

# 2023 Insurance Sector Webinar Programme

## **Warranty and indemnity (W&I)**

**8 November 2023**

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# What we will cover

**01** UK

Intro & overview

**02** Spain

**03** France

**04** The Netherlands

**05** Belgium

**06** Italy

# Your speakers today



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1 UK

# Introduction & Overview

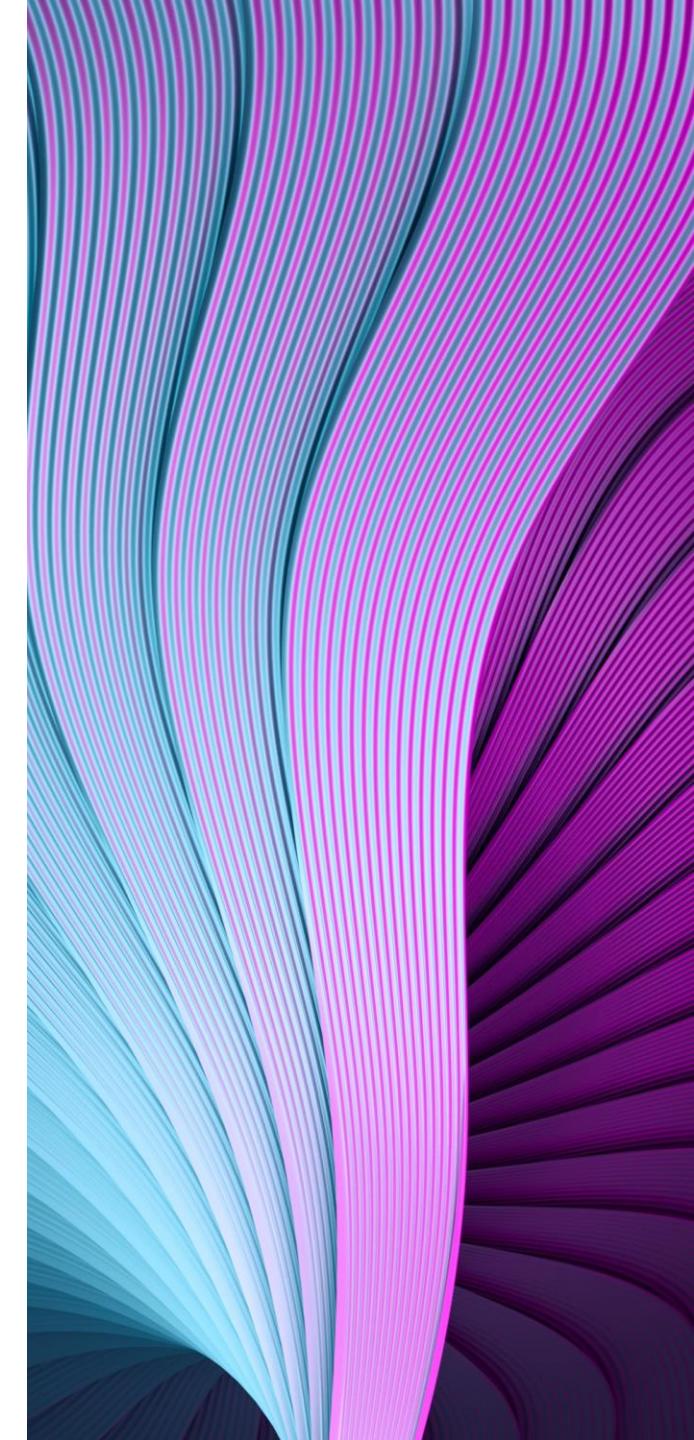
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- W&I insurance remains a common feature of many M&A transactions with overall use of approx. 16% in 2022 albeit with variations across jurisdictions.
- However, the picture varies depending on:
  - Deal size (e.g. 5% for deals less than € 25 m vs 58% for deals over € 100 m)
  - Sector (e.g. 1% for Infrastructure & Projects vs 23% for Energy & Climate Change)
  - Jurisdiction (e.g. 9% for Southern Europe vs 32% for UK)

# Claims experience

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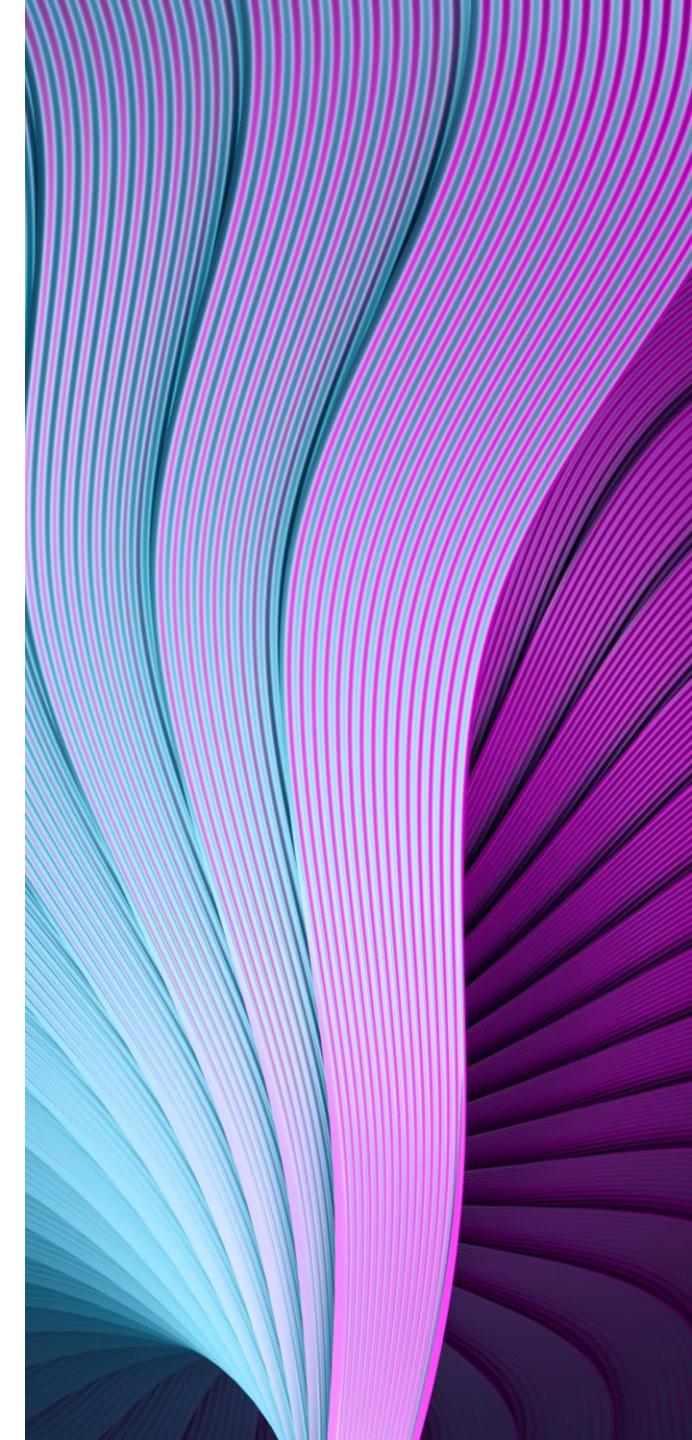
- Alleged breaches of accounts warranties remain common, but claims increasingly also feature other breaches e.g. material agreements/material customers, licenses/IP, condition of assets
- A significant proportion of claims are resolved via a negotiated claims process, but both arbitration and court proceedings are used as a forum for dispute resolution

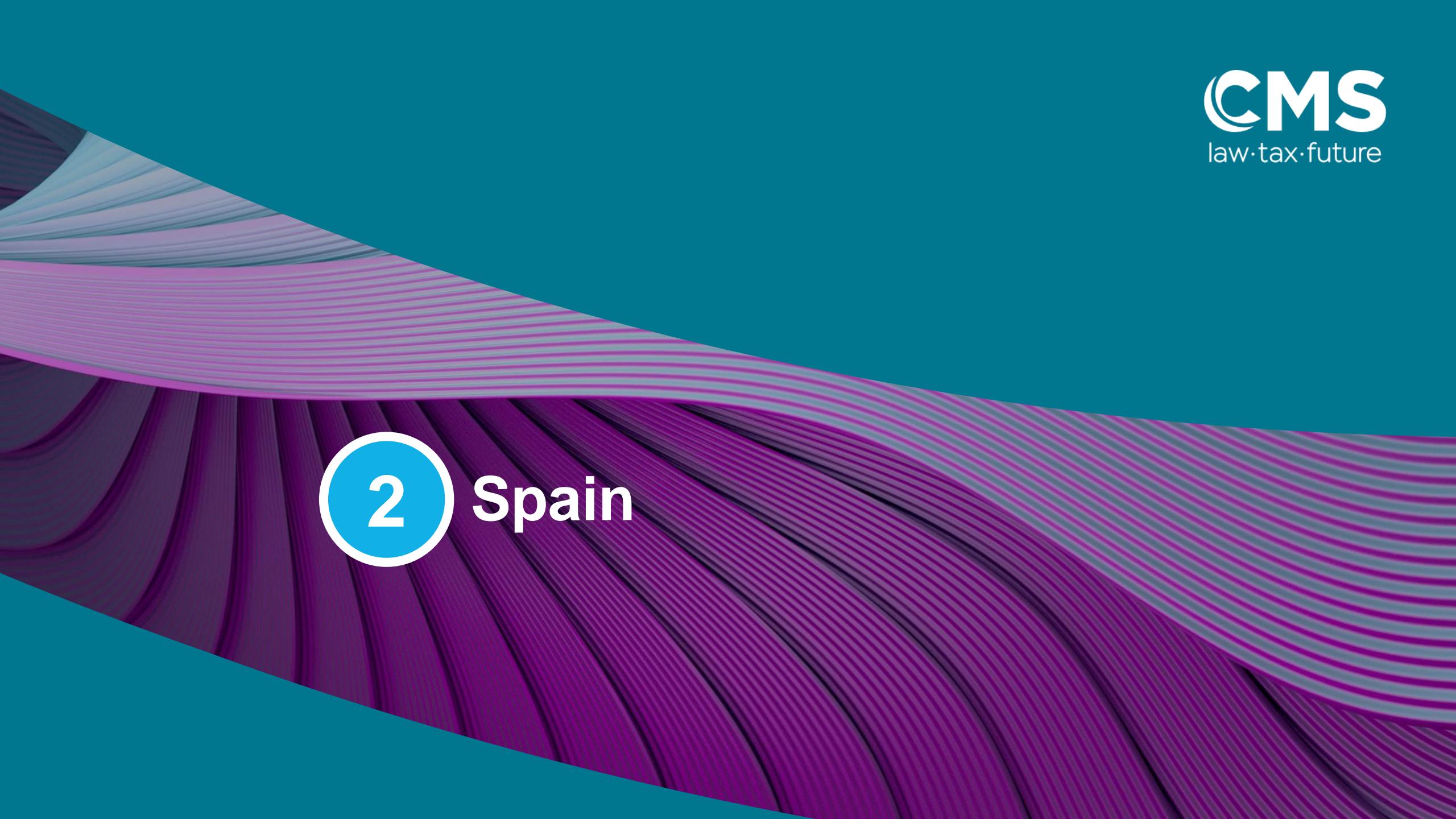


# Key principles for effective claims handling

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- Early access to information is key to swift resolution of claims
- Legal analysis remains critical: wording of warranties & interactions between SPA and Policy / factual matrix / expert input where relevant
- Consider causation
- What principles apply to the calculation of loss (e.g. warranty true/warranty false & objective approach under English law)

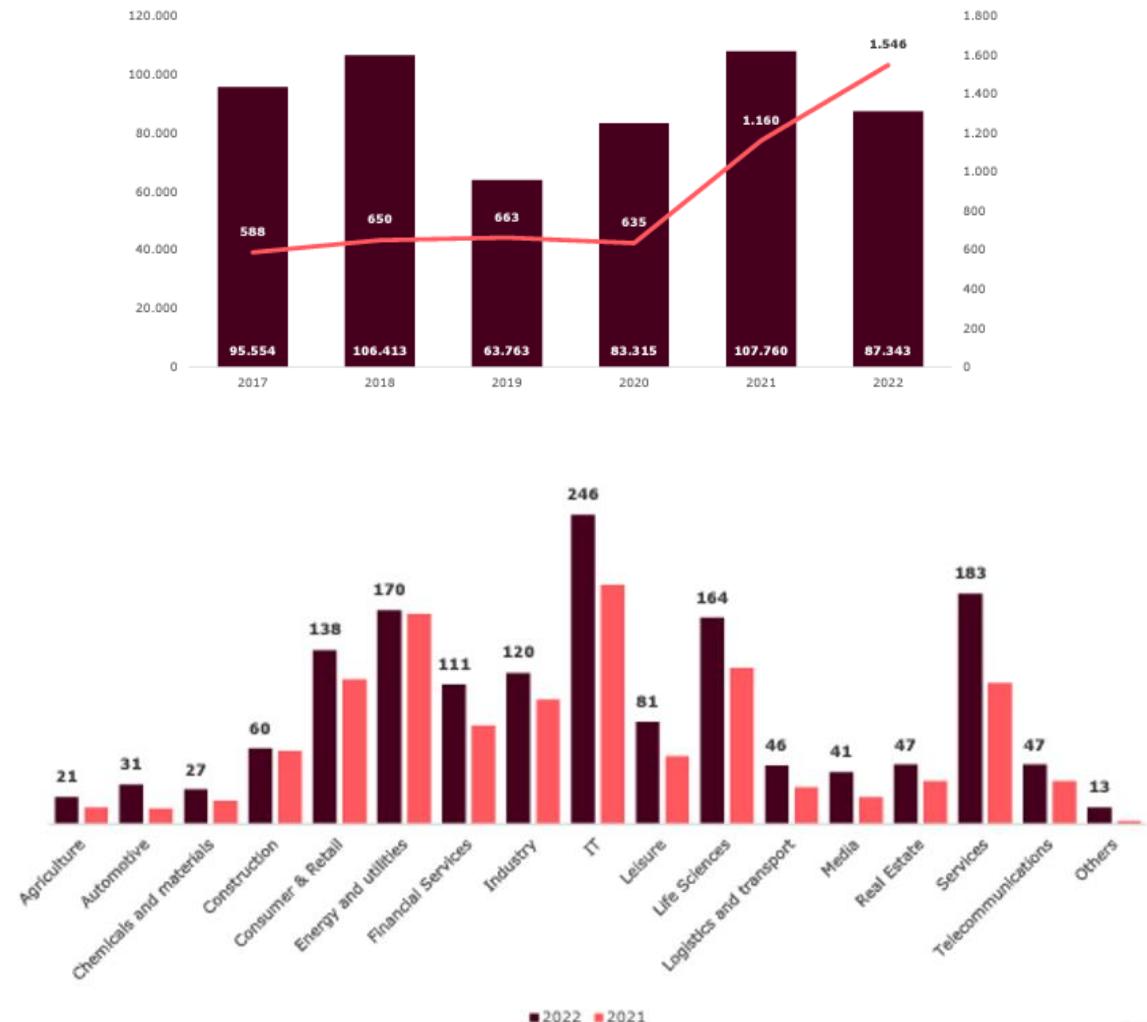




2 Spain

# Spanish M&A market 2021-2022

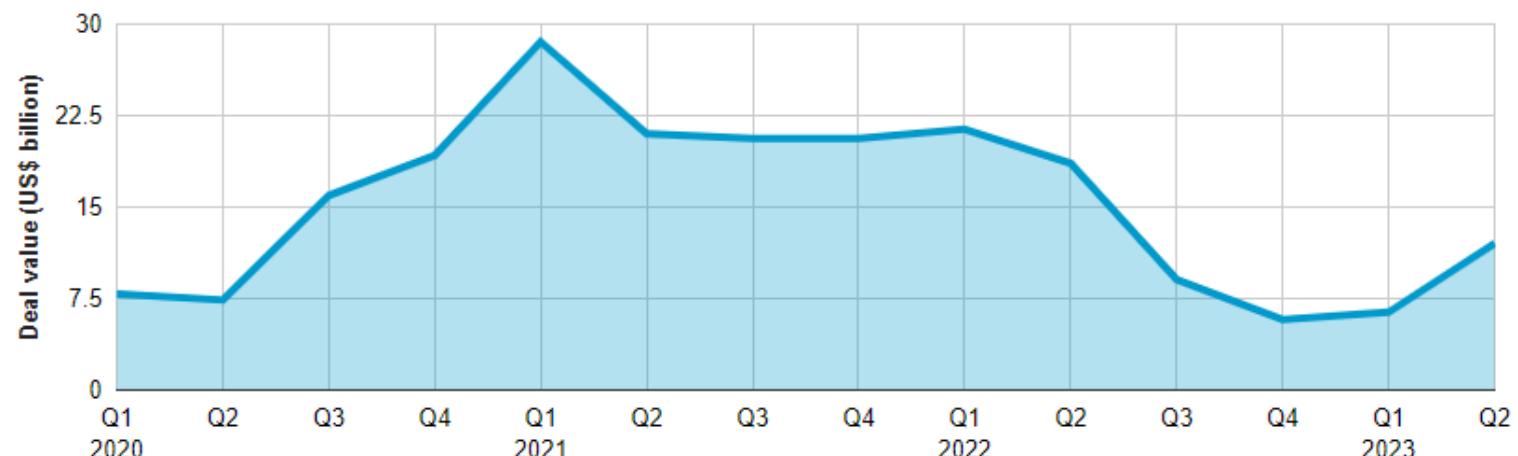
- 2021 record volumes of deals
- Slowdown in 2022 (war in Ukraine, rising interest rates, inflation, the energy crisis, etc.)
- Major drivers of Spanish M&A in 2022:
  - Private equity
  - Venture capital
  - Hotels
  - Transport and logistics
  - IT Infrastructures
  - Renewable energy infrastructures



# Spanish M&A market 2023

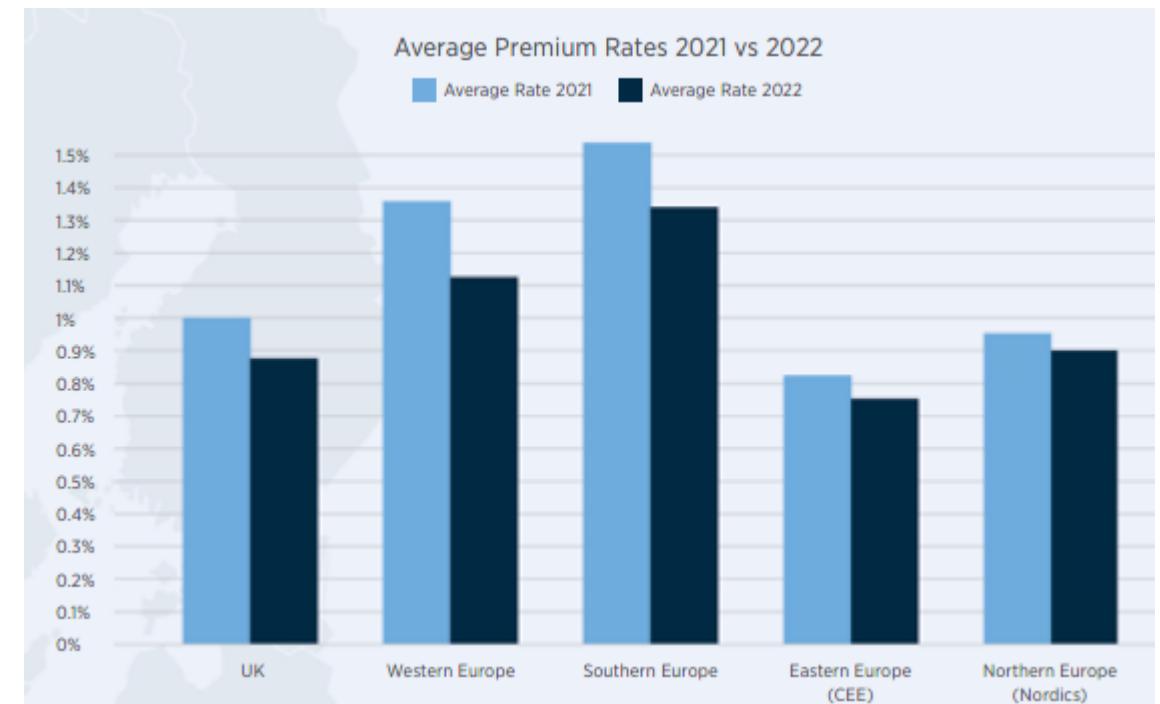
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- Difficult year: geopolitical uncertainty and continued high interest rate have caused deal flow to fall year-on-year
- Signs of M&A reactivation (21% increase in value terms)
- Trends:
  - Mid-sized deals and minority investments
  - Consolidation (e.g. insurance brokers)



# W&I – Spanish market (current situation)

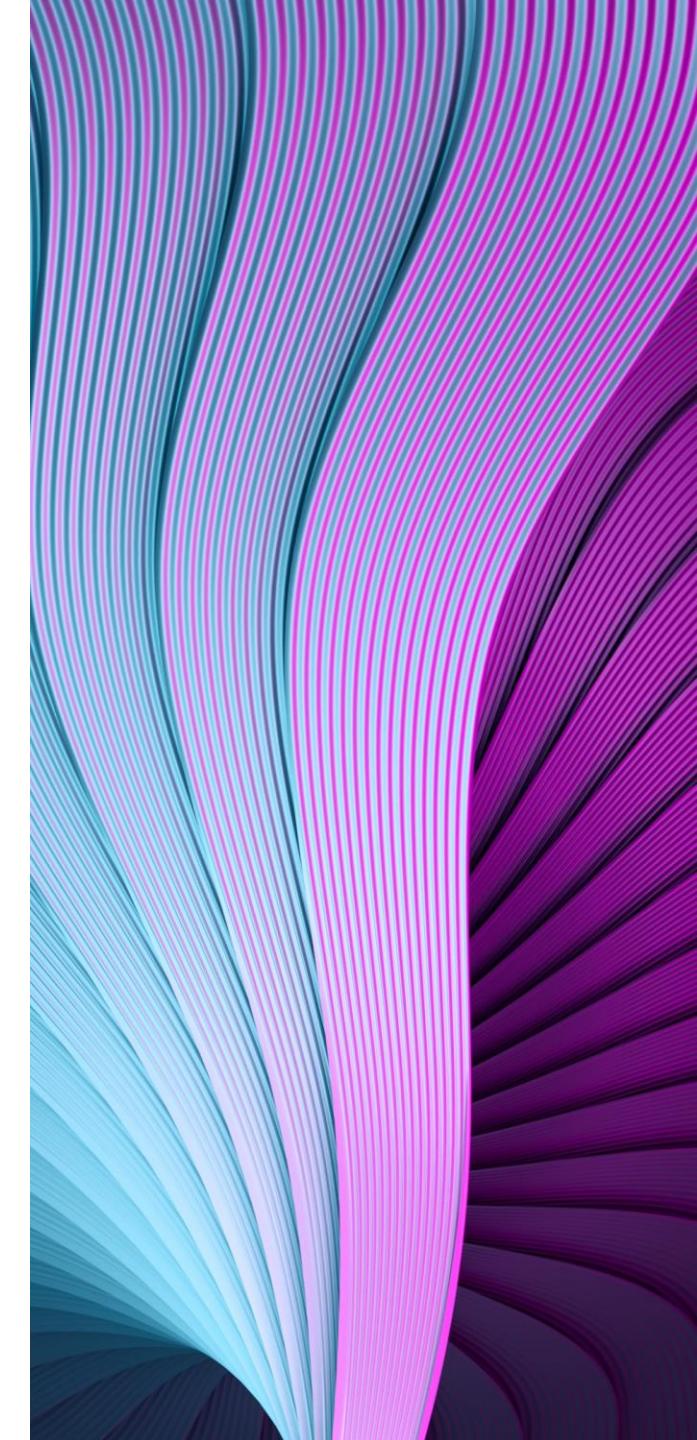
- Significant growth in total premiums during 2022 and 2023
- Mainly in transactions with EV over € 200 m
- Private equity or bidding procedure
- Reduction of premium rates
- Extension of coverage
- Initiation of “synthetic” W&I insurance policies (sellers not giving R&Ws)
- Simplification of the underwriting process
- Main cause: Clean exit, simplification of negotiations, avoid of claims among parties.



# W&I – Spanish market: Type of products

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- W&I to cover the Reps and Warranties (unknown contingencies)
- Title & Capacity
- Identified contingencies insurance (i.e. tax, data protection, administrative licenses, environmental issues, etc.) as long as there is a defence argument.
- ESG
- Insurers: more dynamic, more risk appetite, more coverage, more agile.



# W&I – Spain: Underwriting

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- Buyer side (>90%) vs Seller side
- With recourse vs without recourse (>90%)
- Policy limit: 10% to 25% of the EV
- Premium: 1 % – 1.5 % of the insured limit (one single payment on closing)
- Retention: 0,5 % – 1 % of the EV
- Scope: Similar to SPA with minor amendments on wording of the R&Ws (depending on DD works, “*To the Sellers Knowledge*”,...)
- Insured period: General Warranties 12-36 months (max), fundamental warranties up to 7 years, statute of limitation for particular issues
- Subrogation: No right for insurers to claim against sellers, except for willful misconduct (“*dolo*”) or bad faith. Buyer do subrogate (fraud or in excess)

# W&I – Spain: Scope of coverage

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## Coverage:

- Warranty spreadsheet detailing the coverage of each warranty
- Partial coverage: warranty subject to the amendments introduced by the insurer

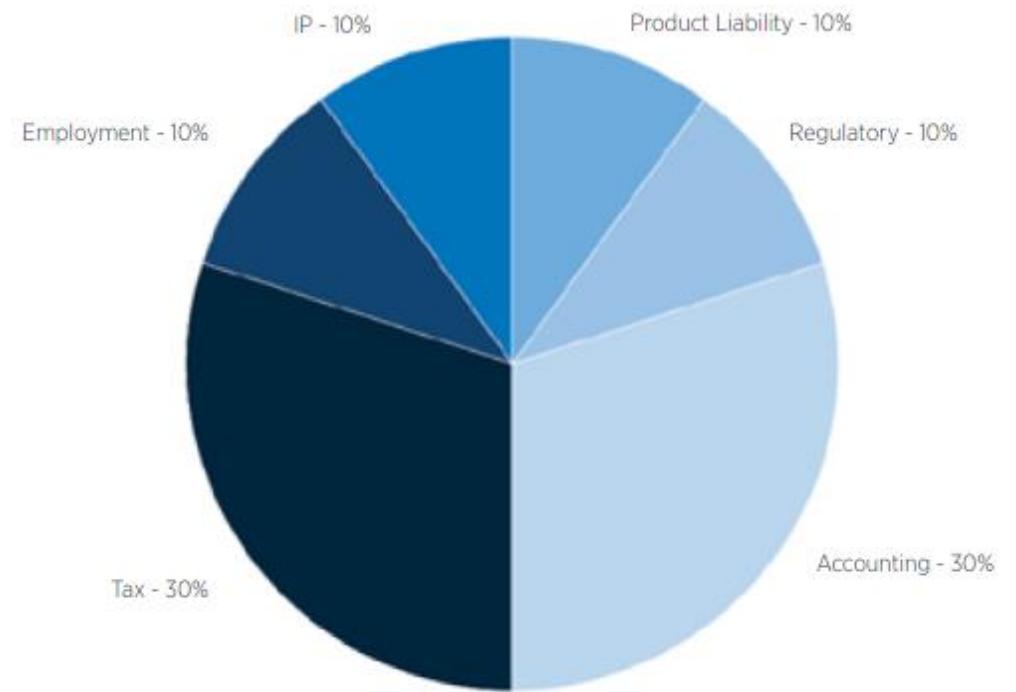
## Exclusions:

- Fraud
- Buyers' knowledge
- Non insurable under Spanish Law (e.g. fines)
- Adjustments to price (e.g. leakage, locked box)
- Others: Events occurred during interim period, issues not covered by DD, asset condition, product liability, etc.

# W&I – Spain: Trends on claims

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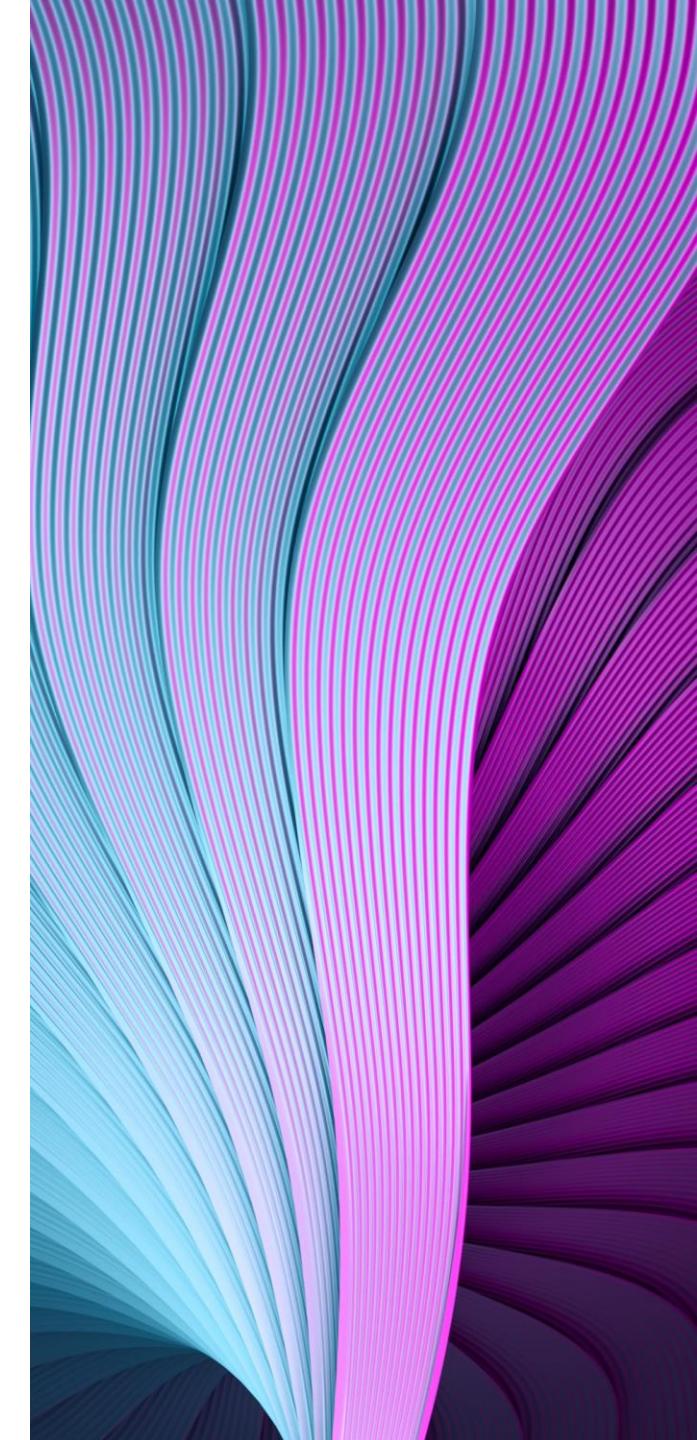
- Claims notification rates: 20% (only a 10% real)
- Majority of the claims (around 80%) resolved with coverage
- Average time between policy inception and claim notification is lengthening (from 1 year to 2 years or more)
- More claims expected during 2023 (lower DD works)
- Most common breaches in Spain:
  - Financial Statements
  - Tax
  - Regulatory, product liability, IP, employment



# W&I – Spain: Key issues on claims

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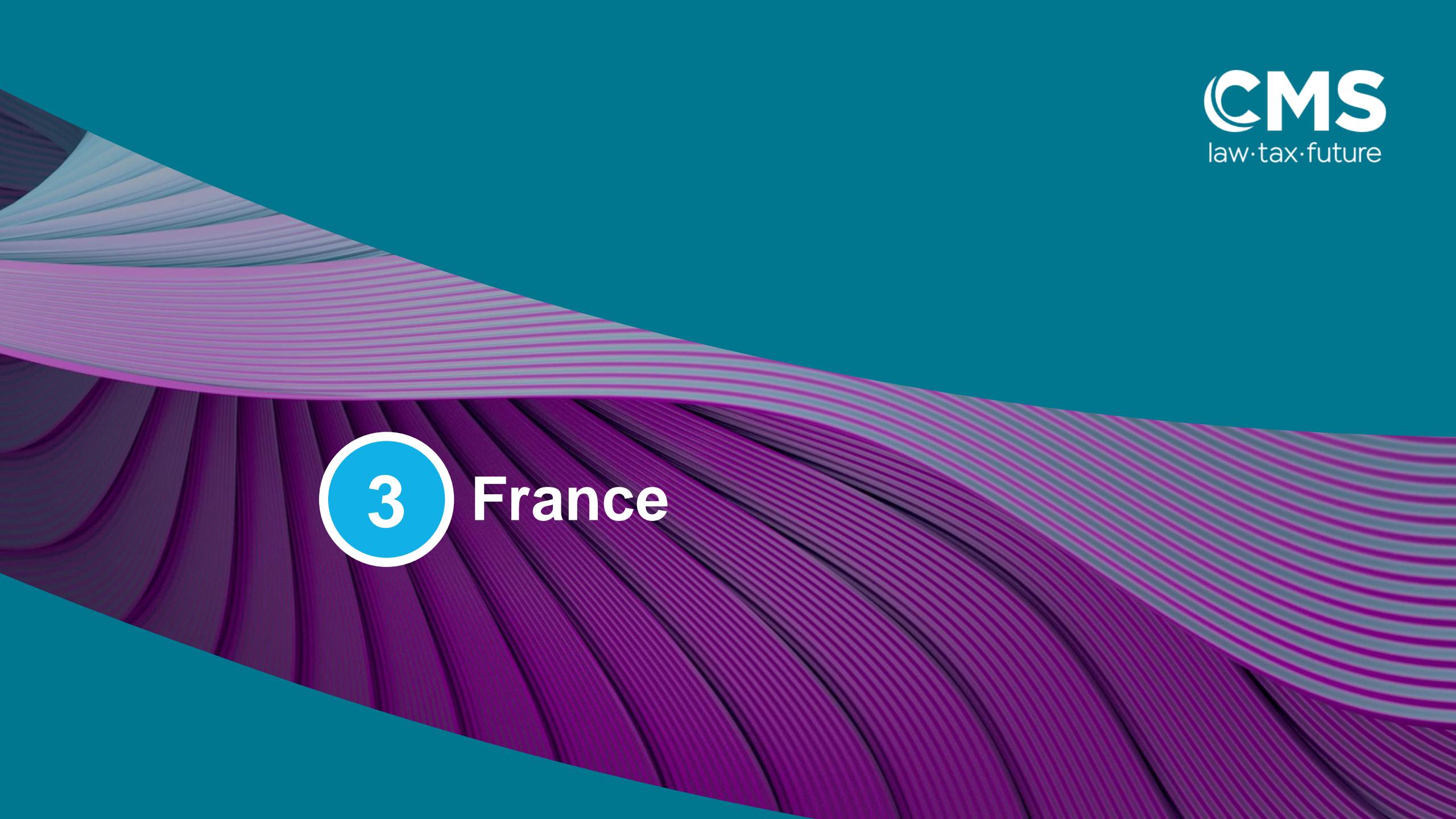
- Disclosure
  - DD materials
  - Definition of the “*Disclosed Information*” term
  - Team Members
  - No Claims declaration
  - Specific indemnities
- DD by the insurers during the underwriting
- Subrogation: Not market standard (but possible). Buyer can subrogate (fraud)
- Loss: Definition and calculation (actual damage to the Insured, genera liability insurance compatibility)
- Importance of the SPA wording (R&Ws)



# W&I – Spain: How to handle a claim?

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- Before the claim: DD works are essential (“*W&I do not substitute the DD, neither do protect the buyer from a bad deal*”).
- Participation of the broker in the claim (high expertise).
- Focus on:
  - What is warranted? What does the policy says? Exclusions?
  - Factual perspective and Loss
  - Avoid unnecessary analysis and investigations of the specific technical issue or SPA.
- Defense of third-party claims: Insurer (if covered), if not (review, kept informed, etc.). Be specific with defense strategy to avoid conflicts.
- Compatibility with liability insurance (W&I cover losses to the insured).



3 France

# W&I – French market

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- 8% drop in number of M&A deals in France in 2022 when compared to an exceptional 2021 year due to inflation, geopolitical instabilities, increased interest rates ; much higher drop in terms of value (46% drop compared to 2021) / similar drop over the first half of 2023 with increased prospects for the latter half
- W&I is now offered on the French market by 20+ providers
- W&I has ceased to be a novelty to become fully integrated to deal processes of all sizes – seen in deals as small as € 12 m
- Significant increase in the use of W&I in 2022: from 4% to 18% - now a standard consideration



*Rate of use of W&I policies in M&A deals (France), 2021 - 2022*

# W&I – Key trends W&I policies

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- Buy side policy is almost systematic (90+%), with stapling being common practice
  - Premium: typically 1% - 1.5 % of the maximum liability
  - De Minimis: usually 0.1% of the purchase price
    - interesting effect in that an increased (although still small) number of deals no longer include De Minimis provisions in W&I due to the existence of W&I insurance
  - Scope of cover: Fundamental + Tax + General warranties / usually covers “gray area” matters which cannot be properly audited within the scope of the deal
    - Standard exclusions apply, with specificity for matters for which an assessment of risk is difficult (salaries...)
  - Specific time limits to take into account; the policy may derogate from the statutory prescription periods (usually tax, labour, and social securities) + may include environmental damage due to the very long life expectancy of such a liability
- <sup>20</sup> Standard deal/business practices apply / French specificities are mainly on the insurance law side

# W&I – Legal framework in France

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- Consequences of misrepresentation or non-disclosure from the insured:
  - Intentional: Article L.113-8 of the French insurance Code
  - Non-Intentional: Article L.113-9 of the French insurance Code
    - No sanction in that case / possibility of reducing the indemnity in proportion to the premium that should have been paid had the risk be correctly assessed

It is specified that pursuant to Article L.113-8 and L.113-9 of the French Insurance Code the **Policy** shall be null and void in the event of intentional omission or intentional false statement of the **Insured**, when such omission or fraudulent misrepresentation materially changes the subject of the risk or decreases the **Insurer's** assessment thereof, even if the risk that the **Insured** concealed or distorted has had no impact on a covered **Insured Loss**. The **Insurer** shall then be entitled to the **Premium** paid.

In the event that the **Insured's** bad faith is proven only after the covered **Insured Loss** has occurred, the compensation shall be reduced in proportion to the rate of the **Premium** paid that would be owed if the risks had been truthfully and exhaustively declared.

# W&I – Legal framework in France

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*“In case of ambiguity, a bespoke contract is interpreted against the creditor and in favour of the debtor, and a standard-form contract is interpreted against the person who put it forward”*

(Civil Code, art. 1190)

- Interpretation of the contract by the judge in light of the common intention of the parties when there is an ambiguity (art. 1188 Civil Code) : (see for ex. Cass. Com., 19 June 2019, n°17-26635)
- Ambiguous contractual warranties against liability are interpreted in favour of the warrantor (CA Aix en Provence, 6 June 2017), whereas ambiguous insurance clauses are usually interpreted in favour of the insured party, unless it is demonstrated that the contract was negotiated between the insurer and policy holder (art. 1190 Civil Code) = risk of discrepancy in coverage between W&I contractual terms and W&I insurance
  - The insurer should ensure either to cover for art. 1190 Civil Code in the policy language or to ensure that negotiation takes place without an intermediary so that in a significant enough manner = numerous questions are left open, esp. when taking into account the role of intermediaries



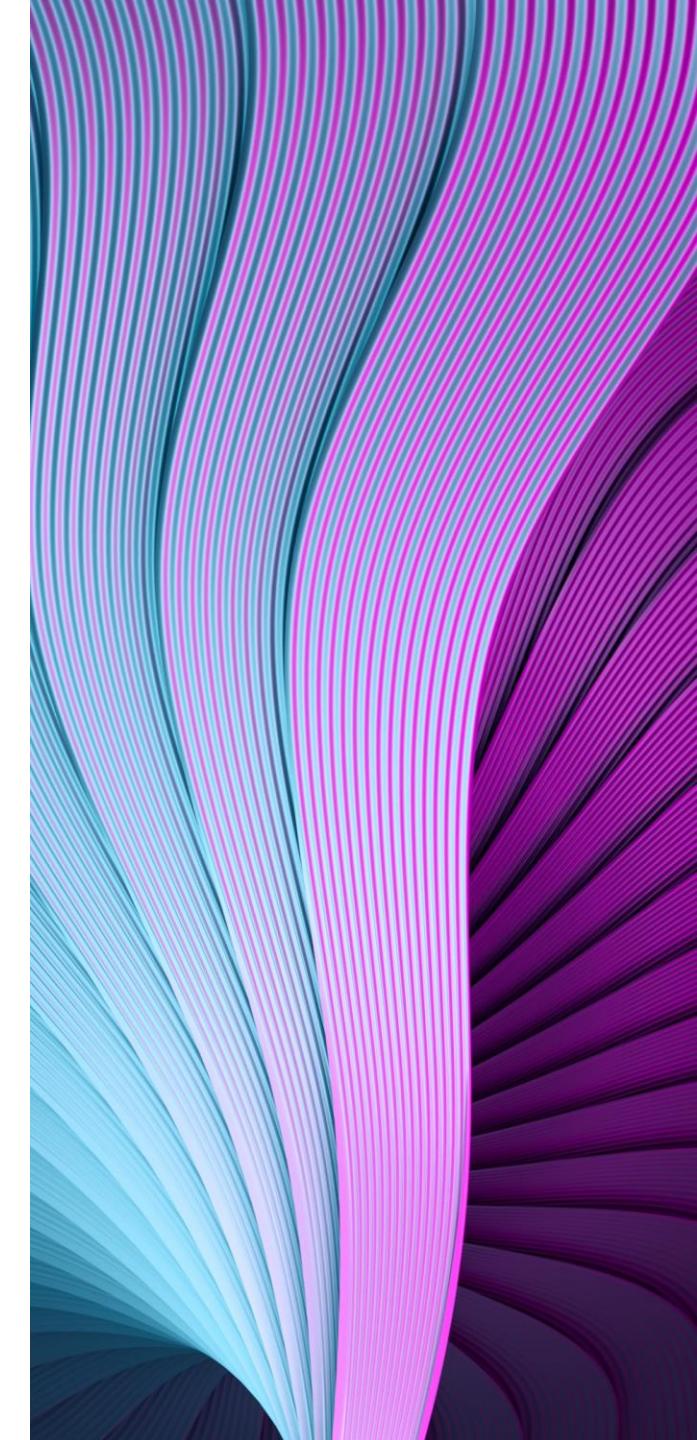
# 4 The Netherlands

# M&A trends

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- Market
  - Mixed sentiment (ample cash, high interest rates)
  - Slight increase SME deals (1-30 million)
  - Active sectors: life sciences, health care, tech and energy
- Outlook
  - General election: 22 November 2023
  - Optimism for Q3 and Q4
  - Lower interest rates as of 2024?
  - Improvement expected in 2024, especially energy

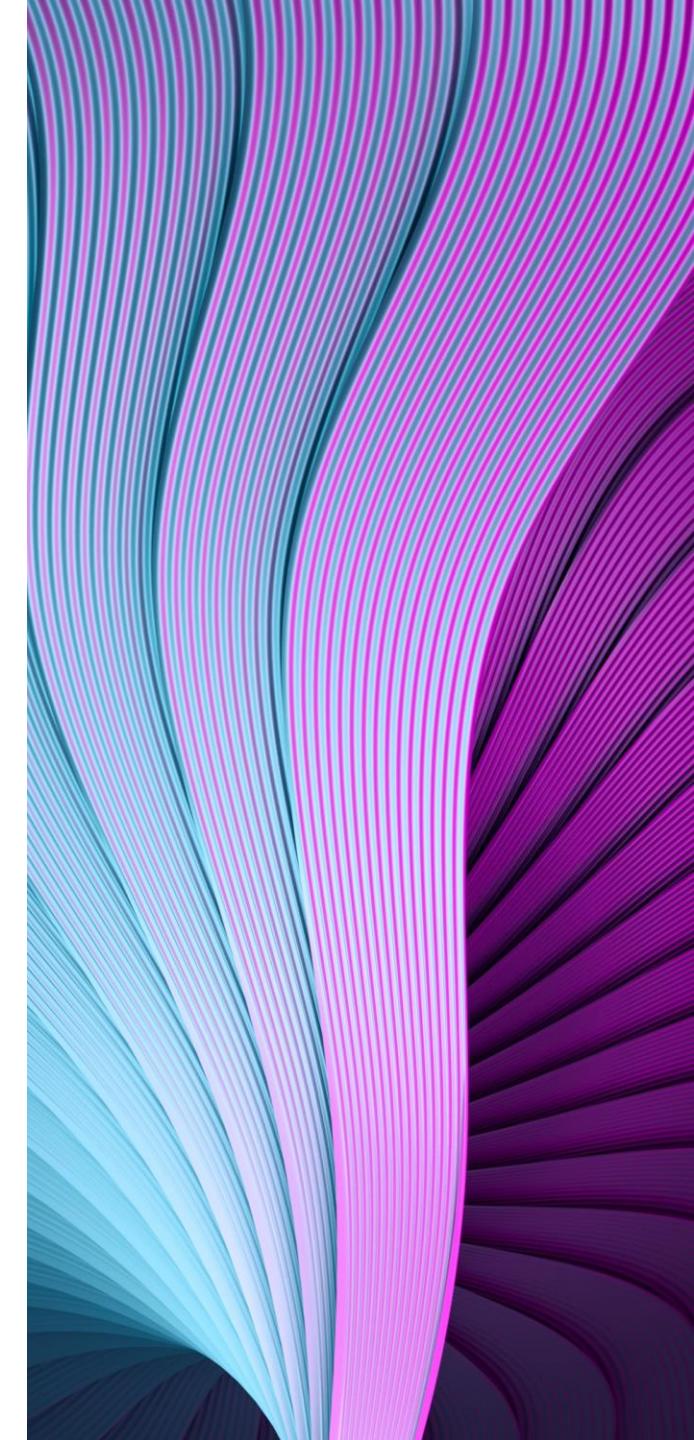
*(Also see CMS' 2024 European M&A Outlook)*



# M&A trends

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- W&I
  - Growing use – large deals, but also midcap
  - Competitive market, MGAs
  - Differences in sectors
- Hot topics
  - Tax and financial warranties
  - Exclusions – asset defect
  - Loss
- Tax Liability Policies



# Interpretation – Dutch law vs English law



- Haviltex standard
- Objective interpretation?
- UW file!
- London market usage



- Ordinary language
- Ambiguity? Other facts
- Importance specific wording



# Disclosure

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## General principles under Dutch law

- Article 7:928 – 7:930 DCC (not mandatory)
- Disclosure of (objectively) material facts
- Policy holder, but also insureds

## Sanctions

- Two month period!
- Proportional reduction, other conditions or no cover at all
- Fraud?
  - No cover, also termination contract
  - again two month period

## Burden of proof

# Disclosure in W&I policies

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Which warranties are covered under the policy?

The insured grants to the insurer:

- access to data room
- copy of the DD reports
- copy of the draft of the SPA



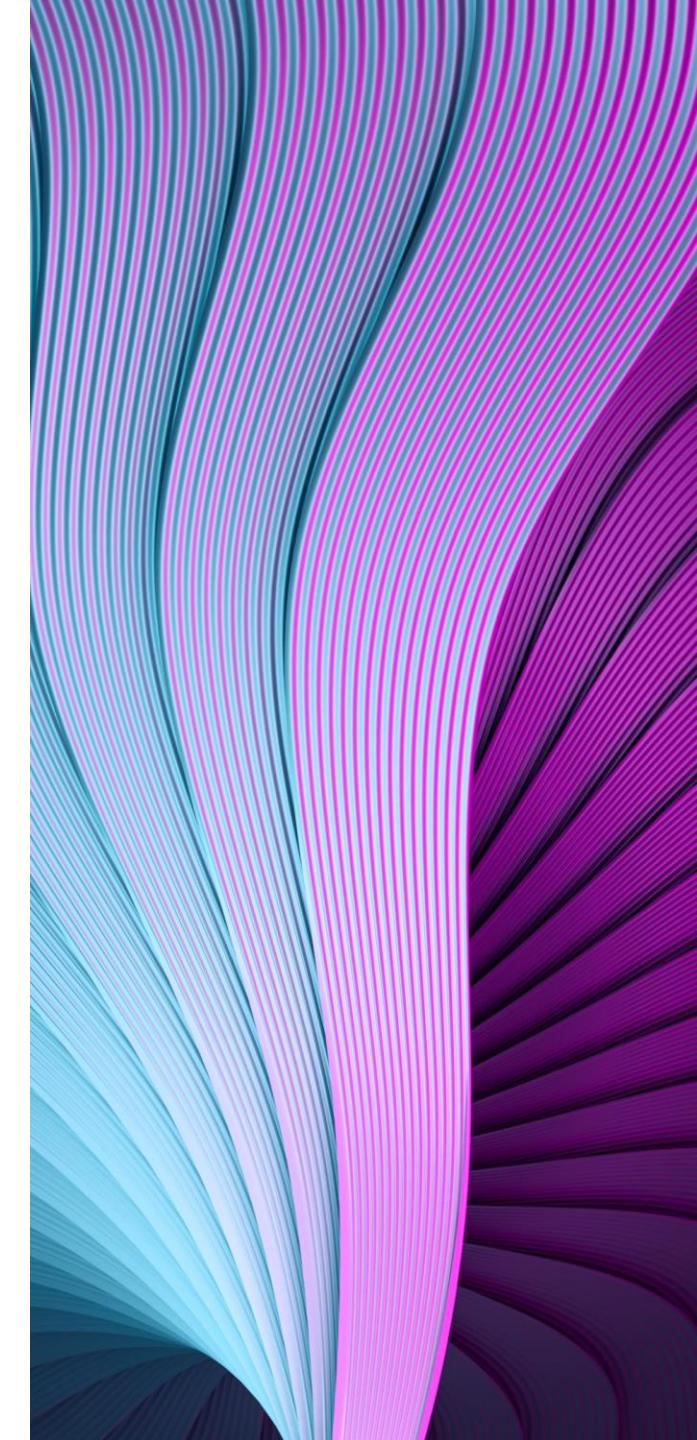
Innocent Non-Disclosure

Re-investing shareholders

# LOSS

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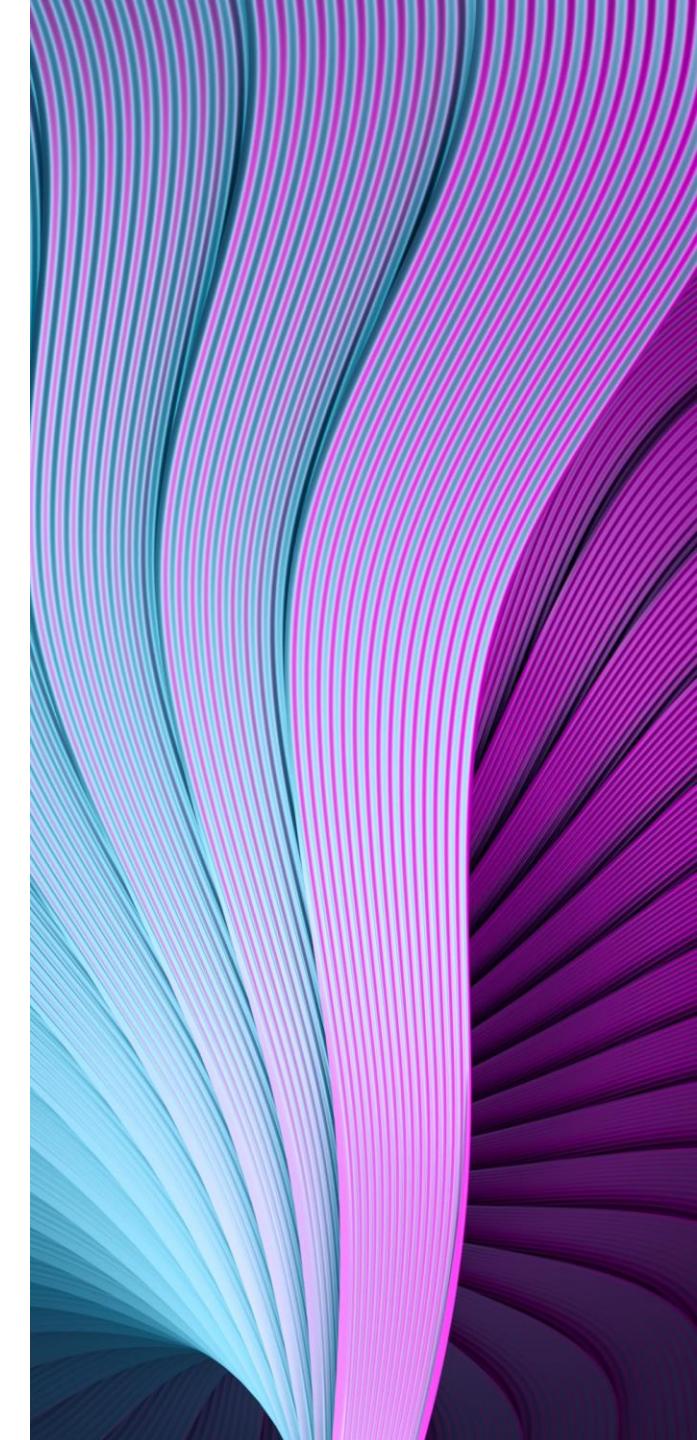
- 6:95-110 DCC. Broad scope, not mandatory
- Provisions SPA vs Policy
- Derivative loss?
- Purchase price?
- W&I vs Tax Liability

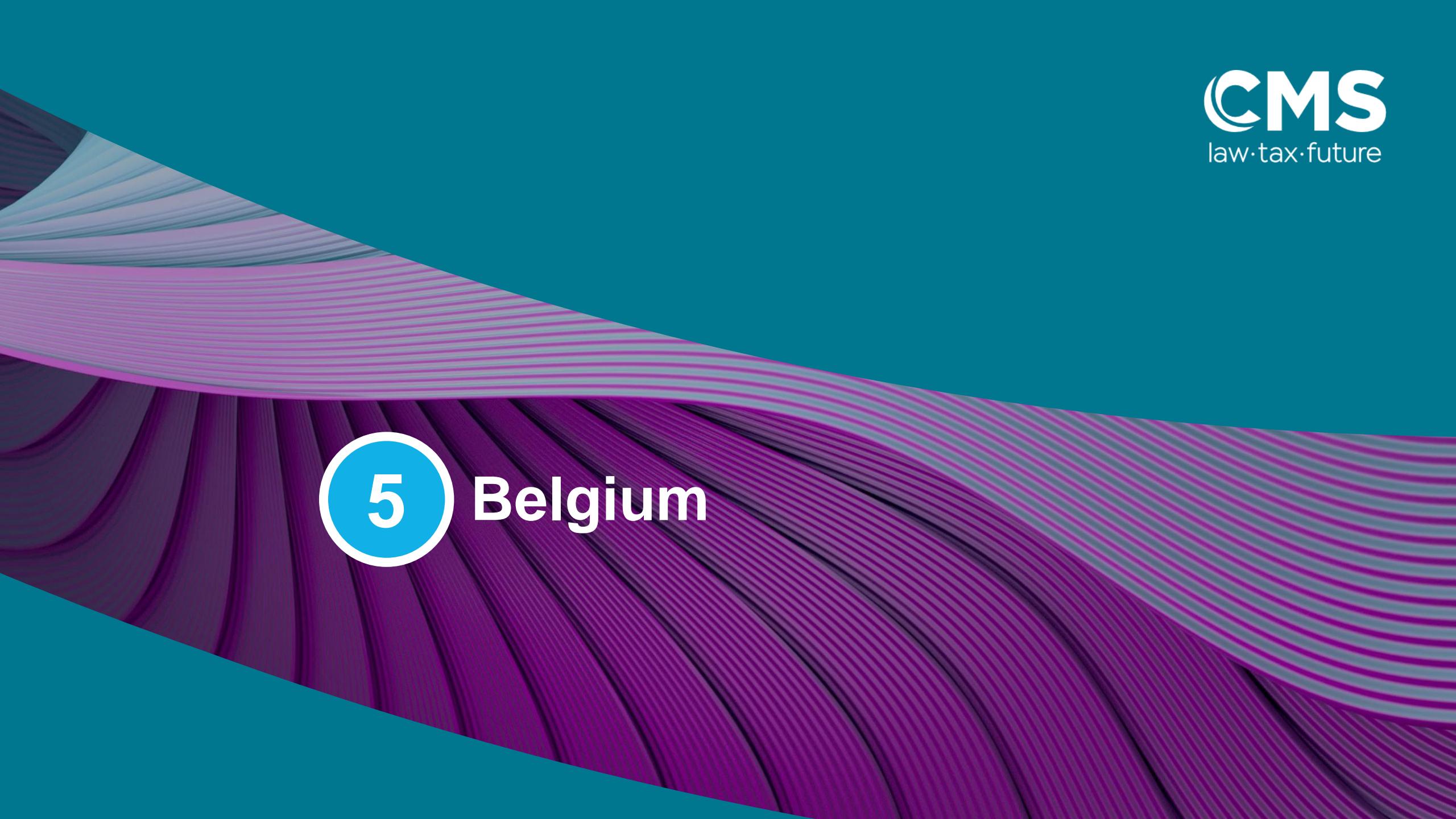


# Practical issues

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1. Address loss and quantum at an early stage
2. Importance of contemporaneous valuation evidence
3. Additional evidence / information
4. What legal and expert input necessary?
5. Terms of the SPA and W&I policy





5 Belgium

# W&I – Belgian market

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- Belgium is mainly an open SME-driven economy with many solid family-owned companies. As a result, the M&A landscape is slightly different from other (especially larger) European countries. Given the size of the Belgian economy and companies, the majority of M&A transactions are small or mid-size transactions.
- In terms of sectors, most of the M&A transactions, as well as the highest EV/EBITDA multiples, are seen in the knowledge-intensive industries such as (in order of priority):
  - technology
  - pharmaceutical industry
  - healthcare and biotech
  - the real estate sector (low risk profile)
  - services (cf Degroof Petercam)

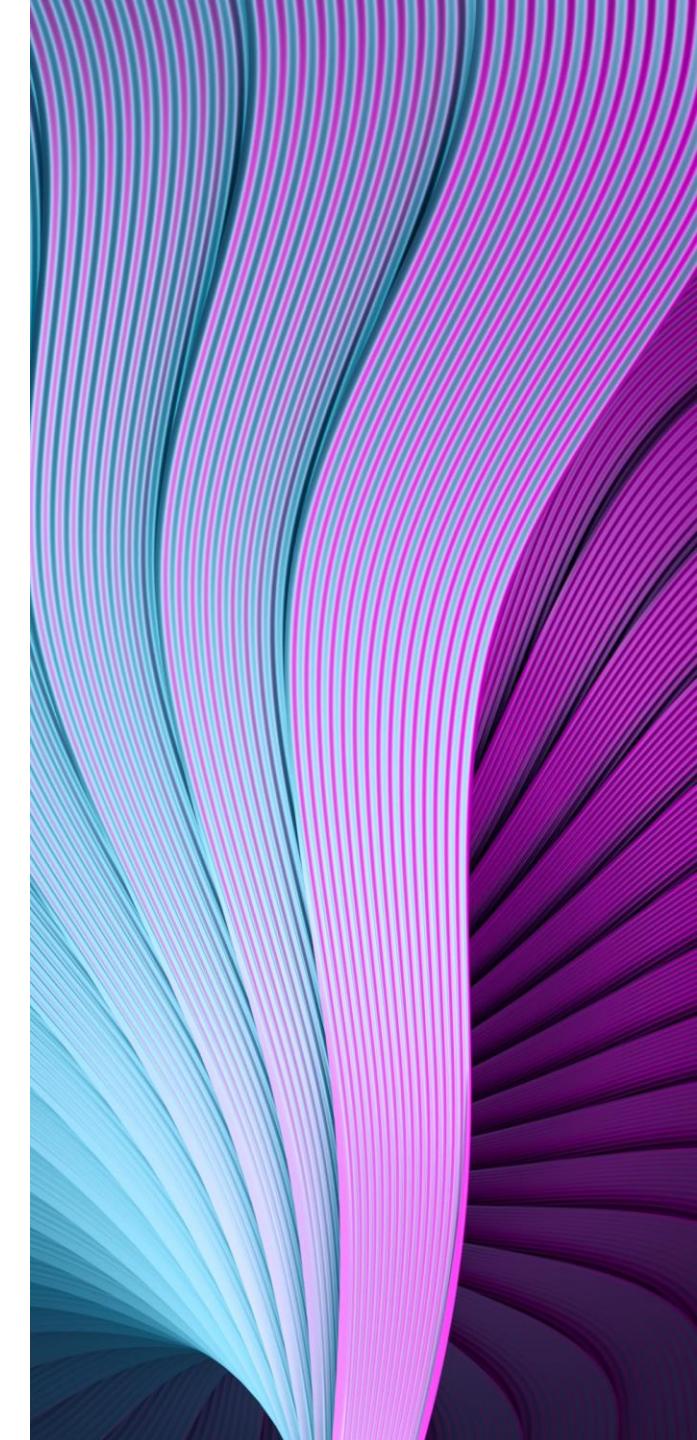
# W&I – Belgian market

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The popularity of W&I insurance has grown significantly over the last five years – although its application stabilised in 2022 at 32%. W&I cover is prevalent primarily in large deals with values over € 100 m with W&I cover being obtained for 58% of those deals. The level of cover purchased varies, although a significant proportion of deals (nearly 40%) had cover of an amount equivalent to more than 30% of the purchase price.

Benelux deals – more and more use of W&I insurance – popular for PE exits and high value deals.

*CMS M&A Study April 2023*

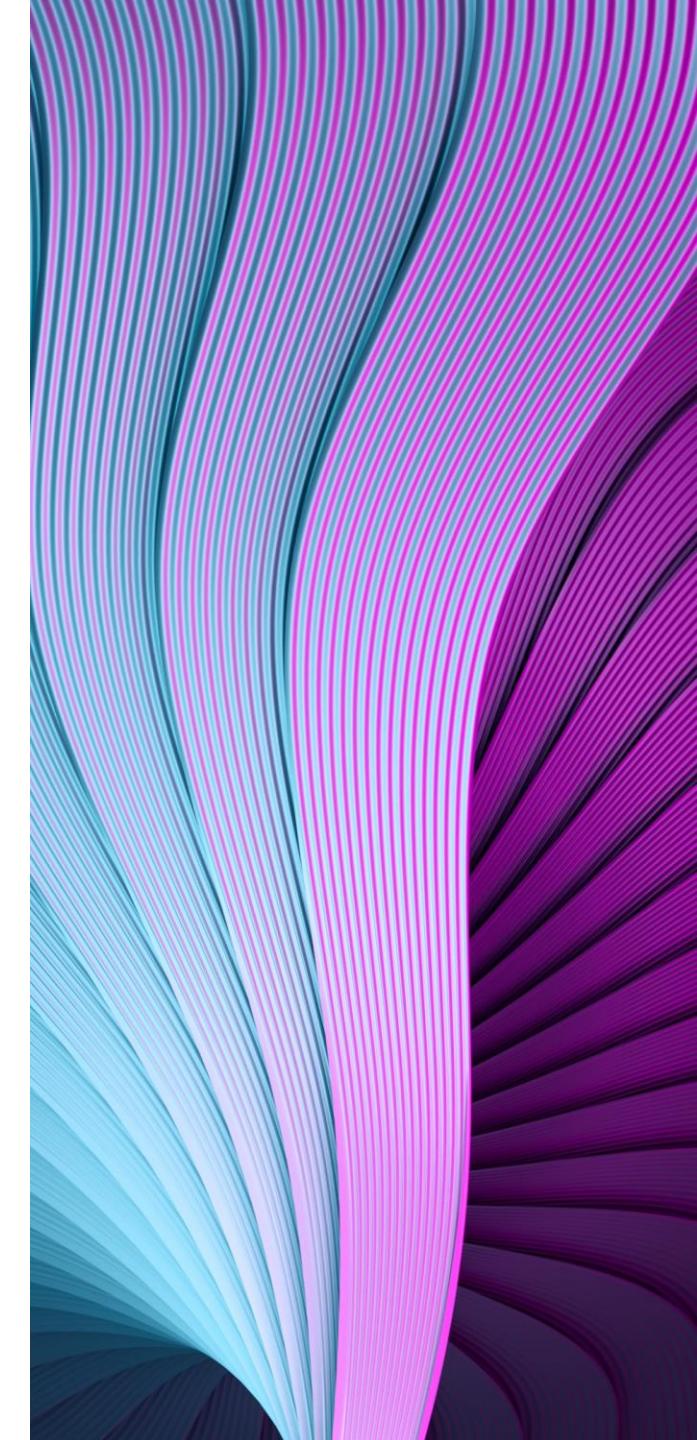


# W&I – Types of products

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Warranty and indemnity insurance will provide cover for issues that are unknown at the time of the policy's inception, however, other M&A insurance cover can be made available for certain known risks:

- Tax: A specific tax risk policy for identified tax risks that fall outside the scope of cover of W&I policies
  - Title & Capacity: Title insurance policies are designed to provide cover for a wide range of both known and unknown title related matters.
  - Contingent Risks & Cash Release (for example when litigation exist but disagreement on likely liability)
- <sup>34</sup> Environmental risk policy



# W&I – Key trends W&I policies

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- Buy side policy is customary
- Policy limit: Typically 10% to 30% of the Enterprise Value (EV)
- Premium: Typically 0.9% - 1.3% of the policy limit for operational deals and 0.6%-0.8% for real estate transactions
- De Minimis: Typically lower than under the SPA but always subject to the materiality thresholds applied in DD
- Scope of cover: Full set of warranties and tax indemnity - standard exclusions apply (known facts, forward-looking warranties, pension underfunding, fraud of the insured or key deal team member, construction defects (real estate deals), asbestos / environment for real estate deals, secondary tax liabilities, transfer pricing, tax evasion schemes)
- Survival period: 7 years for fundamental and tax and 2-3 years for business warranties

# Belgian legal framework - Subrogation

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## Belgian Insurance Act

### Article 95 – The insurance company's right of subrogation :

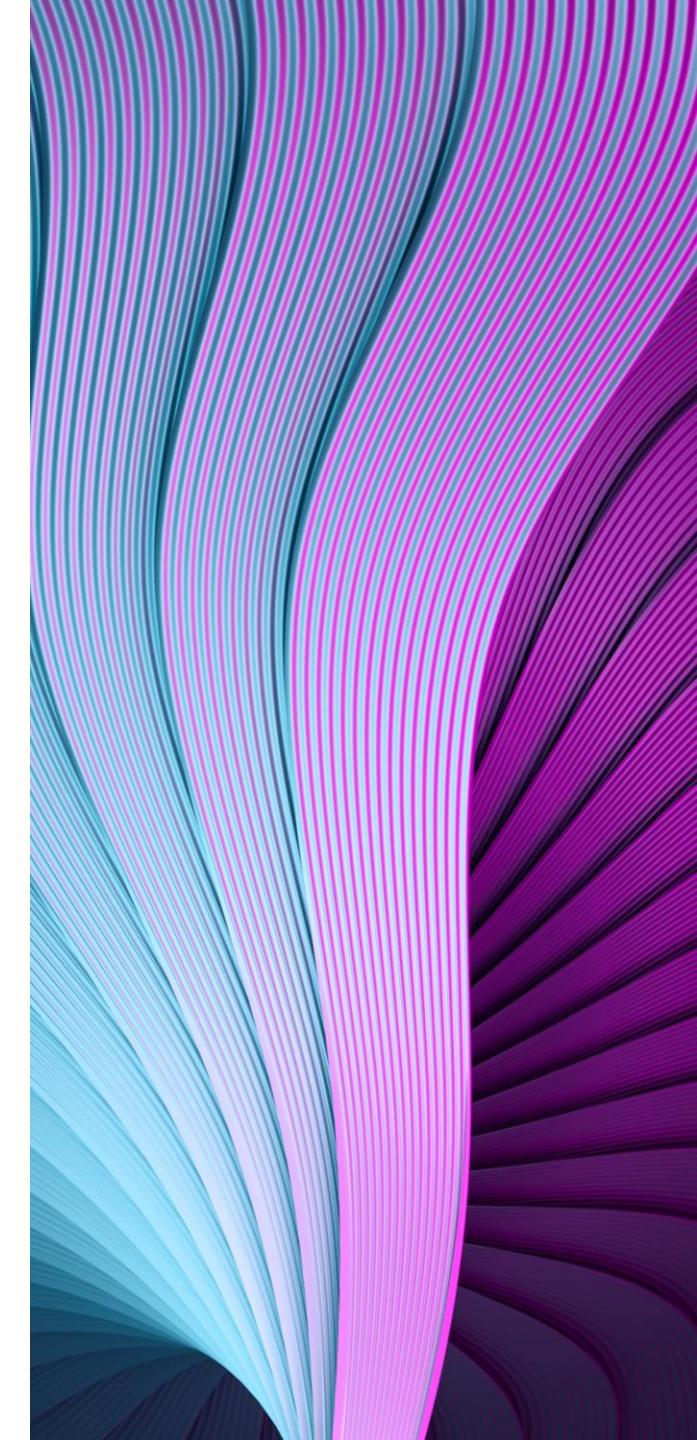
*“The insurer that paid the compensation shall, to the extent of the amount of such compensation, enter into the rights and legal actions of the insured or the beneficiary against the liable third parties.”*

- The importance of the policy specifying that the insurance company waives their right to recourse against the sellers.
- What about advisors/auditor?
- Exception: fraud or willful misconduct

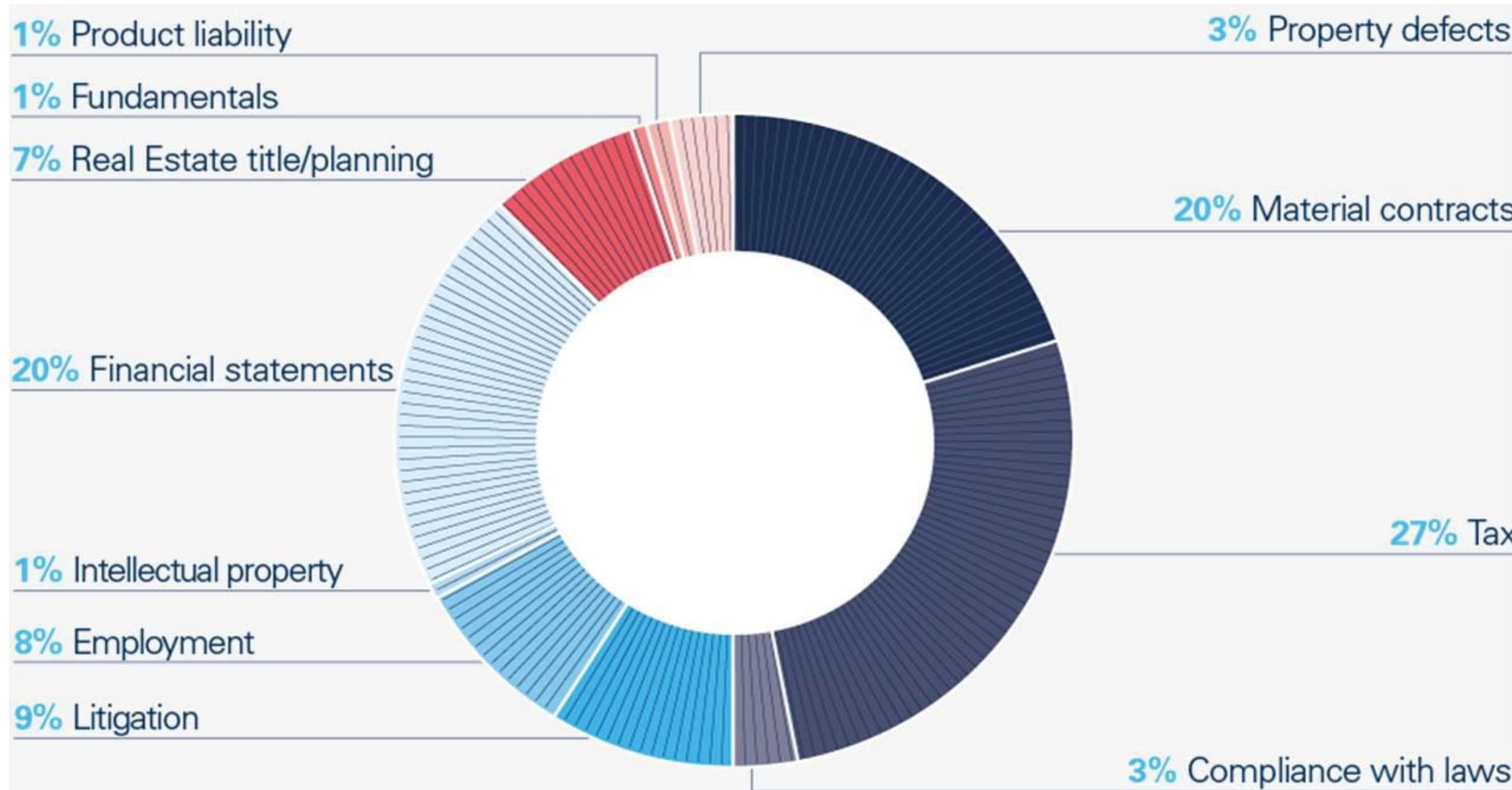
# Belgian legal framework - Disclosures

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- Mechanisms to be agreed upon contractually – interpretation rules (civil code) vs insurance policies (insurance act) to be kept in mind
- Disclosure mechanisms:
  - Common practice to accept disclosure of Data Room/Public Information
  - Common practice to request seller to confirm that the deal team members have no knowledge of a breach of warranties
  - Definition of disclosure – fair disclosure



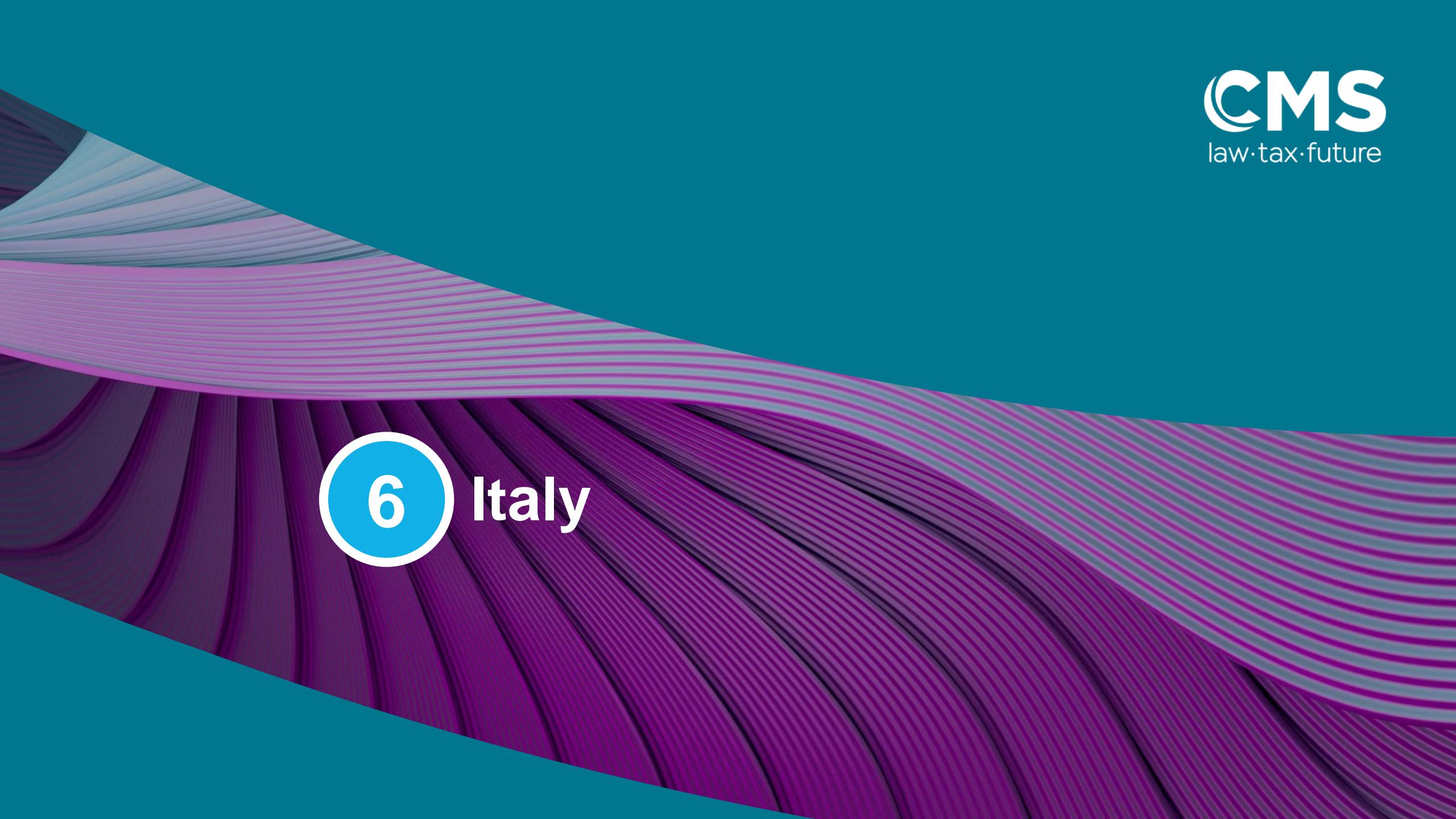
# Claims & trends



# Claims – Key issues

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- Disclosure
  - DD
  - Constructive and imputed knowledge
  - Materials and exchange of information
  - Need of financial advisors
- Loss
  - Definition
  - Did Buyer actually suffer loss?
  - Use of multipliers (!)

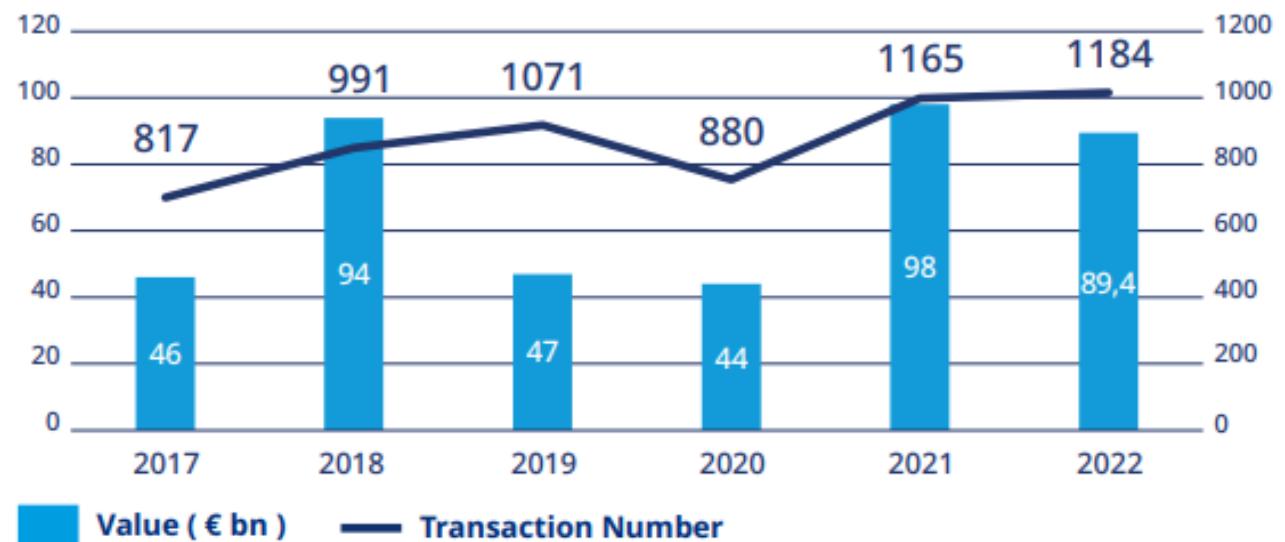


6 Italy

# Italian M&A market 2022

- 2021 record volumes of deals
- M&A activity remained stable (more deals, lower value) in 2022

## 01| Italian M&A market



Source: 1 EY "M&A Barometer - Review 2022 e preview 2023";  
2 PWC "Global and Italian M&A Trends 2022 e Outlook 2023";  
3 KPMG "Mercato M&A in Italia, trend, scenari e prospettive"

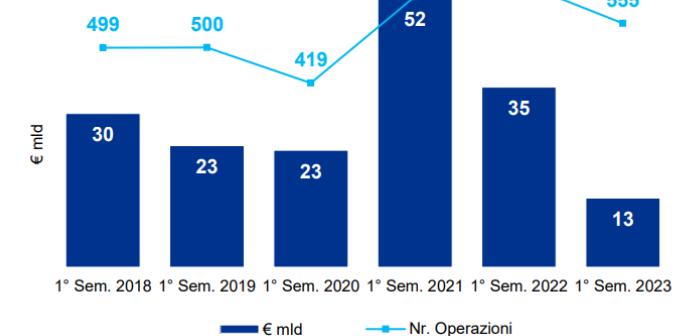
# Italian M&A market 2023

M&A activity experienced a reduction in first semester 2023



Main sectors active in the first half of 2023:

- Consumer Markets
- Industrial Markets
- Energy & Utilities
- Financial Services
- TMT



# Transactional Risk Insurance – Italian market

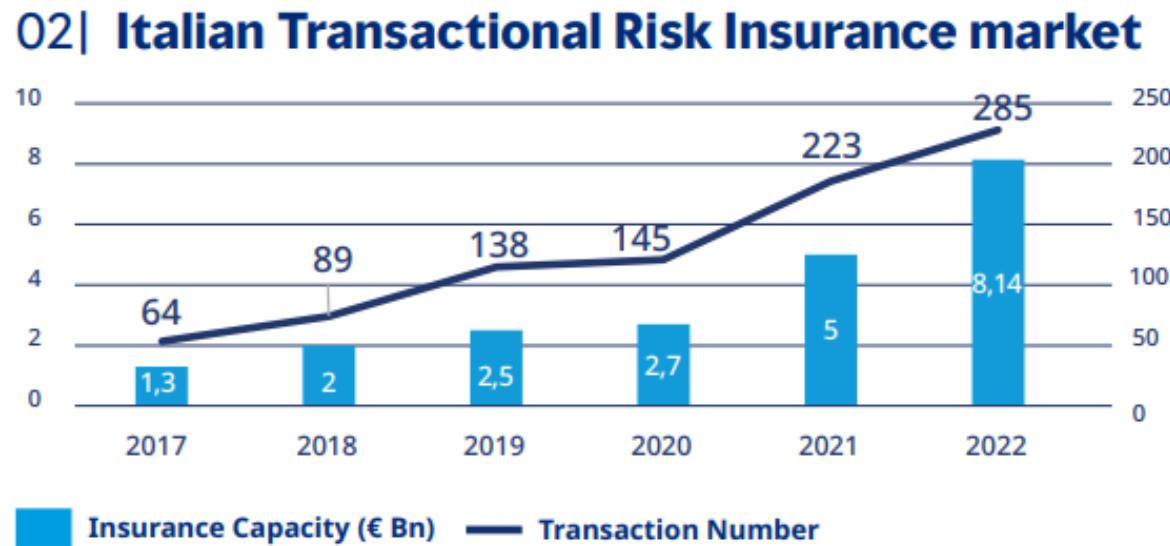
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Type of product:

- W&I
- Contingent Special Risks policies
- Litigation Buy-out policies
- Tax Liability policies

# Transactional Risk Insurance – Italian market

- The Italian Transactional Risk Insurance Market has proven to be one of the fastest growing in Europe, with a 22% increase in policy count and total capacity placed almost doubled compared to 2021.
- The number of policies has increased by 45% year on year, from 151 in 2021 to 219 in 2022.
- The growth of the TR market has been driven by Private Equity in 2022 after several years where the market was almost balanced between Private Equity and corporations.
- In terms of sectors, operational deals took the largest share in terms of deal count, followed by real estate, then energy and infrastructure.



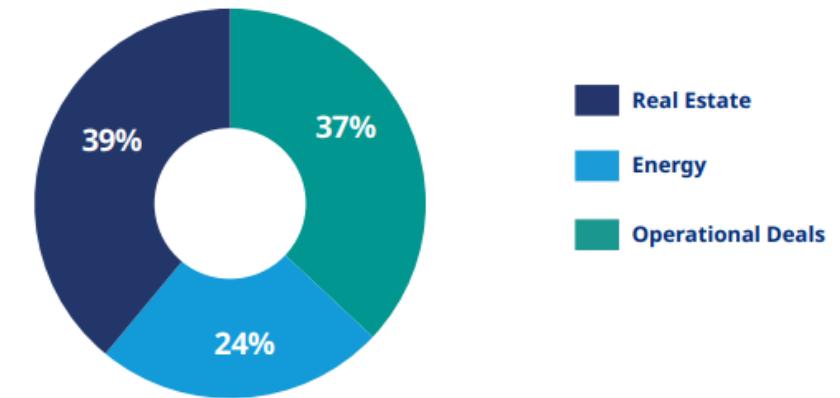
*Source: Marsh Survey that has been sent to Carriers that have participated in the report elaboration.*

# W&I – Italian market

## 03 | Italian Market Numbers

Italian Market Numbers	2021	2022	% of change PY
Total Policies	151	219	+31.93%
Total Market Underwritten Limit	2,430,186,420	3,770,274,707	+50.02%
Total Premium	32,107,033	56,575,134	+74.31%
Average Limit Per Policy	16,093,949	17,215,866	+6.97%
Average Premium Per Policy	212,629	258,334	+32.12%
Average Rate on Line	1.32%	1.49%	+13%

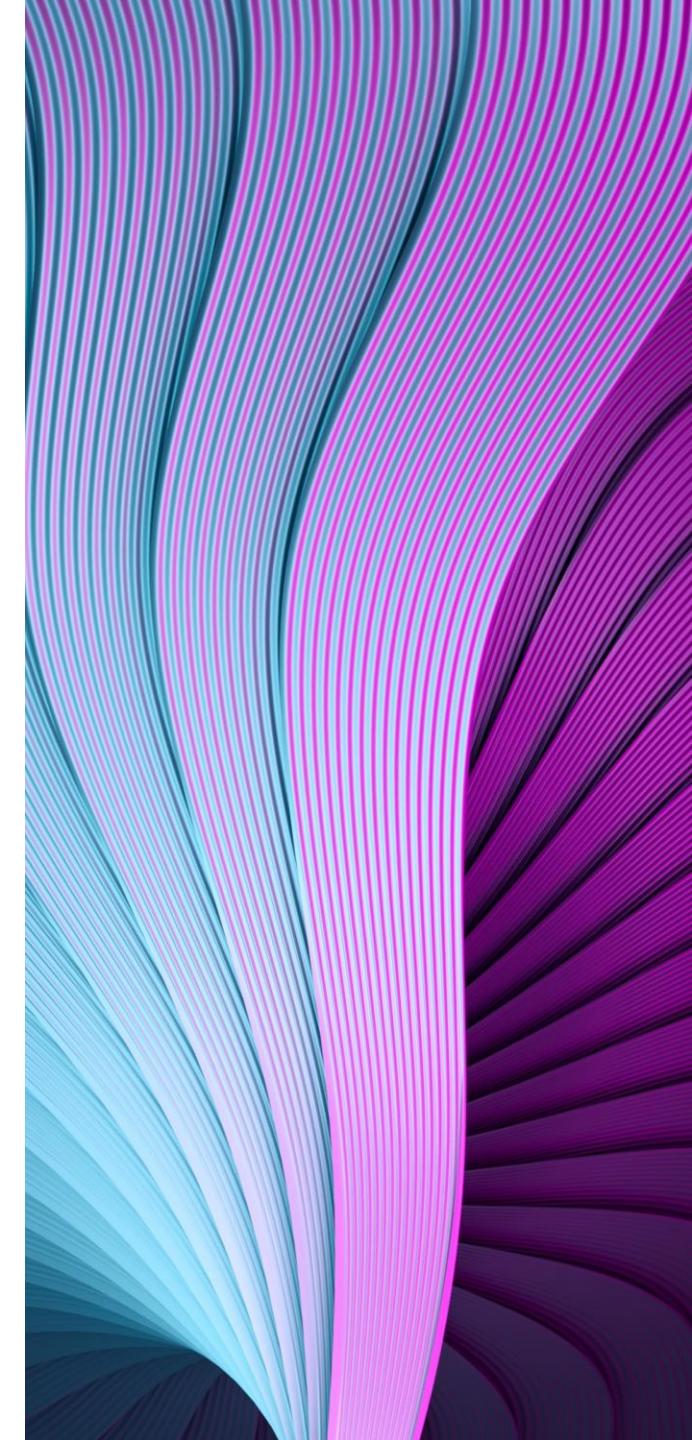
## 05 | Sector Breakdown on Deal number



# Italian legal framework

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- No specific regulation on W&I
- ISVAP Regulation No. 29/2009: an interpretation issue
- IVASS clarification – July 2019: W&I are allowed under certain conditions!



# Italian legal framework - Disclosure

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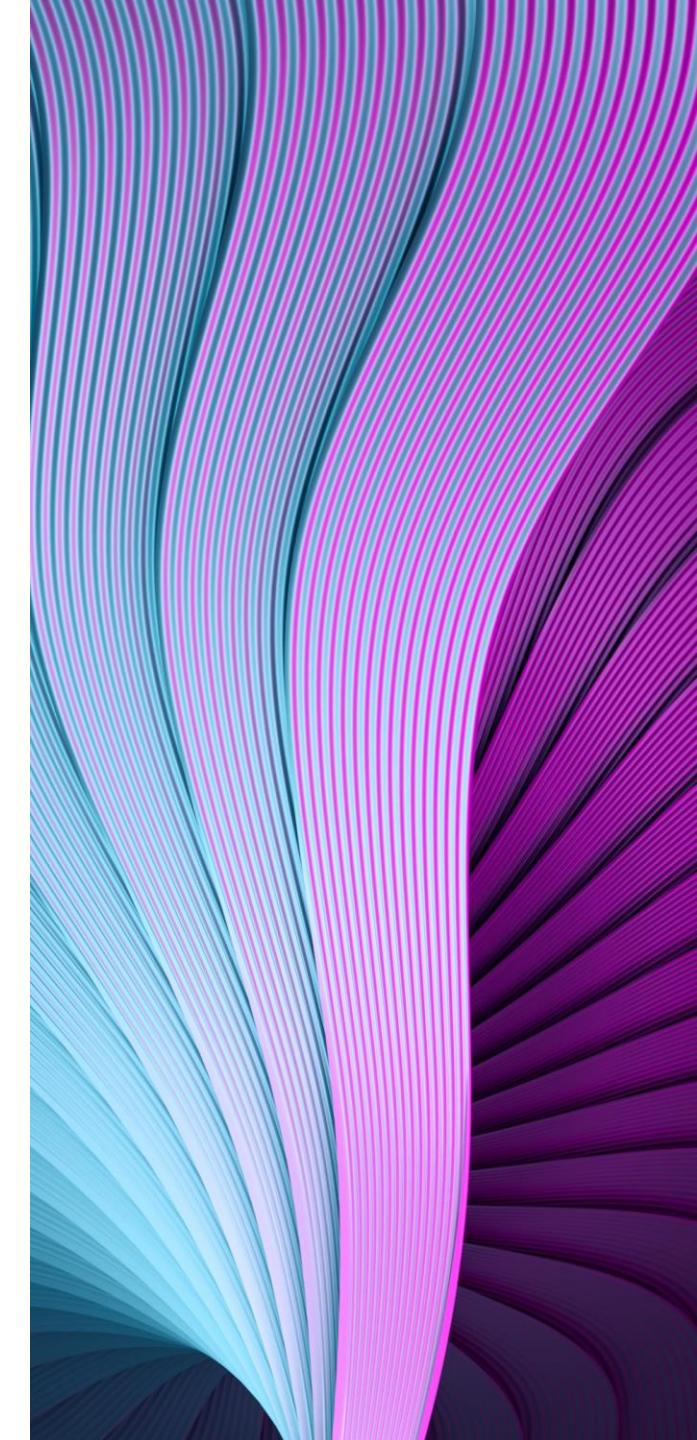
General principles under Italian law

- Article 1892 of Italian civil code
- Article 1893 of Italian civil code

What happens in the event of reticent or inaccurate declarations by the insured?

- Annulment of the contract / Denial of coverage (fraud or gross negligence)
- Termination of the contract/ Proportional reduction of the indemnity (no fraud nor gross negligence)

Who has the burden to prove the misrepresentation?



# Italian legal framework - Subrogation

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## Legal subrogation

Article 1916 of Civil Code: «*The insurer who has paid the indemnity is subrogated, up to the amount of the indemnity, to the rights of the insured against liable third parties*»

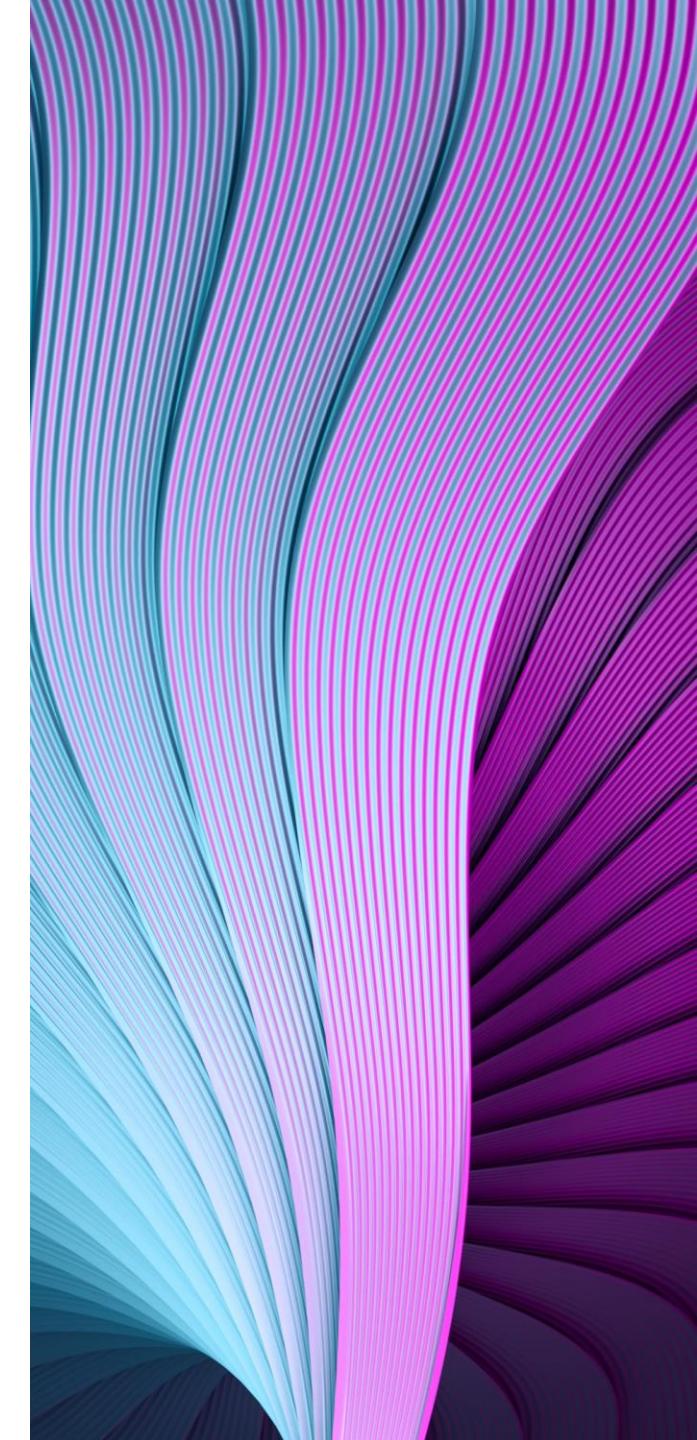
## Conventional subrogation

The parties usually limited the cases of subrogation to Seller's fraud or gross negligence.

# W&I – Italy: Trends on claims

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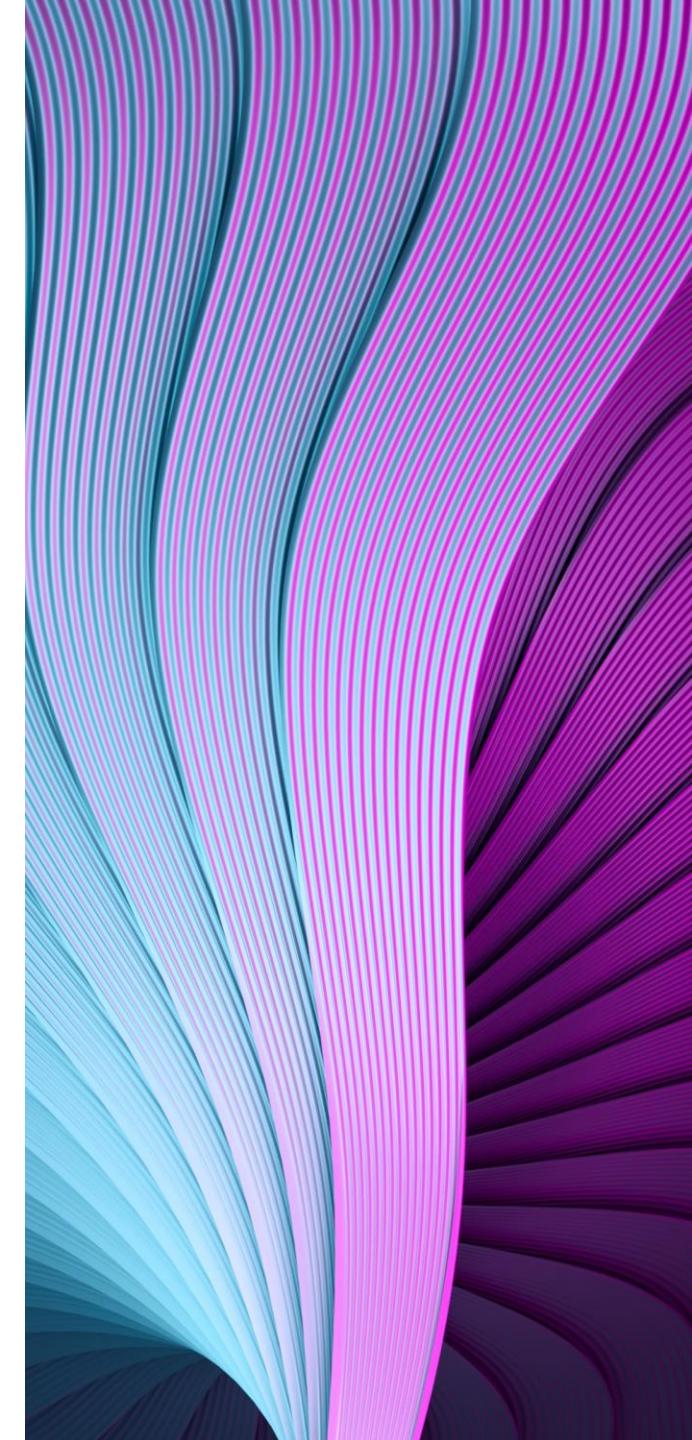
- The number of new M&A disputes decreased in the past two years, with most cases involving small and medium-sized M&A deals.
- Parties usually prefer arbitration, and frequent recourse to arbitration implies that important decisions may remain confidential and not publicly available. Rulings by arbitral tribunals are generally faster than decisions in ordinary litigation before Italian courts.
- Breach of representations and warranties is by far the most frequent source of M&A litigation. Indemnification claims run the full gamut of business warranties (e.g., alleging inaccuracies in the financial statements or undisclosed litigation, non-compliance with laws, infringement of third-party intellectual property rights, labour, tax or environmental liabilities).



# W&I – Italy: Trends on claims

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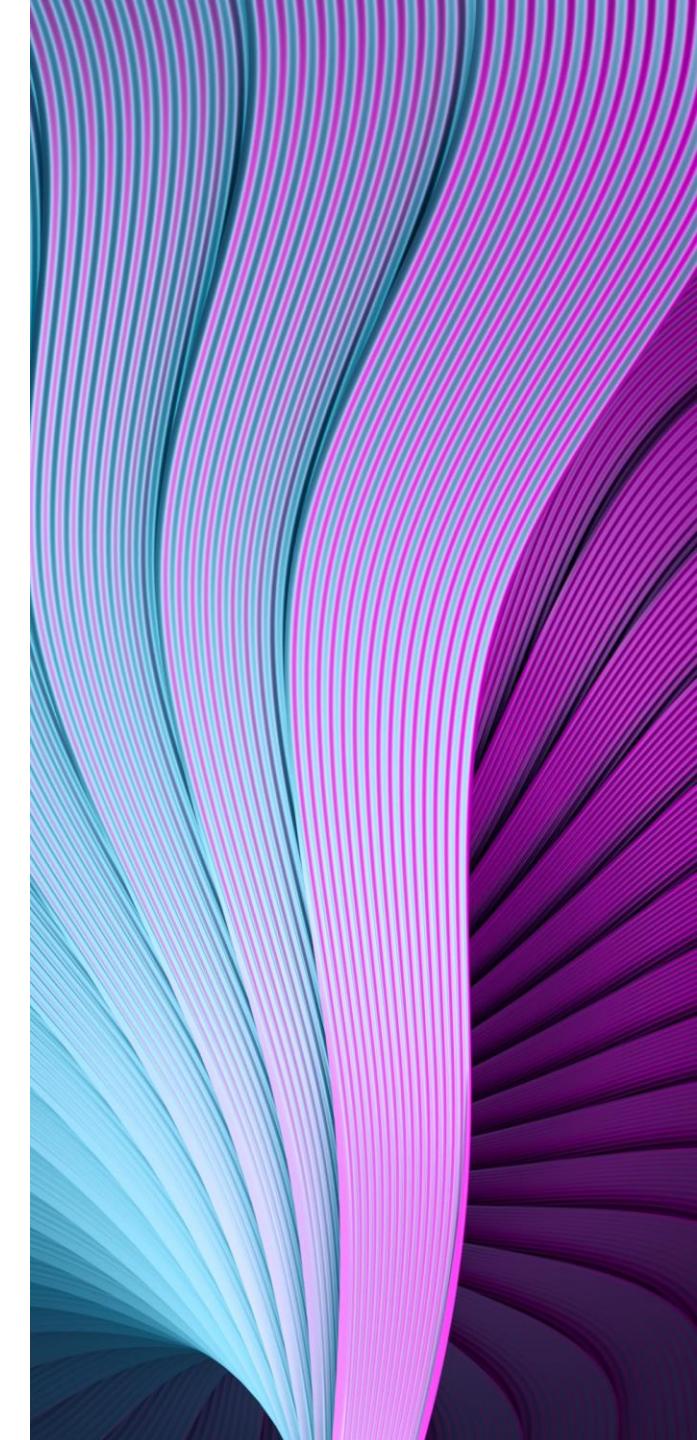
- Average time between policy inception and claim notification is lengthening (from 1 year to 2 years or more)
- Low claim notification rates compared to other jurisdictions (3.6 % in 2022; 6.7 % in 2021)



# W&I – Italy: Key issues on claims

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- Breaches related to known or disclosed matters
  - ✓ Article 1895 of Italian civil code: inexistence of the risk
  - ✓ Specific exclusion provided by the policy wording
- Loss: Definition and calculation
- Importance of the SPA wording (R&Ws)





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