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Warranty & Indemnity policies

## Individual insurance solutions for transaction obstacles

During the due diligence, buyers identify and evaluate the risks of transactions. Sellers usually estimate risks economically more favorable for themselves. During contract negotiations for the transaction, different perceptions regarding the evaluation of risks clash. In many cases, warranty & indemnity insurance (“W&I”) offers an economically reasonable reconciliation of interests for the parties by transferring risks to an insurer.

Principally, most quantifiable risks are insurable. The higher the probability of occurrence of the respective risk, the higher will be the insurance premium. The involved parties often insure tax risks, ambiguous ownership structures of individual assets, possible liability potentials, e.g. resulting from product liability risks, risks from threatened legal disputes, etc.

If the risk is clearly defined and quantifiable and the description of the risk is comprehensible, it usually can be insured.

The W&I makes individual, technically demanding and complex solutions possible which are advantageous for both contract parties. Example: A real estate deal with a transaction volume of approx. EUR 500 million contained approx. 50 properties with a risk of contamination (asbestos, contaminated soil, etc.). The parties estimated the costs of decontamination with EUR 1 million per property, thus in total up to EUR 50 million. The parties transferred the risk of decontamination to several insurers and the sellers gave a warranty in the purchase agreement that the properties were free from contamination. The decontamination risk of EUR 50 million therefore had no impact on the purchase price. In this case, insurance premiums amounted to approx. EUR 4 million.

Today, the W&I is known to transaction lawyers. The individual possibilities of application and the measures required to conclude a policy are though often not known to the parties and their advisors. W&I-risk are placed internationally, often via London markets and the placing is, in relation to the time pressure in transaction negotiations, time-consuming and complex as well.

The insurers conduct an own due diligence for the risks offered. This takes time depending on the complexity of the risks. International insurers usually do not have capacities to examine risks with regard to German law and therefore hire German lawyers. Also for this reason, the appropriate description of the risk and the required documents should be provided at an early point in time. The insurer agrees on insurance terms individually with the policy holder (buyer or seller). Standard products seldom suit the transferred risks. From finding an appropriate risk carrier until concluding the policy, several weeks or even months may pass depending on the complexity of risks. For the contract parties of the transaction it is therefore decisive to identify risks and obstacles for negotiation at an early stage and to think about the risk transfer by means of W&I.

The parties should negotiate the insurance contract with an independent team of advisors, since the policies often target the knowledge of advisors, especially of the transaction team. The imputation of knowledge sometimes leads to discussions in case of an insured event. Insurers might argue that the transaction team knew about the occurrence of the risk already before the conclusion of the W&I.

The heterogeneity of the insured risks also necessitates a negotiation of the general terms of insurance. The general insurance law provisions regarding information towards the insurer, imputation of knowledge, obligations, and exclusions seldom suit the conflict to be solved.

The tactically correct procedure with regard to insurance law starts with choosing the right policy holder (seller or buyer, possibly another party). The exact risk determination is the second decisive step. The description of risks should be part of the insurance contract. Aspects such as sum insured, duration of the insurance contract, and definition of the insured event sometimes also become part of the purchase agreement. In the example of the insured guarantee, an inclusion into the purchase agreement was not necessary. This might also not always be desired, if the seller or buyer identifies a risk that was not identified by the other party and wants to insure it unrecognized.

Conclusion:

The W&I offers scope for creative, economically reasonable solutions. The possibilities of W&I as an instrument to overcome obstacles for negotiations in a transaction are largely unknown in the market. The insurance industry offers a product that can provide considerable advantages to the parties of a transaction.

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