

Dr. Stefan Steinkühler, LL.M., Rechtsanwalt und Partner, sowie René Schnichels, Rechtsanwalt, Wilhelm Rechtsanwälte, Düsseldorf, www.wilhelm-rae.de

„Warranty & Indemnity Insurance“

1. INTRODUCTION

The W&I-Insurance is applied in connection with the acquisition of a company.¹ German literature also refers to the W&I-Insurance as „Gewährleistungsversicherung“ („liability insurance“).²

The subject matter of this insurance and its importance for the insurance industry form the focus of this article.

2. OBJECT OF REGULATION OF THE W&I-INSURANCE

The seller often makes warranty declarations in connection with a sale of a company. These may concern e.g. the provision of the share capital contribution, the correctness of fiscal transactions or the question whether shares are free of any burdens. In case the warranty given by the seller is incorrect, the seller is directly liable to the purchaser on the basis of the contractual warranty.

Without a W&I-insurance the purchaser must make warranty claims directly towards the seller. If the seller does not agree with the purchaser's warranty claims, the purchaser must enforce the claim in front of a court if necessary. The purchaser bears the risk of the proceeding. Furthermore, the purchaser bears the risk of the seller's insolvency.³ A W&I-insurance shall offer protection against such risks.

¹ Beckmann/Matusche-Beckmann, Versicherungsrechts-Handbuch, S. 2110

² Metz, Grundzüge der W&I-Insurance beim Unternehmenskauf, NJW 2010, 813

³ Grossmann/Mönnich, Warranty & Indemnity Insurance – Die Versicherbarkeit von Garantierisiken aus Unternehmenskaufverträgen, NZG 2003, 708, 709

If the seller is the policy holder (seller-policy) he acquires, in case of a liability towards the purchaser resulting from an incorrect guaranty, a claim against the insurer for indemnity from liability claims of the purchaser against the seller on the basis of the guaranty declaration.⁴

The seller may cede his claims for coverage to the purchaser.⁵ In this case, the purchaser gains a direct claim against the insurer for damage compensation resulting from the incorrect guaranty. The W&I-insurance closed by the seller will in such case be directly advantageous for the purchaser.

If the purchaser is the policy holder (purchaser-policy), the purchaser acquires a claim against the insurer for damage compensation due to an incorrect guaranty.

The purchaser-policy usually contains a waiver of recourse of the insurer in favour of the seller.⁶ This means that the purchaser may ask the insurer for a compensation of damages resulting from an incorrect guaranty declaration. The insurer may though not recover from the seller. The W&I-insurance closed by the purchaser does in this case also protect the seller.

The important difference between the seller-policy and the purchaser-policy is that the seller-policy does often not include coverage in case the seller gives maliciously wrongful guarantees to the purchaser. The purchaser-policy though includes coverage independent of the question whether the seller was aware of the faultiness of the guarantees given by the seller or not. The purchaser-policy includes coverage for fraudulent intent of the seller.⁷

According to above details it is given that the W&I-insurance serves both the seller and the purchaser in connection with the sale of a company, not depending on who of the two concludes the W&I-insurance. The W&I-insurance thus provides for liquidity and financial planning security. If W&I-insurance coverage exists, the seller must not make provisions for possible claims resulting from guarantees given in connection with the sale of a company.

⁴ Metz, (a.a.O.), 814

⁵ Grossmann/Mönnich, (a.a.O.), 710

⁶ Grossmann/Mönnich, (a.a.O.), 710

⁷ Grossmann/Mönnich, (a.a.O.), 710

3. PRACTICAL RELEVANCE OF THE W&I-INSURANCE

Since the banking crisis, the M&A-market dropped. First indicators for small business allow the conclusion, that more M&A-deals may be expected for the year 2010 in comparison with the prior year.⁸ An increasing importance of the W&I-insurance seems possible.

This is combined with the hope that formerly detected difficulties with the realisation of insurance solutions do not appear.

3.1 Late identification of risks and late search for risk transfer

Based on experience, the W&I-insurance is relevant in the later part of the Due Diligence procedures. It is discussed in connection with the risk identification and risk classification of the transaction. In order to avoid obstacles with the preparation of the company purchase agreement and in order to avoid a delay of the closing, a possibility of a risk transfer is chosen.

The possible insurers though need detailed underwriting-documents and eventually declarations of the future policy holder. First indications with regard to the expected premium and to the standard requirements are usually gained within a short period of time. It though may take up to fourteen days, until the insurer has received all documents required and until the insurer makes a final offer. If, which is often the case, an English insurer is involved, these insurers will have the risk documents checked by German lawyers. The information chain “insured/lawyer – agent – insurer – lawyers of the insurer and back” is time-consuming. In many cases the efforts to install a W&I-insurance in time before the Closing often fail due to the immense expenditure of time of the underwritings.

3.2 Reconciliation of liability and coverage

As soon as first indications are at hand, the components of coverage can be evaluated with regard to their relevance concerning liability. This logical step often forms a further problem of the W&I-insurance, because the concrete object insured is often not covered within the clauses of the general terms and conditions and it is necessary to make amendments. This evaluation step usually exceeds the assignment of the insurance broker, because a legal consultancy must be performed.

⁸ Keller/Marquardt, Deutscher Small Cap M&A-Markt: Jahresrückblick 2009 und Ausblick 2010, M&A Review 2010, 139, 142 f.

A legal survey of the often English terms and conditions requires further time expenditure due to the differing understanding of coverage. English W&I-insurance contracts for example define the term “loss” in a different way than the German W&I-insurance define the term “Schaden”. Respectively, there is a need to make corrections and to convince the insurer.

Excursus:

In case English terms and conditions must be taken as the basis, a German place of jurisdiction and place of arbitration should be agreed upon. Also, German legislation should be taken as the basis. Furthermore, German legal terms should expand the English terms and conditions, in order to increase the comprehensibility for a German policy holder. Many terms are not known in German insurance law and offer room for interpretation.

3.3 „No claims declaration“ & attribution of knowledge

Besides the terms and conditions of the insurance, insurers usually also request declarations from the insured, that at a determined point of time no further damages or circumstances are known, which may lead to an insured event as defined within the W&I-insurance. At this point, insurers often try to access the broad knowledge within the group of the insured. Beside the insured’s knowledge, also the knowledge of the deal/transaction team, where all members must be named, is relevant. In so far, it may only be given the advise to keep the number of persons, whose knowledge is relevant, as small as possible.

4. CONCLUSION

In order not to delay the company sale, the party that concludes the W&I-insurance contract should take care to deal with the conclusion of the W&I-insurance at the same time as with the preparation of the purchase contract. Individual insurance products are required, which shall apply for the individual acquisition. If the contracting parties only deal with the conclusion of a W&I-insurance after the purchase contract is concluded, then coverage gaps may arise.

In the insurance industry, there are often just English insurers offering a W&I-insurance. In case of English terms and conditions, amendments are often required.

Dr. Stefan Steinkühler, LL.M.
Attorney at law

René Schnichels
Attorney at law

Master of Insurance Law

Wilhelm

Partnerschaft von Rechtsanwälten

Registered office: Düsseldorf - AG Essen: PR
1597

Fürstenwall 63
40219 Düsseldorf

Telephone: + 49 (0)211 687746 - 24

Telefax: + 49 (0)211 687746 - 20

www.wilhelm-rae.de

stefan.steinkuehler@wilhelm-rae.de

Wilhelm

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