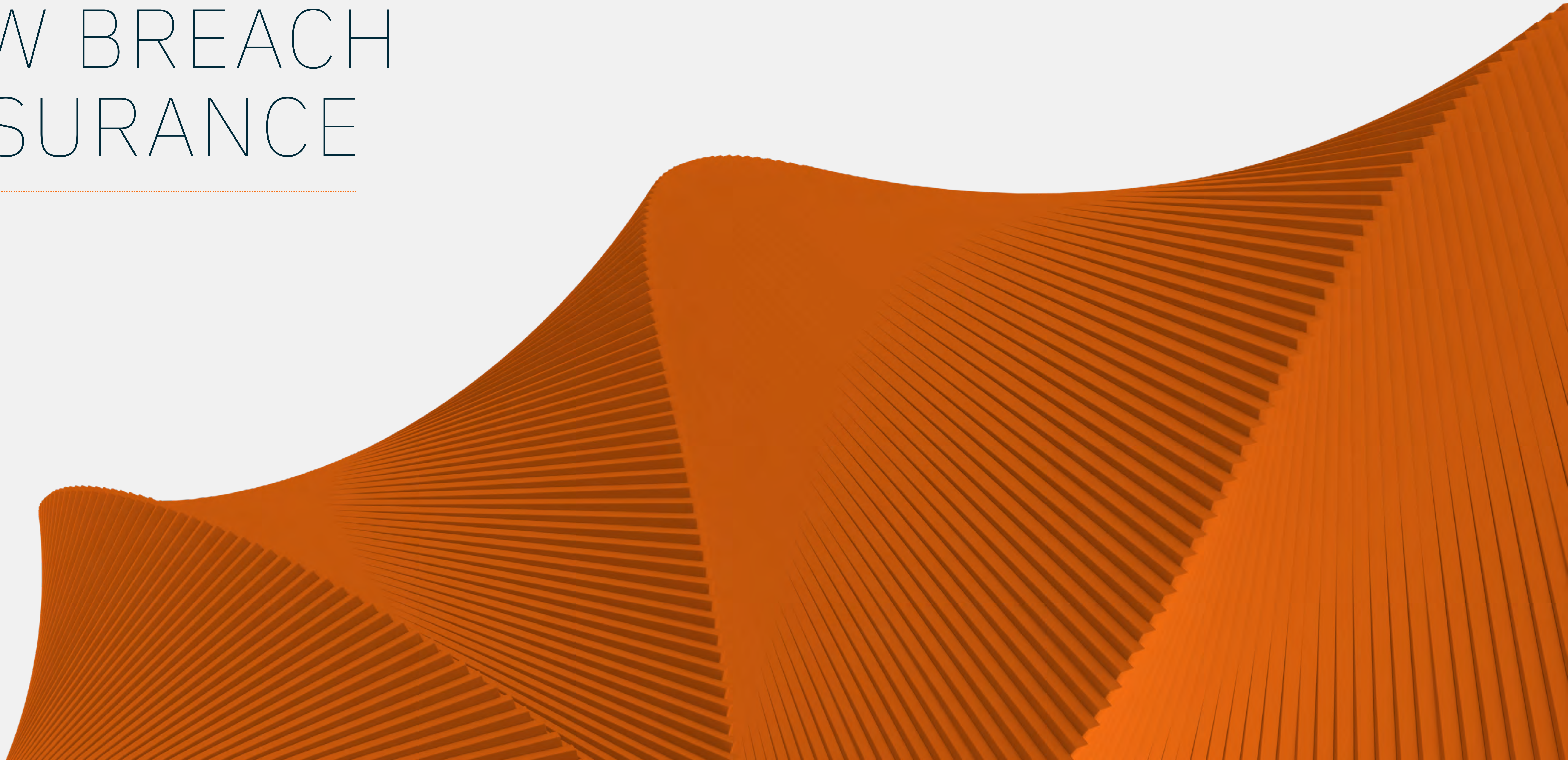
HWF

THE INBETWEENERS

OVERVIEW OF NEW BREACH COVER IN W&I INSURANCE



The negotiation around repetition of warranties and the protection of the target's assets in the interim period is always a hard fought one. This article explores how Warranty & Indemnity ("W&I) insurance can help provide protection for the buyer in the interim period.

In the interim period, whilst a target is under agreement to be sold yet there has not been full legal risk transfer to the buyer, there is a balance to be struck between affording buyers the protection they need to proceed with a purchase and allowing the sellers to operate a business in the usual course without overly restrictive constraints post exchange of contracts for sale. Buyers will want the assurance that the position of a target has not changed since the date of signing a transaction or to have recourse in the event that it does.

There are various ways, and a combination of some of the below are used, to manage the gap in the interim period;

- Interim period covenants including remedies for breaches of covenants; and
- Repeated warranties or the obligation on the seller to disclose any breaches or potential breaches of warranty during the interim period including remedies granting the buyer termination rights and/or material adverse change clauses.

New Breach Cover is an enhancement sometimes offered under a W&I insurance policy which can help bridge this expectation gap where any of these controls might be lacking. Where an underlying deal has a split sign and completion, it enables a buyer to claim for breaches of insured warranties that (i) that arise and (ii) which the buyer obtains actual knowledge of in the interim period between signing and completion under an SPA.

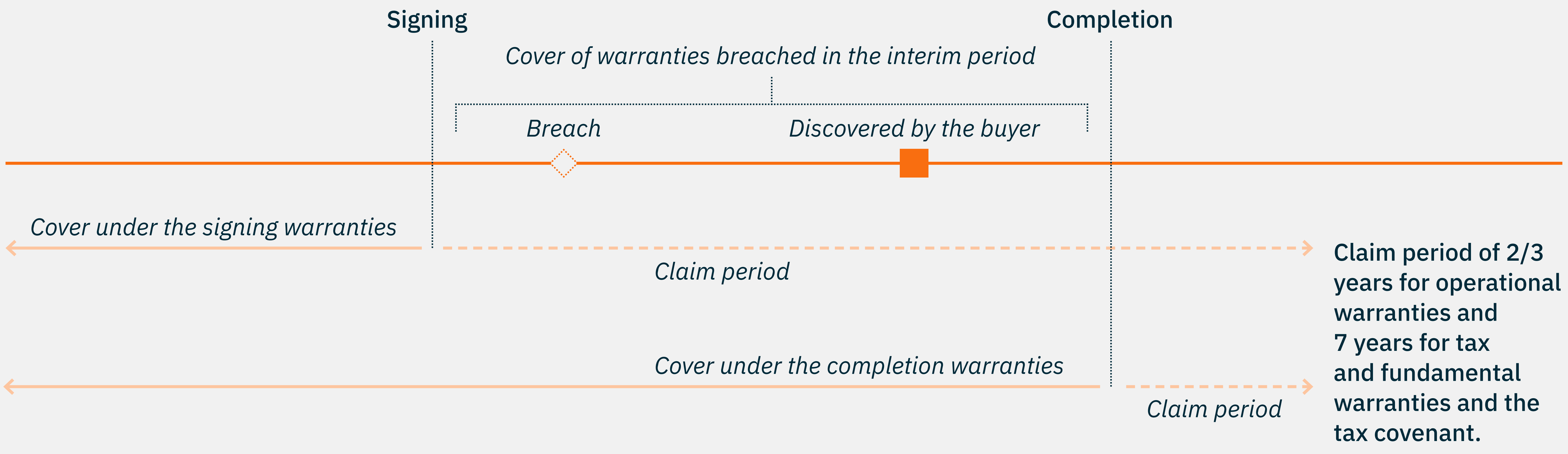
WITHOUT NEW BREACH COVER

For breaches of insured warranties where there is split sign and completion, repetition of warranties and no new breach cover, there are four possible scenarios:

1	The breach occurs **before signing** and the buyer first learns about the breach **during the interim period**	Breach of the signing warranties	Covered (though no breach of the completion warranties)
2	The breach occurs **before signing** and the buyer first learns about the breach **after completion**	Breach of the signing and completion warranties	Covered
3	The breach occurs **during the interim period** and the buyer first learns about the breach **during the interim period**	Interim period breach	Not covered
4	The breach occurs **during the interim period** and the buyer first learns about the breach **after completion**	Breach of the completion warranties	Covered (though no breach of the signing warranties)

WITH NEW BREACH COVER

INTERIM BREACH PERIOD



PROTECTION IN THE INTERIM PERIOD

W&I insurance will cover warranties at the point(s) at which they are given under the SPA which is usually at signing, and if the SPA relates to a transaction with a gap between signing and completion, again at completion. If all of the warranties are repeated at completion and there is an updated disclosure process (usually in the form of a completion disclosure letter in the UK or a bring down process in Europe) a W&I insurance policy will also cover the warranties given at completion.

There are exceptions to this rule, such as where only fundamental warranties (i.e. the warranties speaking to seller's solvency, title and capacity) are repeated at completion; updated disclosure may not be required by the insurer where it is possible to perform corporate and insolvency searches and the results of these are generally disclosed at completion.

A breach of the signing warranties in the interim period would not be considered a breach of the signing warranties, as it occurred after signing, and would not be covered under the completion warranties, as it is a known item to the buyer which will need to be disclosed at the point at which the completion warranties are being given. New Breach Cover bridges this gap.

For English law governed policies, if there is only a breach of the completion warranties under the SPA (and there is no ability under the SPA to walk away from the transaction or renegotiate the purchase price between signing and completion as a result of such breach) then it could be argued that no causation has occurred for loss in respect of such breach of warranty[1].

New Breach Cover may offer the ability to clarify the position at law and avoid any doubt by offering the ability to synthetically enhance the definition of loss to be on an indemnity basis.

New Breach Cover can be helpful to extend cover beyond signing warranties where there is no repetition of warranties at completion or to give a buyer additional comfort after exchange of contracts where there might not be the full remedies to renegotiate or terminate the contract.

HOW NEW BREACH COVER WORKS

Under New Breach Cover, warranties will usually be deemed synthetically repeated (i.e repeated under the policy rather than in the transaction documents) at periodic intervals in the interim period.

In this way, if the buyer obtains actual knowledge of an insured breach of warranty in the gap between signing and completion, and that breach arose for the first time in the interim period, there is the possibility to claim for breach of the warranties deemed given on the day that the buyer became aware of the breach.

1 Finsbury Food Group Plc v Axis Corporate Capital UK Limited [2023] EWHC 1559 para 151 – 158.

POINTS TO NOTE

It is important to note that only around half of W&I insurers will offer New Breach Cover on any transaction and the availability is dependent on a number of factors including:

- **The length of the interim period:** Insurers will typically limit New Breach Cover to between 1-6 months (with the longer periods applying to asset heavy targets – see below). This is usually a fixed period of cover; therefore New Breach Cover may expire prior to the interim period and this risk therefore must be managed.
- **The nature of the underlying asset:** Insurers will generally prefer the target company to be less complex, have limited employees and a stable revenue stream. Asset heavy businesses such as real estate and infrastructure transactions are favoured for this enhancement and attract longer periods of cover.
- **Budget:** Additional premiums for New Breach Cover vary depending on the insurer, the length of the New Breach Cover period and risk profile of the underlying business, but most insurers will charge 10-20% of the base premium for every one month or two months of New Breach Cover. The cost can make this enhancement prohibitively expensive for many buyers; equally it can be the necessary solution to allow a transaction to occur.
- **Jurisdiction and geographical spread:** New Breach Cover is more likely to be offered in jurisdictions that are perceived to be lower in risk such as Northern Europe, USA and Australia, although we have seen it offered across Europe.
- **Confirmation of no breaches:** Most insurers will require the buyer to sign a no claims declaration (“**NCD**”) periodically throughout the New Breach Cover period i.e. every week or every month, confirming that the buyer has not become aware of any breaches of warranty. Where the interim period is longer than a month, some insurers will also reserve the right to cancel the next periods of New Breach Cover should a claim for a new breach be made in advance of the next NCD.

KEY TAKEAWAYS

- New Breach Cover offers enhanced warranty coverage for interim period breaches that a buyer would be unlikely to achieve in an uninsured context.
- New Breach Cover is becoming more common and an increasing number of insurers will offer this enhancement.
- New Breach Cover will only be offered for a limited amount of time (between 1-6 months) and availability is dependent on the jurisdiction and nature of the target business.
- If New Breach Cover is of interest, it is advisable to ask for it at the quoting stage before picking a preferred insurer, as not all insurers will offer it and the price and the terms of the cover may vary considerably between insurers which is where using an experienced broker is advised.

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