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RECOVERY IN INSURED AND UNINSURED CLAIMS

Despite its growing use, a significant proportion of M&A transactions are still implemented without W&I insurance. The decision on use of W&I insurance can be driven by factors ranging from the personal preference of parties to pricing, available coverage and commercial factors outside parties' control. Any discussion on warranty and/or tax covenant claims in the M&A market is therefore incomplete without contrasting insured and uninsured claims.

W&I insurance has developed over the last decade alongside the widespread encouragement and adoption of alternative dispute resolution methods to try and avoid parties needing to litigate in the courts.

In England and Wales, the Ministry of Justice and judiciary have gone to great lengths to incentivise parties to try and resolve disputes by avenues other than the courts as litigation is often time consuming, disproportionately expensive, unnecessarily adversarial, procedurally complex and too regularly it is disconnected from the commercial concerns of the parties. In short, it can be a very inefficient exercise.

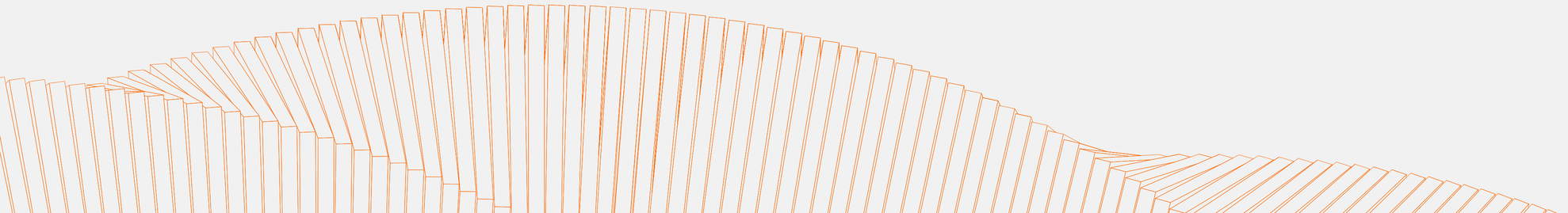
The result has been a series of measures to try and get parties to negotiate earlier, to limit burdensome document requests and witness evidence, to develop mediation and neutral evaluation processes and to apply costs consequences to those parties who do not accept reasonable settlement offers.

> **More parties to M&A transactions should be aware of the benefits of bringing a claim under a policy as a form of alternative dispute resolution.**

The benefit of these initiatives is now self-evident and any lawyer will routinely advise their client early on in a potential dispute on how to avoid court proceedings or arbitration.

However, in the context of M&A, there has been very little commentary on the very obvious benefit of warranty and indemnity insurance as a form of alternative dispute resolution:

- **Efficient resolution:** for a buyer, by replacing the counterparty to the transaction with an insurer, you immediately avoid many of the significant downsides of bringing a claim for breach of contract against the seller and make an efficient resolution of any dispute significantly more likely.
- **Time, cost and complexity savings:** the claims process under a warranty and indemnity insurance policy is more time efficient, less costly, less adversarial, less complex and arguably more likely to be successful than bringing the same claim against a counterparty to a transaction.
- **Pre-packaged form of alternative dispute resolution:** more parties to M&A transactions should be aware of the very obvious benefits of bringing a claim under a policy rather than having to litigate against a seller to recover what they are owed.



TIME

In an uninsured context, bringing even the simplest claim for a warranty breach can often take years to resolve.

Assuming a claim is not able to be resolved commercially at the very outset of any threatened claim, which is rare in circumstances when there is any material amount of money involved, time periods involved in any court proceedings or arbitration are extremely lengthy.

Under the Civil Procedure Rules in England and Wales there are prescribed time periods for pre-action correspondence, completing the steps to formally file a claim, pleading statements of case, allowing the defendant adequate time to respond, convening a Case Management Conference, allowing time for any interim applications, undertaking extensive document disclosure, drafting witness statements and expert reports and preparing for trial.

> **In contrast to a claim against a seller, insurers generally have a commercial incentive to pay good claims promptly.**

Assuming a complex breach of warranty claim is contested to trial, it would be rare to see a resolution by judgment from the English High Court in less than 2.5 - 3 years, and very often longer.

Even if a claim is capable of settling before trial, because of the procedural hurdles that the parties have to comply with to formally articulate the claim in full, and then to start exchanging documents, which may shed light on the actual merits and facilitate settlement, it is still very difficult for a claim to be settled quickly.

In practice, it is not uncommon for it to take six months to a year before statements of case have been finalised and for it to be two years before a full document disclosure exercise has been completed. To take a recent example, MDW Holdings Ltd v Norvill [2021] EWHC 1135 (Ch) concerned a breach of warranty claim. The factual issues in dispute were not overly complicated and the quantum claimed not particularly high:

- first notification of a claim under the SPA was made on **23 August 2017**.
- first instance judgment by the High Court awarding the Claimant £382,600 in damages for breach of warranty was handed down on **4 May 2021**.
- further judgment on consequential matters including costs was handed down on **23 July 2021**.
- High Court judgment was then appealed by the Defendants and the decision of the Court of Appeal was handed down on **28 June 2022**.

It took almost five years to obtain a payment of less than £400,000 in the courts. While in certain circumstances arbitration can be procedurally quicker the difference in time periods with litigation is often not meaningful.

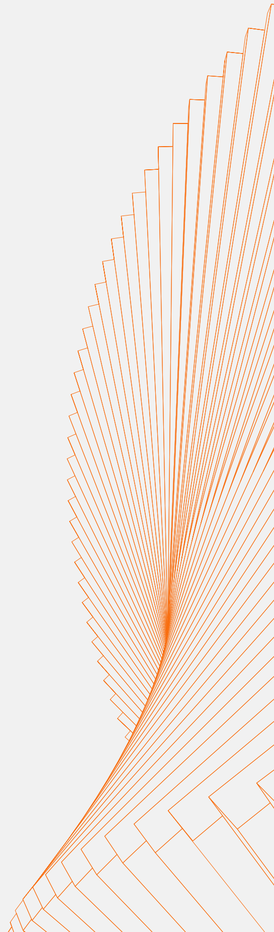
In contrast, HWF's claims study data shows that of the paid claims on primary W&I policies placed since 2016, 94.58% of payments were made in less than 2 years.

The main reason for this difference is because upon receipt of a claim the insurer's process is immediately to analyse and understand the merits and assess whether a payment should be made under the policy.

In contrast to a claim against a seller, insurers generally have a commercial incentive to pay good claims promptly. As such, the process for reviewing the claim is often one of fact-gathering and neutral analysis from the beginning rather than being adversarial, which obviously has the benefit of increasing the speed of the process.

As only a very small percentage of claims against insurers are contested before the courts or arbitration, the parties to an insured claim generally do not have to concern themselves with following the procedural steps required under the Civil Procedure Rules or arbitral procedure in anticipation of a claim being issued. Obviously each case will turn on its merits, but in general far fewer claims against an insurer will reach court proceedings or arbitration.

Instead, correspondence is focused on the insurer identifying the key legal and factual points of dispute as quickly as possible and seeking supporting documentation from the insured.



PROSPECT FOR SETTLEMENT

As already noted, unlike an uninsured defendant, insurers generally have a commercial incentive to pay meritorious claims. All insurers who participated in our study made it clear that they wanted their claims data to be published and examples of paid claims known more widely precisely because they know that the strength of W&I insurance as a product relies on insurers responding positively to good claims.

This dynamic is unique to an insurer and materially increases the prospects of settlement of a claim compared to an uninsured seller.

Even if a claim is meritorious, defendants to a claim in an uninsured context will regularly employ delay tactics and be obstructive in response even if they are aware that ultimately they will likely have to make a settlement payment. This is because defendants know a claimant will often accept a lower settlement amount if faced with the prospect of incurring higher costs associated with a contested dispute over a prolonged period. Even in commercial negotiations where there is very little chance of a claim ever reaching court or arbitration, the prospect of lawyers running up fees is often a key issue in the negotiations.

In contrast, insurers have a reputational incentive to avoid taking claims to litigation or arbitration, as well as a clear desire to obtain repeat business from their insured clients, and therefore will very rarely use the prospect of litigation as a form of leverage over the claimant or employ obstructive tactics.

In general, claims processes under W&I insurance policies are collaborative and parties are often more willing to concede points to reach a constructive solution. From HWF's perspective, we are able to assist in this process by engaging with an insurer as soon as a notification is made to try and facilitate an efficient and focused exchange only on the most important aspects of the claim.

As the HWF claims study data shows, almost 10% of primary W&I policies placed in 2018-2019 resulted in a paid claim, which is very significant for an insurance product which is responding to unforeseeable risks. The importance of W&I insurance is illustrated further by the fact that 63.78% of closed notifications between 2016 and June 2023 resulted in a paid claim.

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COST

One significant advantage of bringing a claim for breach of warranty under a W&I insurance policy is the cost saving in comparison to advancing the same claim against a seller in a contested dispute. Obviously there remains a remote possibility of a claim against an insurer being litigated or going to arbitration but the likelihood of that occurring is significantly less than the same claim against a seller being contested in the same way.

To return to MDW Holdings Ltd v Norvill, following the first instance judgment in which the Claimant was awarded £382,600 in damages (the original claim was for £1.2 million), the Claimant made costs submissions at the consequential hearing stating that its costs to date were over £1.1 million (net of VAT and prior to the Court of Appeal hearing).

In short, the costs of bringing the claim to the point of a first instance judgment were almost equivalent to the amount of damages actually being sought for the breach, and the amount of damages actually awarded were significantly less.

The costs of bringing a claim against an uninsured party in England (and elsewhere) are so high because of the detailed procedural requirements that a claimant has to comply with under the relevant procedural rules (even including during pre-action correspondence). In contrast, a claim under a W&I policy does not require formal pleadings, document disclosure exercises or detailed witness statements. Instead the claims procedure is usually an iterative process in which the insured outlines the factual and legal position in correspondence, sometimes evidenced by relevant documents or expert work as the claim develops, and the insurer generally has follow up questions and requests additional information until it can provide a clear coverage position.

Having spoken to a number of lawyers who have brought successful claims under W&I policies with HWF, we estimate that the average cost of bringing such a claim would be 10% of the value of an equivalent uninsured litigation or arbitration claim.

PRESERVING COMMERCIAL RELATIONSHIPS AND THE CREDITWORTHINESS OF THE INSURER

One of the main advantages of bringing an insured claim is that clearly it allows a buyer to preserve its commercial relationship with the seller as well as ensuring that any payment is being made by an ‘A’ rated entity.

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SUMMARY OF CLAIMS PROCESS

The claims process under a W&I insurance policy is more time efficient, less costly, less adversarial, less complex and actually more likely to be successful than bringing the same claim against a counterparty to a transaction.

More parties to M&A transactions should be aware of this important benefit of W&I insurance.

ABOUT US

We are an independent advisor and broker of transactional and tax risk insurance which allows for value creation and risk mitigation. In addition, we provide bespoke insurance solutions that mitigate tax liabilities arising in the lifecycle of investment structures and operational companies. We are recognised as a market leader.

Our team, comprising of individuals who have significant insurance, legal and tax backgrounds with extensive advisory, broking and underwriting experience, have advised on over 4,000 transactions and structured over 1,000 policies in over 50 jurisdictions. In addition, we have offices in London, Dubai, Frankfurt, Munich, Paris, Warsaw and New York and specialists dedicated in their focus on the MENA, CEE and Southern European regions.

This collective expertise allows us to provide specialist insight with an advisory focus, taking ownership of any insurance structured and allowing our clients to focus on the wider transaction.

We would be happy to provide references if required and for further details about us please see hwfpartners.com.

HWF has led the first independent European W&I market claims study, using data from 16 insurers over a 7-year period, view the report in full here.

KEY CONTACTS

Alex Harding
Head of Claims
+44 7590 916 950
alex.harding@hwfpartners.com

David Wall
Director, Co-Head of Private Equity
+44 7971 627 060
david.wall@hwfpartners.com