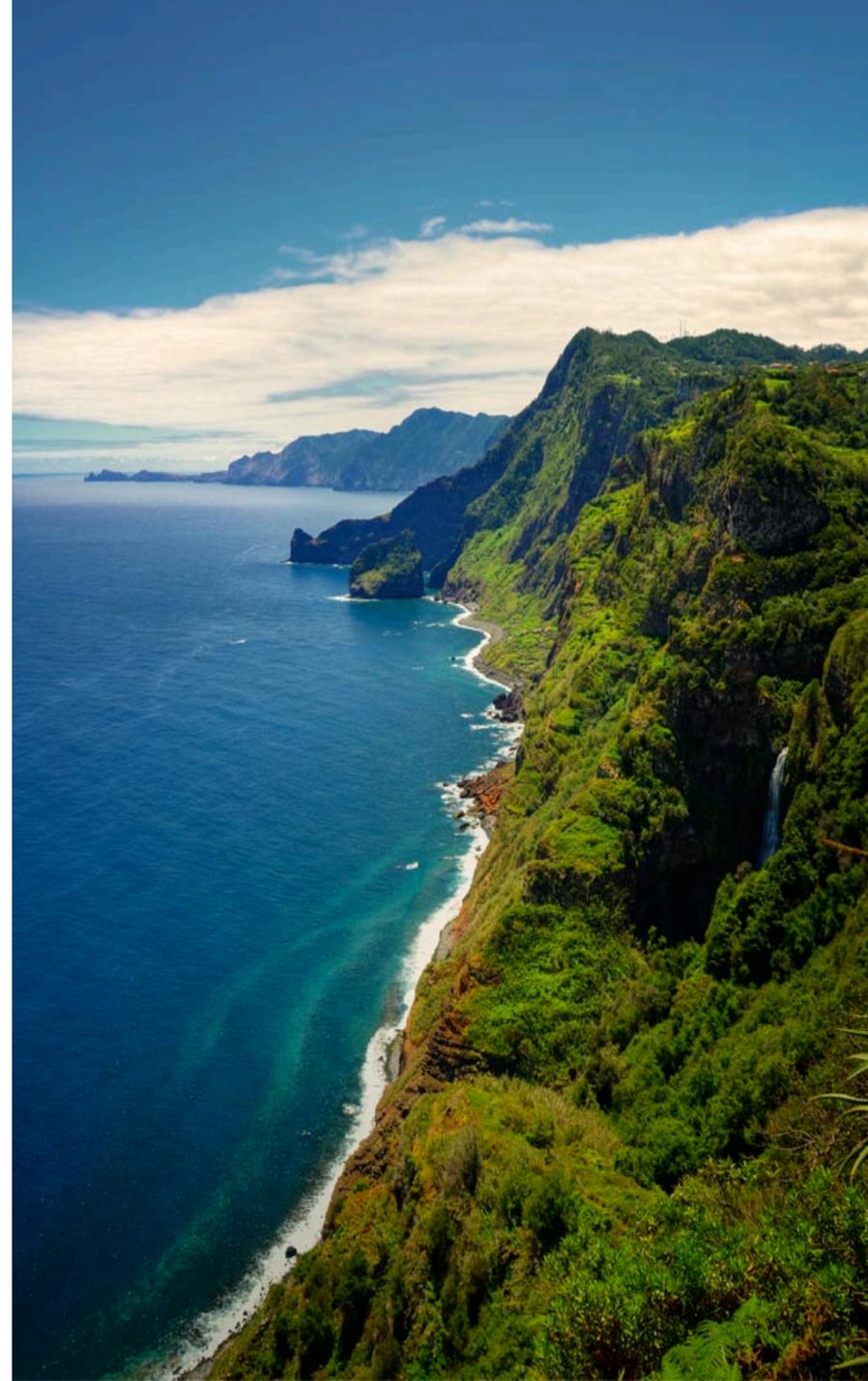
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## R & W INSURANCE

- Protection against financial losses in case of seller's R&W breach in M&A's agreements
- “Warranty & Indemnification (W&I) Insurance” in Europe and UK
- UK: London as the “centre” of M&A Insurance in Europe
- Sweden: M&A leader in nordic countries
- Southern Europe: R&W Insurance used in a smaller scale



## R & W INSURANCE

- EMEA: lowest frequency of claims (11, 4% according to AIG) but largest losses
- European insurers increasingly conservative in extent of coverage and thoroughness of deal review
- Europe: most significant R&W breaches
  - Contracts
  - Financial statements
  - Tax



## TYPES OF POLICIES

### BUY-SIDE

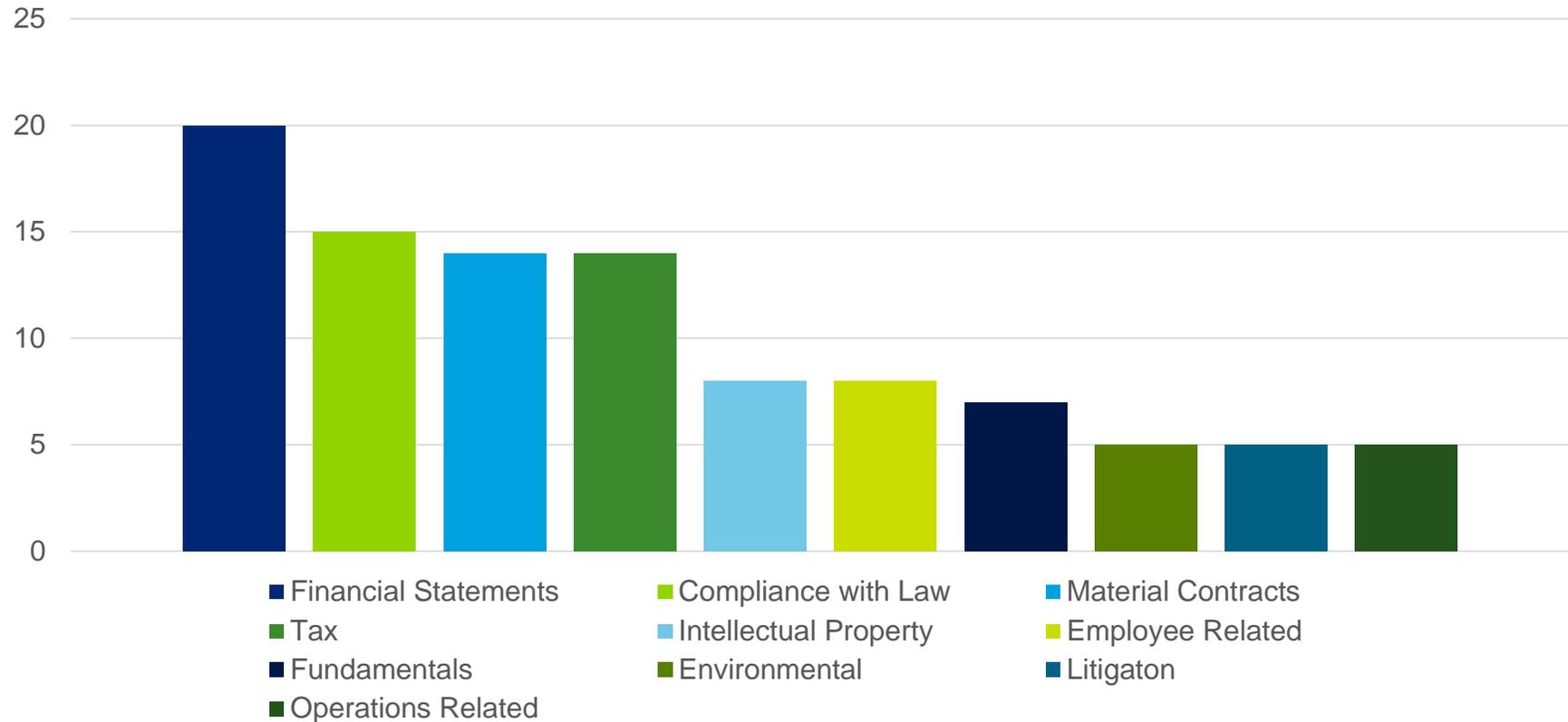
- Indemnify buyer of financial losses resulting from sellers' M&A breach
- Buyer may claim directly against insurer
- Only kicks in after erosion of seller's guarantees
- Can be extended beyond survival period of M&A's in SPA

### SELL-SIDE

- Protect seller from financial liability arising from buyer's claim
- Insurance coverage restricted to liability limit set forth in SPA
- Generally coincident with survival period of M&A's liability (12 - 24 months after closing)

# TYPES OF BREACH

## R&W Reported Incidents by Types of Breach



Source: AIG Global M&A Claims Study 2017

## 6 TYPICAL EXCLUSIONS

- Issues known, revealed during diligence or otherwise disclosed
- Seller's fraud, in sell-side policy
- Post-closing working capital or purchase price adjustments
- Net worth
- Environmental or regulatory damages
- Forward-looking statements
- Matters of a risk level deemed as uninsurable
- Asbestos matters
- Corrupt practices and bribery issues
- Tax liabilities related to transaction



## ANTI-SANDBAGGING

- Buyer's reaction against seller's breach of R&W typically limited to issues not known before closing
- Buyer shall prove seller's breach and its own absence of knowledge
- In sell-side policy, seller's knowledge / omission of its breach deemed as fraud.
- Example of European civil law principle of *bona fides*



# ANTI-SANDBAGGING IN THE INSURANCE CONTRACT

Typical inclusions:

- Anti-sandbagging provision – express or tacit (if no provision considered)
- Knowledge qualification clause - what is deemed as buyer's knowledge
- No claim declaration - buyer's unawareness of pending or potential claims arising from SPA



# ADDITIONAL GUARANTEES

- **Escrow**
  - implies direct liability from seller
  - may be reduced with R&W Insurance
- **Bank guarantee**
  - guarantor shall compensate buyer for losses arising from seller's breach
  - usually "on first demand" - guarantor cannot oppose buyer's claim for payment
- **Price hold back / Deductible**
  - part of SPA price hold for an agreed period to secure full compliance of seller's R&W



# ADDITIONAL REMEDIES

- **Buyer put option**
  - seller in breach must buy securities previously sold
  - commonly used in stock market transactions
- **Penalty clause**
  - parties previously fix compensation due in case of breach
- **Seller's obligation to compensate**
  - buyer's compensation for losses by reduction in business value



# SPECIFIC INSURANCES

## Tax / Contingent Liability Insurance

- Reduce / eliminate contingent tax and other liability exposure
- Typical covers:
  - legal / advisory expenses
  - non criminal fines / penalties
  - litigation
  - successor liability issues
- Typical exclusions
  - criminal / fraudulent acts
  - changes in law
  - material omissions / inaccurate facts



# MORAL HAZARD

- When perceived risk is reduced, the risky behavior increases.
- Insured's careless conduct increases likelihood of damages occurring / aggravating:
  - deliberately - *moral hazard*
  - by mere negligence - *morale hazard*
- Impacts on R&W's quality / Likely to origin more insurance claims.
- *Bona fides* principle: insured's willful /negligent conduct → contractual obligations breach → liability towards insurer



## THE INSURED'S INFORMATION DUTIES

- Parties' good faith conduct in negotiating and executing insurance contract under penalty of liability for damages
- *Culpa in contrahendo* doctrine – insured's duty to inform of material facts basic to insurer's intention to provide insurance
- *Bona fides* principle – insured's duty to inform of material circumstances related to risk increase



# BREACH OF INSURED'S INFORMATION DUTIES

During contract formation:

- due to guilt - insurance contract invalid
- due to negligence - contract valid but can be changed (type of coverage / price) or terminated

Respecting risk increase:

- due to guilt - aggravated damages' coverage may be refused
- due to negligence - coverage may be reduced according to real circumstances of risk / payment may be refused (in specific cases)

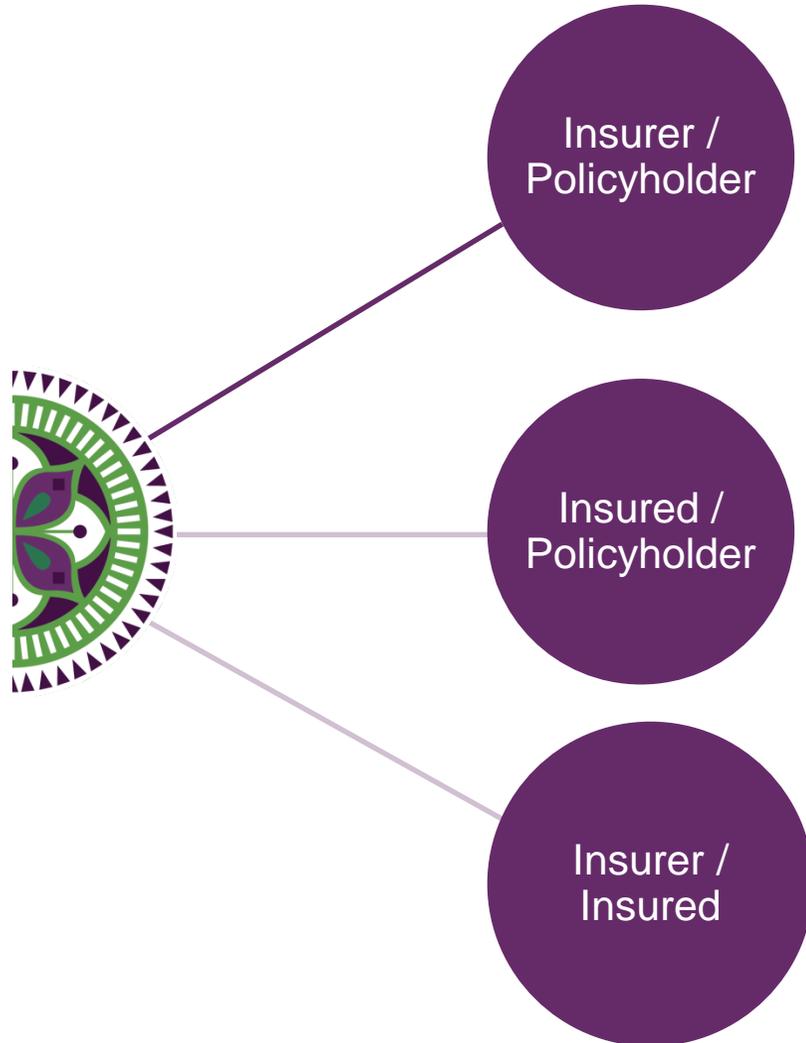


# THE PORTUGUESE CASE –THE FINANCIAL GUARANTY INSURANCE

- Insurer agrees to indemnify insured
- Protection against material damages arising from policyholder's breach of contract entered into with insured
- Mere indemnification scope
- Independent of damages assessment



# FINANCIAL GUARANTY INSURANCE – CONTRACTUAL RELATIONSHIPS



- Contract in favour of a third party
- Three different relationships:
  - Insurance relation - insurer and policyholder
  - Underlying relation - insured and policyholder
  - Indemnifying relation - insurer and insured

# R&W INSURANCE VS FINANCIAL GUARANTY INSURANCE

## R&W INSURANCE

- Specific breach of seller's R&W in M&A
- Payment damages depending on assessment by insurer

## FINANCIAL GUARANTY INSURANCE

- Any contractual breach by any of the parties
- Specified indemnifying amount fixed
- No prove of damages required if subject to "on first demand" clause

# FINANCIAL GUARANTY INSURANCE & BANK GUARANTEE

- Functionally similar if “on first demand”
- Differences:
  - nature - contract in favor of a third party /personal guarantee
  - provider – insurer / bank
- Advantages of financial guaranty insurance:
  - quicker subscription
  - lower costs
  - no capital tied-up



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