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The W&I Insurance as a facilitating tool in the negotiation process for the acquisition of a controlling shareholding

O Seguro de *W&I* como instrumento facilitador do processo negocial de aquisição de participação social de controlo

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ABSTRACT: Corporate acquisitions, known in national and international legal jargon as M&A transactions, are based on a demanding, challenging and complex negotiation process, dynamic and phased over time, characterised by its uncertainty. The pre-contractual phase is characterised by an information asymmetry between Buyer and Seller. This informational inequality leads the negotiating parties to take *ab initio* particular precautions in order to protect their respective interests, setting up mechanisms and designing solutions to safeguard against future pathological scenarios, allowing for the allocation of negotiating risks and providing the negotiating process with legal certainty and security, thereby promoting its predictability and transparency. We propose in this study to analyse the specific features of the W&I Insurance as a tool for mitigating transactional risk and to identify its impact on the negotiation process of company's acquisitions.

KEY WORDS: W&I Insurance; M&A transactions; negotiation process; transactional risk; due diligence; representations and warranties.

RESUMO: As aquisições de empresas, designadas na gíria jurídica nacional e internacional por operações de *M&A*, assentam num processo negocial exigente, desafiante e complexo, dinâmico e faseado no tempo, caracterizado pela sua lentidão e incerteza. A fase pré-contratual é caracterizada por uma assimetria de informação entre o Comprador e o Vendedor. Esta desigualdade informacional leva a que as partes negociadoras tomem *ab initio* particulares precauções para proteger os respetivos interesses, criando mecanismos e desenhando soluções para acautelar futuros cenários patológicos, permitindo a repartição dos riscos negociais e conferindo ao processo negocial certeza e segurança jurídica, promovendo assim a sua previsibilidade e transparência. Propomo-nos, neste estudo, analisar as especificidades do Seguro de *W&I* enquanto instrumento de mitigação do risco transacional e identificar o seu impacto no processo negocial de aquisição de empresas.

PALAVRAS-CHAVE: Seguro de *W&I*; operações de *M&A*; processo negocial; risco transacional; *due diligence*; declarações e garantias.

SUMMARY:

1. The W&I Insurance and M&A transactions

1.1. Introduction

The interest that has always been shown in M&A transactions has persisted over time and has taken on new guises in recent decades. The acquisition of companies is based on a challenging process, where the stakes and financial and personal expectations are high, and the path travelled by the negotiating parties is surrounded by anxiety and uncertainty. It consists of a complex and structured economic and legal transaction, subject to demanding planning, with the intervention of specialised players, and therefore multidisciplinary, with significant legal diversity and versatility[1].

In recent years, W&I Insurance, a (financial) insurance product, has gained significant and relevant national prominence in M&A transactions as an instrument for mitigating transactional risk. In fact, over the last decade we have seen the national insurance market take increasing steps in search of an identity and field of application. Until then, this product was seen as an outsider in the so-called insurance and corporate *praxis*. One of the main driving forces behind it in Portugal has been the presence of international insurers operating in the national market under the freedom to provide services.

The fact that this is a relatively recent product in national legal practice certainly does not diminish its relevance in terms of covering the transactional risk inherent in company acquisitions nor the curiosity it has aroused over time among the different players in today's insurance market, in a clear positive trend towards its use[2].

Known as *representations and warranties* insurance (*R&W*) in the US insurance market, where it dates back to the 1990s[3], or as *warranties and indemnities* insurance (W&I Insurance) in the European insurance market[4], it has a privileged field of action in the context of company

[1] ANDREAS GRAN, "Abläufe bei Mergers & Acquisitions", *in NJW*, 61(20), 2008, pp. 1409-1415, 1409. *See* ANDREW J. SHERMAN/MILLEDGE A. HART, *Mergers & Acquisitions From A to Z*, 2nd ed., New York, AMACOM, 2006.

[2] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung im Unternehmenskauf unter besonderer Berücksichtigung der Gewährleistungsversicherung*"*, *in Kölner Schrift zum Wirtschaftsrecht*, 7, n.º 1, 2016, pp. 49-54, for whom the W&I Insurance (*W&I-Versicherung, Gewährleistungsversicherung*), as *complementary insurance*, is becoming increasingly accepted in *practice*, p. 49; ANGELO BORSELLI, "Insurance in M&A Transactions", *in The Governance of Insurance Undertakings*, New York, Springer, pp. 199-215, 200, available at link.springer.com/content/pdf/10.1007/978-3-030-85817-9_9.pdf; KLAUS MARINUS HOENIG/SEBASTIAN KLINGEN, "Die W&I-Versicherung beim Unternehmenskauf", *in NZG*, 32, 2016, pp. 1244-1248, 1245.
This study does not analyse other transactional insurance products available in the market such as title insurance, tax insurance, contingent insurance and environmental insurance.

[3] ELENA F. PÉREZ CARRILLO, "Aproximación al aseguramiento de las manifestaciones y garantías contractuales vertidas en la compraventa de empresas. El seguro R&W", *in Dimensiones y desafíos del seguro de responsabilidad civil*, Madrid, Civitas, 2021, pp. 251-270, 251; CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era de los seguros de manifestaciones y garantías en operaciones *de* M&A", *in Revista Española de Capital Riesgo*, 3, 2016, pp. 19-28, 20, available at perezllorca.com/wp-content/uploads/es/actualidadPublicaciones/ArticuloJuridico/Documents/161121-recari-la-nueva-era-de-los-seguros-de-manifestaciones-y-garantias-en-operaciones-de-ma-crs-pdb-fna.pdf.

[4] NIKI DEMIRBILEK/GREGORY WALKER, "Strategische Vorteile der Gewährleistungsversicherung bei M&A-Transaktionen und ihre Wirkungsweise im Schadenfall", *in SECA Yearbook*, Zug, SECA, 2015, pp. 37-42, 37, available at risksolution.ch/downloads/artikel_ma-gewaehrleistungsversicherung_wirkun.pdf; GREGORY WALKER/THOMAS MANNSDORFER, "Gewahrleistung bei M&A Transaktionen: Grundlagen, Risiken und Versichedrung (2)", *in M&A Mergers and Acquisitions Review*, 5, 2012, pp. 207-213, 211, available at https://risksolution.ch/downloads/artikel-gewaehrleistungen_bei_mua_vertraegen_2.pdf.

acquisitions, especially the acquisition of the entire share capital of the target company (controlling shareholding)[5].

We are referring in our analysis to a process whereby the Buyer acquires from the Seller the entire share capital of the target company (100% acquisition). This acquisition will be a way of obtaining control (dominance) by exerting a dominant influence on the target company, based on the exercise of rights and duties specific to company law[6].

In this study we shall analyse the main general features of the W&I insurance in the light of the Portuguese insurance regulation although primarily focusing our analysis in establishing its connection with the negotiation process for the acquisition of companies, as a private (*one-to-one*) negotiation process for the acquisition of a controlling shareholding, characterised by a dynamic and case-by-case dimension, which aims for balanced solutions between the negotiating parties[7].

Once executed, both the Share Purchase Agreement (*SPA*) and the W&I Insurance acquire immediate and full legal effectiveness, aimed at satisfying the economic and social purpose of the negotiating parties[8]. The underlying negotiation process is, however, complex[9], precisely because both the SPA and the W&I Insurance reveal equal complexity, high value and level of sophistication.

Within the scope of the W&I Insurance, the negotiation process is more standardised in the negotiation relationship with the Insurer, with specific specificities, which we will analyse to determine to what extent W&I Insurance influences the negotiation process between the Seller and the Buyer.

The questions we aim to answer are the following: what role does W&I Insurance play in the negotiation process for acquiring a company and what specific negotiating features does it bring for the current negotiation process? What requirements does the negotiation of this insurance product impose and which are reflected in greater rigour and completeness at the level of the due diligence exercise carried out by the Buyer on the target company and in the negotiation of the SPA itself, especially in relation to the warranties clause, which forms the basis of the W&I Insurance?

We understand that the Insurer's coverage of the risk of false representations and warranties provided by the Seller in the SPA in favour of the Buyer presupposes a different approach to

[5] KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity Insurance Die Versicherbarkeit von Garantierisiken aus Unternehmenskaufverträgen", *in NZG*, 15, 2003, pp. 708-712, 708. The scope of application of the W&I Insurance extends, alongside the *share deal* (sale of shareholdings), to the asset deal (sale of assets) for the acquisition of real estate assets. *See*, CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty & Indemnity-Versicherung bei der Unternehmenstransaktion", *in Betriebliches Risikomanagement und Industrieversicherung*, Berlin, Springer, 2020, pp. 471-483, 471.

[6] ANA PERESTRELO DE OLIVEIRA, *Manual de Grupos de Sociedades*, Coimbra, Almedina, 2016, p. 28.

[7] ÁLVAREZ ARJONA, "Elementos comunes y la Estrategia del Cierre", *in Adquisiciones de empresas*, 5th ed., Madrid, Thomson Reuters Aranzadi, 2019, pp. 51-121, 55.

[8] We will use the terms "parties" or "negotiating parties" interchangeably, with a preference for the latter, in the sense of participants in a pre-contractual negotiation process.

[9] PATRÍCIA AFONSO FONSECA, "A negociação de participações de controlo. A jurisprudência", *in I Congresso Direito das Sociedades em Revista*, Coimbra, Almedina, 2011, pp. 27-41, 28; MENEZES CORDEIRO, *Tratado de Direito Civil Português*, Vol. I - Parte Geral, Coimbra, Almedina, 2009, pp. 492-493.

the traditional due diligence process and negotiation of the warranties clause between the Seller and the Buyer, in the context of mitigating the informational asymmetry that the negotiating parties will have to observe.

The intersection, on the one hand, between the due diligence carried out by the Buyer and the warranties clause and, on the other, the W&I Insurance, will be addressed in this study, demonstrating to what extent a negotiation process initiated with the Insurer influences — and to what extent — the negotiation process between the parties of the SPA.

Both due diligence and the warranties clause are two voluntary tailor-made mechanisms for mitigating transactional risk, and their configuration will effectively depend on the specific negotiation process and the specific transaction underway. Both risk management mechanisms make it possible to learn about realities that are intricately linked to the W&I Insurance.

1.2. The W&I Insurance and the transactional risk

Without prejudice to the significant role played in the SPA, the representations and warranties, as a risk allocation mechanism, which are generally heavily negotiated, together with the compensation schemes contractually agreed between the negotiating parties and associated with the warranties clause, are not sufficient to mitigate the negotiators' risk. It is safe to say that when negotiating warranties (and indemnity) clauses, the parties' interests are not aligned[10].

In two aspects Buyer and Seller will certainly agree: both want, based on interests that are misaligned, to limit the risk of the transaction and limit their exposure to it[11].

As a rule, the Buyer may have genuine concerns about the Seller's financial standing after the transaction has been finalised, especially about its ability to meet any liabilities that may be detected and wants to assess whether or not the Seller is a high-risk indemnitor. To this end, the Buyer wants the warranties to be provided by the Seller to include a mixture of breadth and materiality, to be assessed on a case-by-case basis, depending on the results obtained from the due diligence carried out on the target company.

The Seller, on the other hand, not only retains its liability after the completion of the acquisition, albeit contingent, which it aims to minimise (*Haftungsrisiken zu minimieren*)[12] by introducing provisions in the SPA that limit its liability if the Buyer claims damages resulting from the breach of the warranties provided in the SPA, thus not achieving a clean break with

[10] FRANZ EINIKO/CHRISTINA KEUNE, "Warranty and Indemnity Insurance - Die Gewährleistungsversicherung bei Unternehmenskäufenist auch in Deutschland auf dem Vormarsch", *in VersR*, 2013, no. 31, pp. 1371-1377, 1371; ANGELO BORSELLI, "Insurance in M&A", cit., p. 200.
[11] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., p. 52; KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity", cit., p. 708; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I (Warranties and Indemnities) em operações de M&A no Brasil", *in Fusões e Aquisições (M&A)*, 3rd edition, São Paulo, Quartier Latin, 2022, pp. 547-580, 550-551.
[12] KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity", cit., p. 708; ANGELO BORSELLI, "Insurance in M&A", cit., p. 200.

the sale of the relevant shareholding, but it also undertakes to provide the traditional guarantees required by the Buyer in acquisition operations, notably: (i) autonomous on-demand bank guarantees[13]; (ii) the holdback of part of the purchase price by the Buyer during the term of the warranties[14]; (iii) escrows[15]; and, (iv) comfort letter from the parent company of the Seller's group, which it will endeavour to avoid at all costs.

It should be noted that these mechanisms not only immobilise liquidity, but also have the disadvantage of being expensive and prone to disputes between the parties[16]. In addition, they are unattractive to the Seller and may not even be available[17]. Lastly, they do not allow for the substitution of the Seller in terms of compensation for damages to the Buyer as a result of a breach of warranties provided by the Seller in the SPA.

Briefly, the interests of the negotiating parties are conflicting, as in any negotiation process, and the acquisition of a controlling shareholding is no exception. The intense negotiation of the warranties clause — its scope, time limits, damages and compensation limits, retention of part of the price in escrow — raises issues which, in the end, may not be overcome during the negotiation process, leading to two potential scenarios: (i) either the parties abandon the ongoing negotiations; or, (ii) an agreement is reached, although it may have fallen short of the expectations initially desired by both the Seller and the Buyer.

It is precisely in this context that recourse to W&I Insurance, in order to overcome the shortcomings associated with the warranties clause and the contractually agreed compensation mechanisms, is becoming increasingly common[18], with the premium to be paid to the Insurer being perhaps less than the inconveniences associated with the traditional means available, which have the consequence, as indicated, of encumbering assets as well as the unavailability of funds (escrow)[19].

The W&I Insurance can therefore function not only as an instrument to *replace* the Seller's indemnity obligation under the SPA, but can also *supplement* this liability, especially in cases where the Buyer has not achieved the desired levels of indemnity during the negotiation process or has serious concerns about being compensated after the transaction has closed, and can also eliminate or mitigate the need for the Seller to set up, for example, an escrow

[13] PÉREZ CARRILLO, "Aproximación", cit., p. 259; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 473, noting that the bank guarantee represents for the Seller the disadvantage of encumbering its credit line, whilst at the same time there is the potential risk of the Buyer calling on the guarantee on the basis of an unfounded claim (*Risiko einer unberechtigten Inanspruchnahme*).

[14] MICHAEL JAKOBS/ALEXANDER FRANZ, "Können W&I-Versicherungen das M&A-Geschäft beleben?", *in VersR*, 2014, pp. 659-665, 660-661; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 473; PÉREZ CARRILLO, "Aproximación", cit., p. 259.

[15] PÉREZ CARRILLO, "Aproximación", cit., p. 259; JAVIER GOIZUETA VELASCO, ""El seguro de M&A: la eficacia de las manifestaciones y garantías y la responsabilidad del vendedor en los contratos *de* compraventa *de* empresas", *in Revista Española de Seguros*, 183/184, 2020, pp. 399-416, 405; JOSÉ LUIS LUCEÑO OLIVA, "El seguro de manifestaciones y garantías en la compraventa de empresas", *in Derecho de seguros. Nuevas realidades y nuevos retos*, Madrid, Marcial Pons, 2021, pp. 427-433, 430.

[16] CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang der W&I-Versicherung bei Unwirksamkeit des Unternehmenskaufvertrags", *in NZG*, 2021, p. 144.

[17] CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 473, giving the example of comfort letters, which will only be considered in group structures.

[18] ANGELO BORSELLI, "Insurance in M&A", cit., p. 204.

[19] MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", cit., p. 554.

deposit[20]. We also note that, generally, the Seller will be naturally resistant to accepting purchase price retention mechanisms, escrows and indemnity clauses, and W&I Insurance is a response to these negotiating challenges[21].

With the W&I Insurance, we can even say that the arduous, long and tense negotiations between Buyer and Seller are mitigated, becoming more efficient in terms of time and cost spent and ultimately — why not say it — more amicable.

We are therefore dealing with an instrument that facilitates the mitigation of transactional risk, *maintaining* or *extending*, in terms of amount and time, or *replacing* the traditional guarantee mechanisms associated with the breach of warranties set out in the SPA[22]. In this way, W&I Insurance can be configured as a *plus* in relation to the Buyer's indemnity claims, or even replace the Seller's liability under the SPA.

Therefore, W&I Insurance as a voluntary insurance product, constitutes a mechanism to facilitate the negotiation process between Seller and Buyer, allowing to overcome negotiation issues associated with the Seller's liability in the SPA, optimising the latter's negotiation and reducing the negotiating parties' exposure to transactional risk[23].

W&I Insurance will make it possible to eliminate or mitigate the need for the Seller to provide guarantees in favour of the Buyer[24], meeting the Buyer's expectations of collateral in the transaction, including the Buyer's own financiers, in a context of acquisition financing[25]. From a credit risk point of view, the potential risk of losses that may arise in the target company as a result of the Seller's breach of warranties will be covered by a (solvent) third party which, as a rule and due to strict regulatory requirements, has the capacity to deal with a claim made by the Buyer[26].

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[20] ANGELO BORSELLI, "Insurance in M&A", cit., p. 212; SEAN J. GRIFFITH, "Deal Insurance: Representation and Warranty Insurance in Mergers and Acquisitions", *in Minnesota Law Review*, 104, 2020, pp. 1839-1920, 1842, available at ir.lawnet.fordham.edu/faculty_scholarship/973/; DANIEL W. GERBER *et al.*, *Mergers and Acquisitions Insurance - New Appleman on Insurance Law Library Edition*, New York, LexisNexis, 2010 , Chapter 32, [32.01-32.05], 32.01[1].

[21] DANIEL W. GERBER *et al.*, *Mergers and Acquisitions*, cit., 32.02[b]; BRUNO MARTÍN BAUMEISTER, "La cláusula de manifestaciones y garantías como ejemplo de "Legal transplant" en Derecho español", *in Revista Crítica de Derecho Inmobiliario*, 97(787), 2021, pp. 2931-2961, 2946-2947.

[22] SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1866; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung in der M&A-Beratungspraxis", *in BB*, 2018, pp. 1475-1480, cit., p. 1475; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 659.

[23] ANGELO BORSELLI, "Insurance in M&A", cit., p. 212; DENNIS FRONEBERG/MICHAEL GAUL/SASCHA KOLARIC, "W&I-Versicherungen als Transaktionsbeschleuniger und erste Schadenerkenntnisse", *in M&A Review*, 6, 2017, pp. 216-222; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 665; HELENA GUIMARÃES/ANA LUISA FUCCI, "Utilização de Seguros em Operações de M&A – Uma alternativa possível no Brasil?", *Fusões e Aquisições em Foco: Uma abordagem Multidisciplinar*, II, Rio de Janeiro, Lumen Juris, 2022, pp. 53-66, 58; JAVIER GOIZUETA VELASCO, "El seguro de M&A", cit., p. 405.

[24] CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 20; DANIEL W. GERBER *et al.*, *Mergers and Acquisitions*, cit., 32.01[2].

[25] PÉREZ CARRILLO, "Aproximación", cit., p. 252; SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1899; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1475; GUILLERMO SAN PEDRO MARTÍNEZ/GUILLERMO DEL RÍO, "El seguro de manifestaciones y garantías: cuestiones prácticas de interés", *in Manual de fusiones y adquisiciones de empresas*, 3rd ed, Madrid, La Ley/Wolters Kluwer, 2021, pp. 483-514, 495.

[26] CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang", cit., p. 144; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1475; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 664; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 478; JAVIER GOIZUETA VELASCO, "El seguro de M&A", cit., p. 404; GUILLERMO SAN PEDRO MARTÍNEZ/GUILLERMO DEL RÍO, "El seguro", cit., p. 494.

2. Due diligence on the target company

Carrying out a due diligence[27] on the target company falls within the scope of the negotiation agreements typically contained in the Letter of Intent, a pre-contractual instrument widely used in negotiation processes for the acquisition of a controlling shareholding, which is a condition accepted by the Seller in favour of the Buyer, thus allowing negotiations between the parties to continue with a view to the future conclusion of the SPA. The Letter of Intent is the legal instrument that "opens the door" for the Buyer to carry out a due diligence. Together, the Letter of Intent and the due diligence intensify the negotiation process[28].

In the context of acquiring control of a company, a due diligence exercise consists of analysing the target company to be acquired in order to obtain as much information as possible. It is a snapshot of the *status quo* of the target company as of a certain date. The due diligence process is a demanding, interactive, evolving process of analysis and clarification, of significant importance, an intense and time-consuming task that requires careful preparation and implementation, constituting a core step in the acquisition of companies[29], with a view to mitigating information asymmetry[30]. It is important to put together a team of specialists in different areas of Law so that the due diligence report can fully assess all the contingencies identified, whether current or potential.

It should be emphasised that, as is also the practice in this type of auditing exercise, the interactions (requests for clarification, information and/or documents and the respective response) between buyers and sellers are made through a questionnaire (commonly known as

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[27] On the due diligence process in Portuguese law, NUNO MOURA ROLDÃO/ANA GUEDES TEIXEIRA, "O processo *de* auditoria legal", *in Aquisição de Empresas*, Coimbra, Coimbra Editora, 2011, pp. 107-126; PATRÍCIA AFONSO FONSECA, *Da Responsabilidade na Transmissão de Participações Sociais nas sociedades anónimas*, Master's Thesis, Lisbon, FDUL, 2009, p. 86 *et seq*; FÁBIO CASTRO RUSSO, "Due Diligence e responsabilidade", *in I Congresso Direito das Sociedades em Revista*, cit., pp. 13-26*; idem*, "Das cláusulas de garantia nos contratos de compra e venda de participações sociais de controlo", *in DSR*, 2(4), 2010, pp. 115-136, 122-123; JÉSSICA RODRIGUES FERREIRA, "Share deal e vícios no patrimônio da sociedade alvo: breves notas a propósito da tutela inibitória", *in DSR*, 10(19), 2018, pp. 169-206, 195-205; RITA CARRILHO DA CUNHA, "Dos mecanismos voluntários de tutela do adquirente em contratos de compra e venda de empresa – em especial: a *Due Diligence* e as *Representations & -Warranties*", *in DSR*, 12(23), 2020, pp. 273-303, 282-292; PAULO CÂMARA/MIGUEL BRITO BASTOS, "O direito de aquisição de empresas: uma introdução", *in Aquisição de Empresas*, cit., pp. 13-63, 26-38; CATARINA MONTEIRO PIRES, *Aquisição de Empresas e de Participações Acionistas - Problemas e litígios*, Coimbra, Almedina, 2018, pp. 32-62; ENGRÁCIA ANTUNES, "A empresa com objeto de negócios - 'Asset Deals' versus 'Share Deals'", *in ROA*, 68(2/3), 2008, pp. 715-793, 750-754; JOSÉ FERREIRA GOMES, *M&A - Aquisição de Empresas e de Participações Sociais*, Lisbon, AAFDL, 2022, pp. 199-215. In Spanish law, JESÚS ALEMANY EGUIDAZU, *Auditoria Legal - Due Diligence y opiniones legales en los negocios mercantiles*, Madrid, Thomson Civitas, 2008; LUIS HERNANDO CEBRIÁ, *La revisión legal ("legal due diligence") en el derecho mercantil*, Granada, Comares, 2008; *idem*, "La incidencia de la 'Legal Due Diligence' ('revisión legal') en la contratación mercantil contemporânea", *in Revista de derecho mercantil*, 260, 2006, pp. 603-640; ROSANA HALLET CHARRO, "Due Diligence", *in Adquisiciones de Empresas*, 5th ed., Madrid, Thomson Reuters Aranzadi, 2019, pp. 163-226; ANTONIO SERRANO ACITORES, "La importancia de la "due diligence" en los procesos de compraventa de empresas", *in La Ley Mercantil*, 36, 2017, p. 6; TOMÁS JOSÉ ACOSTA ÁLVAREZ, "La due diligence legal previa a la adquisición de empresa", *in Manual de Fusiones y Adquisiciones de Empresas*, 1st ed., Madrid, La Ley, Wolters Kluwer, 2016, pp. 65-98. In Italian law, LUCA PICONE, "Trattative, due diligence ed obbligi informative", *in BBTC*, I, 2004, pp. 234-269; SILVIO TERSILLA, "La 'Due Diligence' per l'Acquisizione di un Paccheto Azionario di Controllo di una Società Non Quotata in Borsa: Obblighi di Informazione e Responsabilità dei Soggetti Coinvolti", *in Diritto del Commercio Internazionale*, XV (4), 2002, pp. 969-999; LUCA RENNA, *Compravendita di partecipazioni sociali*, Bologna, Zanichelli, 2015, pp. 81-101.

[28] CATHY HWANG, "Deal Momentum", *in UCLA Law Review*, 65, 2018, pp. 376-425, 407; MIGUEL GIMENO RIBES, *La protección del comprador en la adquisición de empresa. Estudio comparado de los ordenamientos español y alemán*, Granada, Comares, 2013, p. 180.

[29] ANDREAS GRAN, "Abläufe", cit., p. 1410; SILVIO TERSILLA, "La 'Due Diligence'", cit., p. 969.

[30] JESUS ALEMANY EGUIDAZU, *Auditoria Legal*, cit., p. 61.

Q&A). During the due diligence process, the Buyer asks questions, requests clarifications and documents from the Seller, or the teams of professionals hired by them, and they respond and provide the requested information. This process is repeated as many times as necessary until the parties reach an agreement[31].

Therefore, in an attempt to clarify the concept of due diligence, we can say that it is an investigation aimed at reducing the risk of the transaction (*risk allocation*), considering the specific problems of the transaction and identifying the issues that require legal protection. Analysing this information is crucial for the Buyer to be able to properly assess the value of the target company and to offer a final price (notwithstanding the provisional price put forward in the Letter of Intent, based on a preliminary analysis) that is as close as possible to the real value of the target company and perhaps higher than the price it would offer if it did not have access to this information, which the Buyer believes to be relevant, given the risk of the target company's contingencies.

In the context of complex processes, such as corporate acquisitions, the underlying negotiation is not compatible with the mere verbal discussion of topics of mutual concern, otherwise the Buyer's behaviour may be qualified as negligent. The existence of representations and warranties provided by the Seller cannot mean that the due diligence exercise is disregarded.

Acting diligently, the Buyer must request specific clarifications from the Seller to become aware of facts that are within its power to know. If it fails to do so, it shall be liable for any damage/loss it may suffer, provided that it would have been in a position to detect the contingency in question if it had used the diligence required of it, making the requests for clarification that a normal buyer, placed in that situation, would have made. Inertia or lack of diligence on the part of the Buyer in conducting the due diligence process in relation to facts or circumstances that have been fairly disclosed by the Seller, will lead to the risk being exclusively attached to the Buyer.

Both the Buyer and the Seller will have an interest in carrying out a due diligence check. In fact, due diligence is a bilateral process that involves both the Seller and the Buyer. The Buyer, wishing to preventively safeguard his negotiating position, *i.e.* to identify contingencies (skeletons in the wardrobe)[32] *ex ante* rather than be involved in litigation after the SPA has been executed (with an uncertain outcome), will want to know what is being bought and thus calculate the price to be paid, in order to make a decision as informed as possible as to whether or not to contract and — if so — on what terms[33].

Furthermore, the Buyer's precautions in the case of the acquisition of a controlling shareholding are largely the result of the representations and warranties provided by the Seller in the SPA,

[31] ANDREW J. SHERMAN/MILLEDGE A. HART, *Mergers & Acquisitions*, cit., p. 66: "[e]ffective due diligence is both an *art* and a *science*".
[32] *Ibidem*, pp. 63-64. According to GIACOMO GREZZANA, "O Qualificador de Conhecimento (Knowledge Qualifier) e suas Relações com a Cláusula de Declarações e Garantias em Alienações de Participação Societária", *in Mergers and Acquisitions (M&A)*, 3rd ed, São Paulo, Quartier Latin, 2022, pp. 221-278, 222, contingency should be understood as "all liabilities, defects and/or vicissitudes of the target company, regardless of whether they materialise or not, which triggering event is prior to the purchase of a shareholding".
[33] SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1860 *et seq*.

the drafting of which presupposes knowledge of the *quid* transacted, which will often involve carrying out an audit, and the drafting of the warranties clause will only gain the necessary precision as a result of a due diligence carried out in advance[34]. Due diligence thus allows the Buyer to shape, throughout the negotiation process, the warranties that will ultimately be provided by the Seller in the SPA. Throughout the due diligence, as a commercial practice, the risks and contingencies detected will make it possible to adapt, adjust and conform the representations and warranties to be given by the Seller in the SPA to the reality of the facts, thus allowing them to be drafted in a more precise manner and adapted to the underlying reality of the target company.

Due diligence is, therefore, a forward-looking instrument that prepares for the later stages of the negotiation process, making it possible to identify and allocate risks, which are essential for setting the purchase price of the target company and the Seller's obligation to indemnify.

To summarise: the due diligence both serves as a valuable process in preparing the SPA promoting the (future) contractual balance between the parties, insofar as carrying it out will allow for an allocation of liabilities between the negotiating parties, facilitating the transparency of the negotiation process, since it allows for as precise a definition and knowledge as possible of the underlying object (target company), so as to allow the Buyer to decide on the acquisition being negotiated and on the respective terms and conditions.

3. The representations and warranties

As previously analysed, the purpose of carrying out a due diligence assessment is to mitigate and attenuate the information deficit that the Buyer has in the context of the negotiations - a deficit that is gradually eroded as the negotiation process progresses[35].

It will be up to the Buyer (as creditor of the information), as opposed to the Seller (debtor of the relevant information), to take the necessary measures to combat this inequality of information, namely by setting out a warranties clause, as a result of the duty of information arising from the principle of objective good faith, which regulates the distribution of risk in the event of a mismatch between the information provided by the Seller and the underlying reality[36]. Throughout the due diligence process, the contingencies detected in the different areas reviewed will allow the Buyer to adapt and adjust the warranties to be provided by the Seller to the reality of the target company[37].

[34] CASTRO RUSSO, "Due Diligence", cit., pp. 15-17.
[35] ÁNGEL CARRASCO PERERA, "Manifestaciones y garantías y responsabilidad por incumplimiento", *in Adquisiciones de empresas*, cit., pp. 285-358, 264.
[36] JÉSSICA RODRIGUES FERREIRA, "Share deal", cit., p. 188; SEAN J. GRIFFITH, "Deal Insurance", cit., pp. 1841, 1942. *See* ABRAHAM J.B. CABLE, "Comment on Griffith's Deal Insurance: The Continuing Scramble Among Professionals", *in Minnesota Law Review*, 104, 2020, pp. 75-108, 78, available at minnesotalawreview.org/wp-content/uploads/2020/04/Cable_Final.pdf.
[37] JEFFREY MANNS/ROBERT ANDERSON IV, "The Merger Agreement Myth", *in Cornell Law Review*, 98, 2013, pp. 1143-1188, 1184, available at scholarshilaw.cornell.edu/clr/vol98/iss5/3/.

The provision of representations and warranties, as contractual provisions in the SPA, is clearly the result of an influence of common law *praxis* on our legal system, translating into a "mimicking of the famous North American *representations and warranties* clauses"[38], and are admittedly the most negotiated clauses during the negotiation process for the acquisition of a controlling shareholding. Their presence is indispensable in commercial *praxis* for company acquisition transactions - it is, dare we say, a *sine qua non* condition for any SPA - bringing together the *de facto* and *de jure* qualities relating to the target company, with an exhaustive identification and which were the basis of the *animus* to contract.

In national contractual practice, *representations and warranties* are commonly translated as "*declarações e garantias"* and tend to take on an increasingly standardised configuration[39].

There is a basic difference between declarations and warranties (albeit "somewhat abstract and fraught with difficulties")[40]:

(i) representations (*declarações*) refer to statements about past or contemporaneous facts at the time the statement is issued, *i.e.* they denote the Seller's knowledge of a certain set of facts, which will be taken as true by the party to whom the statement is addressed[41].

[38] PAULO CÂMARA/MIGUEL BRITO BASTOS, "O direito de aquisição", cit., p. 38; GIACOMO GREZZANA, *A cláusula de Declarações e Garantias em Alienação de Participação Societária*, São Paulo, Quartier Latin, 2019, 19; BRUNO MARTÍN BAUMEISTER, "La cláusula", cit., p. 2935.

[39] In Portuguese doctrine, *see* CASTRO RUSSO, "Das cláusulas", cit.; CATARINA MONTEIRO PIRES, *Aquisições de empresas*, cit., pp. 63-81; JOSÉ FERREIRA GOMES, *M&A*, cit., pp. 251-286; PAULO CÂMARA/MIGUEL BRITO BASTOS, "O direito de aquisição", cit.; ANTÓNIO TELES/JOÃO CARMONA DIAS, "Garantia na Alienação", *in Aquisição de empresas*, cit., pp. 65-105; GONÇALO SIMÕES ALMEIDA, "Declarações e garantias na transmissão de empresas", *in DSR*, 12(23), 2020, pp. 243-272; PATRÍCIA AFONSO FONSECA, *Da Responsabilidade*, cit., pp. 158-169; CLEMENTE V. GALVÃO, "Declarações e Garantias em Compra e Venda de Empresas – Algumas Questões ", *in Actualidad Jurídica Uría Menendez*, 12, 2005 , p. 103 *et seq*; *idem*, "Conteúdo e incumprimento do contrato de compra e venda de participações sociais", *in ROA*, 70, no. 1/4, 2010, pp. 533-573, available at portal.oa.pt/publicacoes/revista-da-ordem-dos-advogados/ano-2010/ano-70-vol-iiv-2010/doutrina/clemente-v-galvao-conteudo-e-incumprimento-do-contrato-de-compra-e-venda-de-participacoes-social/; CATARINA TAVARES LOUREIRO/MANUEL CORDEIRO FERREIRA, "As cláusulas de declarações e garantias no direito português - Reflexões a propósito do Acórdão do Supremo Tribunal De Justiça de 1 de Março", *in Actualidad Jurídica Uría Menéndez*, 44, 2016. Cf, in Spanish law, CARRASCO PERERA, "Manifestaciones", cit.; GÓMEZ POMAR/MARÍA ANGELS GILI SALDAÑA, "Las manifestaciones y garantías en los contratos *de* compraventa de empresas", *in Manual de fusiones y adquisiciones de empresas*, Madrid, Wolters Kluwer, 2016, pp. 417-447, 435; GÓMEZ POMAR, "El incumplimiento contractual en Derecho español", *in InDret*, 3, 2007, available at indret.com/wp-content/themes/indret/pdf/466_es.pdf; MARÍA ANGELS GILI SALDAÑA, "Compraventa de acciones: causa del contrato y remedios frente al incumplimiento de las manifestaciones y garantias", *in InDret*, 2, 2010, available at indret.com/wp-content/themes/indret/pdf/736_es.pdf; JUAN AGUAYO ESCALONA, *Las manifestaciones y garantías en el Derecho de contratos español*, Madrid, Civitas/Thomson Reuters, 2011; MIGUEL GIMENO RIBES, *La protección*, cit.; BRUNO MARTÍN BAUMEISTER, "La cláusula", cit., pp. 2931-2961. In Italian law, SILVIO TERSILLA, "Le clausole di garanzia nei contratti di acquisizione", *in Dir. comm internaz.*, 2004; MARCO CASSOTTANA, *Rappresentazioni e Garanzie nei Conferimenti D'Azienda in Società per Azioni*, Milano, Giuffrè, 2006; LUCA RENNA, *Compravendita*, cit., p. 224 *et seq*; ANDREA TINA, *Il contratto di acquisizione di partecipazioni societarie*, Milano, Giuffrè, 2007, p. 361 *et seq*; PAOLO CASELLA, "I due sostanziali metodi di garanzia al compratore", *in Acquisizioni di società e pacchetti azionari di riferimento*, Milano, Giuffrè, 1990, pp. 129-144; ROBERTO PISTORELLI, "Le garanzie 'analitiche' sulle voci della situazione patrimoniale di riferimento", *in Acquisizioni di società*, cit., pp. 155-167. On the subject, in Brazilian law, GIACOMO GREZZANA, *A cláusula*, cit..

[40] ENGRÁCIA ANTUNES, "A empresa", cit., p. 783. For the author, "[i]n a strict sense, the 'Representations' are distinct from warranties: whereas the former are essentially declarations attesting to the de facto state of the company's business at the time of the conclusion of the contract, the latter aim to create reciprocal obligations between the parties with regard to a number of matters or aspects of that business after that conclusion.". According to PAULO CÂMARA/MIGUEL BASTOS, "O direito de aquisição", cit., pp. 38-39, "representation" is a statement of fact, usually made by the seller, which aims to describe past or present facts. They differ from "warranties" in that they do not constitute legal obligations that can be breached if they do not conform to reality. The latter, on the other hand, aim to assure the counterparty of a certain factual situation or quality of the object of the deal, and are the source of legal obligations that protect the interests of that counterparty. Each of these designations refers to individual business statements whose technical and legal qualifications, and consequent applicable rules, are considerably different".

[41] According to ANA PERESTRELO DE OLIVEIRA, *Desvinculação Programada do Contrato*, Coimbra, Almedina, 2021, p. 348, "representations" are assertions made as to the veracity of a fact at the time that the representation is made".

Representations therefore qualify as legal statements, issued by the Seller, as far as they merely affirm or recognise the existence of a factual situation;

(ii) warranties (*garantias*), in turn, complement the representations, confirming them, with the aim of ensuring and guaranteeing the counterparty a certain and specific factual situation or quality of the object of the deal, creating legal obligations to protect the interests of the counterparty. To that extent, they warrant that the representations made are not false (therefore, accurate, true and complete) and made with the (necessary) due diligence, following the formulation *the Seller represents and warrants to the Buyer*, with the list of relevant matters relating to the target company. Warranties (*garantias*) correspond to "the promise that a state of affairs exists, through the fixing of characteristics or qualities of a certain good, or set of goods, a certain business or a certain legal situation, giving the buyer additional rights in relation to the legal catalogue"[42].

It is a common practice for the parties to agree on tailor-made clauses contractually regulating the allocation of risks (*risk-sharing*) inherent in the transaction in progress, both in relation to the shareholdings and in relation to the target company, with regard to their respective legal and financial position, without, however, relegating the remedies, in the event of pathological situations, to the legal rules, because they understand that these are insufficient[43].

The tendency is to complementarily link[44] representations and warranties in the aforementioned warranties clause, in the sense that representations are always confirmed by warranties.

It should be noted that the warranties clause refers to present or past facts concerning the target company, and that the Seller does not make "predictions about the future"[45], *i.e.* the Seller certifies present or future facts (*facts giving rise to the falsehood*) which may turn out to be false (*revealing facts*)[46].

According to ENGRÁCIA ANTUNES, "within the framework of share deals modelled on analytical negotiating standards", "representations and warranties clauses have become commonplace, essentially designed to ensure the reliability, certainty and legal binding nature of the parties' representations as to the direct (shareholdings) and indirect (company) object of the deal"[47].

The following functions are generally assigned to warranties clauses[48]:

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[42] CATARINA MONTEIRO PIRES, *Aquisição de empresas*, cit., p. 63; ANA PERESTRELO DE OLIVEIRA, *Desvinculação*, cit., p. 348, "warranty is the promise to pay compensation if the assertion is incorrect or false (indemnity)".
[43] CATARINA MONTEIRO PIRES, "Cláusulas de preço fixo, de ajustamento de preço e de alteração material adversa ("MAC") e cláusulas de força maior: revisitando problemas de riscos de desequilíbrio e de maiores despesas em tempos virulentos", *in ROA*, 80(1/2), 2020, pp. 73-93, 75.
[44] ANTÓNIO TELES/JOÃO CARMONA DIAS, "Garantia na Alienação", cit., p. 66.
[45] GIACOMO GREZZANA, *A cláusula*, cit., pp. 64-65.
[46] *Idem*, "O Qualificador", cit., p. 265.
[47] ENGRÁCIA ANTUNES, "A empresa", cit., pp. 783 and 749, for whom representations and warranties clauses have become an "unavoidable risk management instrument".
[48] PAULO CÂMARA/MIGUEL BASTOS, "O direito de aquisição", cit, 38-39: "these representations may, among other things, be in the nature of negotiating statements that contribute to *contractually determining the due object of the contract* or to constituting *autonomous guarantee obligations*, as well as being unilateral declarations devoid of the character of modelling the negotiating content but *generating trust in the recipient*, and therefore capable of justifying the declarant's liability for the breach of the declarant's trust, or even as mere legally inoperative declarations, but which inscription in a document has evident *evidential relevance* with regard to psychological

(i) *insurance or guarantee function* (*função securitária ou de garantia*) — allows the Buyer to react, on the basis of a guarantee obligation (*obrigação de garantia*) provided by the Seller, if the falsity of any of the warranties is revealed, *i.e.* a non-conformity between what has been represented and warranted and the reality of the facts, on the basis of the distribution of risk agreed between the parties, with the assumption by the Seller of the duty to indemnify the Buyer[49];

(ii) *modelling function* (*função modeladora ou conformadora*) — modelling the object of the acquisition ("obligation of delivery (*obrigação de entrega*) of the seller to the buyer [art. 879 (1),b) of the Portuguese Civil Code]"[50]), since they integrate the *essentialia negotti*, specifying the contractual object in the event of the Buyer's will being inadequately formed, complementing the other legal remedies potentially applicable in the event of a breach of the warranties[51];

(iii) *informative function* (*função informativa*) —allow the disclosure of relevant facts and information of the target company to be acquired (*flush out material facts*), helping the Buyer in matters of error or deceit of the Seller[52];

(iv) *probative function* (*função probatória*) — the Seller's warranties may be a relevant element in assessing any pre-contractual liability of the Seller, as well as the requisites of error or wilful misconduct[53].

In the process of acquiring a controlling stake, warranties can therefore take on a different legal nature, depending precisely on the *role* that the negotiating parties attribute to them in the *SPA*. As mentioned above, they can be identified as having an *insurance or guarantee function*, *modelling*, *informative* and *probative* role.

Only the *insurance* or *guarantee* function and the *modelling* function transform the liability arising from the falsity of warranties into a *contractual* one, *i.e.* into an *obligation of guarantee (obrigacão de garantia)* and an *obligation to perform (obrigação de prestar)*, respectively, and they are mutually exclusive, in the sense that "they can coexist with the informative and probative functions, but not with each other"[54].

facts attributable to the acquirer or the seller". We agree with the authors' analysis, which shows the functional profile that representations and warranties can generally assume; GIACOMO GREZZANA, *A cláusula*, cit., p. 70, according to the author, "the representations and guarantees clause does not have a single legal nature, but is a type that includes a multiplicity of legal natures, which can be determined according to the function envisaged by the parties at the time of the agreement". Also agreeing with GIACOMO GREZZANA, JOSÉ FERREIRA GOMES, *M&A*, cit., p. 266 (footnote 816).

[49] JOSÉ FERREIRA GOMES, *M&A*, cit., p. 264, speaks of "autonomous warranties clauses" (*cláusulas de garantia autónomas*), which associate "specific contractual consequences to the eventual incorrectness of what is stated in the contract"; GIACOMO GREZZANA, *A cláusula*, cit., p. 72, refers that the declarant merely warrants a certain state of things assuming the risk that it is not true.

[50] JOSÉ FERREIRA GOMES, *M&A*, cit., p. 264.

[51] PATRÍCIA AFONSO FONSECA, "A negociação", cit., pp. 38-39.

[52] GÓMEZ POMAR/MARIAN GILI SALDAÑA, "Las manifestaciones", cit., pp. 443-445; SIMON BESWICK, *Buying and Selling Private Companies and Businesses*, UK, LexisNexis, 2001, 210, where the author refers to warranties as a "means to flush out information regarding the target".

[53] GIACOMO GREZZANA, *A cláusula*, cit., pp. 78-79.

[54] *Ibidem*, pp. 70-71.

The warranties to be provided by the Seller contribute, more generally, to increasing legal certainty by mitigating the existence of blind spots regarding the target company, which could lead to litigation between the parties, based on a thorough comparative analysis between the Seller's warranties and the information gathered by the Buyer during the due diligence process carried out on the target company[55].

The functional profile of the Seller's warranties identified above shall be assessed on a case-by-case basis, *i.e.* the role played by the different warranties clauses will depend on the outcome of the negotiation process between the parties (negotiating power of the parties involved, timings, information made available, both quantitatively and qualitatively), based on the autonomy of will and the freedom of contract.

However, the warranties clause, which is socially typical in operations to acquire a controlling shareholding, is a *standard risk distribution* clause, as a "central problem of contract law"[56], adjusted according to the results obtained in the due diligence carried out by the Buyer.

In our opinion, the insurance function (*função securitária ou de garantia*) is the typical function performed by the warranties clause in the SPA in corporate acquisition transactions of a controlling shareholding. It should be remembered that the difficulties, doubts and lack of clarity regarding the application of the sale and purchase regime (*i.e.* sale of encumbered goods — Article 905 of the Portuguese Civil Code — and sale of defective goods — Article 913 of the Portuguese Civil Code) to the indirect acquisition of shareholdings with a view to acquiring control[57], justifies the presence of the warranties clause with this specific *function* and *legal nature*, the express provision of which undoubtedly protects the Buyer[58].

To this extent, there is a contractual management of the SPA by the negotiating parties, based on freedom of contract and party autonomy, distributing the risks identified and underlying the transaction in progress. The warranties clause aims to safeguard against contractual risks and promote contractual equilibrium[59].

With the use of the warranties clause, together with an indemnity clause also set out in the SPA, the Seller lists a series of statements relating to the target company which, if they prove to be false, allow the Buyer, after the closing of the transaction, to be compensated for the damage caused to the target company. The aim of the parties in setting forth a warranties clause is to transfer to the Seller the responsibility and risk (the risk which is the *cause of* the warranties) in the event of non-compliance with the warranties given by the Seller.

What does *false warranties* mean? We agree with GIACOMO GREZZANA who notes that the incorrectness, imprecision and incompleteness of warranties, as typical references in the warranties clause provided for in the SPA, must be "understood within the umbrella of 'falsity'", in what the author calls a "dialectical exchange of meaning between words", *i.e.* whenever a

[55] BRUNO MARTÍN BAUMEISTER, "La cláusula", cit., pp. 2935-2936.
[56] CATARINA MONTEIRO PIRES, "Cláusulas de preço fixo", cit., p. 87.
[57] PATRÍCIA AFONSO FONSECA, *Da Responsabilidade*, cit., p.162.
[58] JOSÉ FERREIRA GOMES, *M&A*, cit., p. 268.
[59] ANA PERESTRELO DE OLIVEIRA, *Desvinculação*, cit., p. 349.

warranty is incorrect, inaccurate or incomplete to the point of being inconsistent with the underlying reality, it is therefore false — so these words end up materialising the falsity of the statement. Falsehood is not to be confused with knowledge of it by the provider of the warranty, *i.e.* for a declaration to be false all it takes is for it to be incorrect, inaccurate or incomplete, regardless of the Seller's will, knowledge or guilt that the declaration is false[60].

Under the freedom of contract, the warranties in the case under analysis have the legal nature of a *obligation of guarantee (obrigação de garantia*) through which the debtor (Seller) warrants the creditor (Buyer) a certain result, assuming the legal risk of it not occurring, whatever it may be. The insurance function will, therefore, be the function performed by the warranty clause in the SPA in company acquisition transactions (control shareholding), the configuration of which will depend on the agreement between the negotiating parties.

The materialisation of the risk will therefore not constitute a breach of contract (*incumprimento do contrato*) on the part of the Seller, insofar as it has not undertaken an obligation to prevent the realisation of the same[61]. In fact, in the warranties clause, the "mere fact of assuming the warranty against the risk already fulfils the guarantor's obligation"[62].

The warranties clause, as a contractual clause of the SPA which, once agreed, is the result of the information flow conveyed and negotiated between the parties, aims to establish between the parties an autonomous contractual mechanism of liability[63] that is intended to be sufficient, and which does not require subjective assessment. In the event of a mismatch between what has been negotiated between the parties and ultimately set out in the warranties clause and what has been purchased (i.e., target company), the Seller assumes objective liability towards the Buyer in the sense that it is obliged to make a payment of a pecuniary nature in favour of the Buyer[64].

The Seller warrants to the Buyer (assuming a risk) a set of circumstances relating to the target company, ensuring that they are true (*complete and up to date*), and the warranty deals specifically with the veracity of the statement (convergence — and not divergence — between what the Seller states and the reality of the facts). The Seller assumes a risk, and does not guarantee itself in the proper sense, as a guarantee of fulfilment of contractual obligations (*garantia das obrigações*), whether it is a guarantee (*garantia pessoal*) or security (*garantia real*). The occurrence of the risk will be of particular significance to the Buyer, in that it will be

[60] GIACOMO GREZZANA, *A cláusula*, cit., pp. 66-67.
[61] CATARINA MONTEIRO PIRES, " Cláusulas de preço fixo", cit., p. 87; JÉSSICA RODRIGUES FERREIRA, "Share deal", cit., p. 189.
[62] GIACOMO GREZZANA, *A cláusula*, cit., p. 175. In Spanish law, CARRASCO PERERA, "Manifestaciones", cit., p. 304; GÓMEZ POMAR, "El incumplimiento contractual", cit., pp. 6-7.
[63] JOSÉ FERREIRA GOMES, *M&A*, cit., pp. 267-268, refers to an "autonomous contractual solution that excludes undesirable legal consequences" and a "self-sufficient contractual solution" under clauses which "are constructed as a solution of pure distribution of contractual risk: the one who declares [Seller] does not assume any obligation susceptible of fulfilment".
[64] CATARINA MONTEIRO PIRES, *Aquisição de empresas*, cit., p. 27, the parties can conventionally objectify the imputation for the impossibility of non-performance, at the same time as agreeing on the measure of diligence required of the Seller.

able to demand compensation from the Seller ("*dever de prestar*") as a result of its occurrence[65].

4. The W&I Insurance

4.1. Framework

Having analysed the due diligence process and the warranties clause in the context of the acquisition of a controlling shareholding, it is now time to focus on the key features of W&I Insurance.

In the international insurance market, the W&I Insurance is the order of the day when it comes to structuring M&A transactions, as a way of mitigating transactional risk[66], where it has already gained substance, especially in company acquisitions involving international players. As such, it constitutes an insurance product geared towards company acquisitions (acquisition orientated W&I policy).

The natural *habitat* of the W&I Insurance can be traced back to the insurance market in the United Kingdom, the United States of America and Australia, having subsequently expanded to Continental Europe, Asia, Africa and the Middle East[67]. It is a type of insurance that has received its *modus vivendi* from international insurance practice and whose steps in the national insurance market, although initially slow, are (certainly) consistent, beginning to form part of the repertoire of national corporate acquisition transactions[68], optimising the negotiation process.

Whilst commercial practice has been intense, scholarly analysis in Portugal, unlike other legal systems (German or Spanish), is still sparse[69].

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[65] CARRASCO PERERA, "Manifestaciones", cit., pp. 254-255; GÓMEZ POMAR/GILI SALDAÑA, "Las manifestaciones", cit., p. 478.

[66] In Germany, KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung als Risikominimierungsmodell bei Private-Equity-Transaktionen und sonstigen Unternehmenskäufen", *in ZIP*, 2005, pp. 377-384, 377. In Spain, GUILLERMO DEL RÍO, "El funcionamiento de los seguros de manifestaciones y garantías en la práctica. Una visión desde la praxis norteamericana", *in Dimensiones y desafíos del seguro de responsabilidad civil*, Madrid, Civitas, 2021, pp. 271-302, 275. In American law, SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1842. In Brazilian law, HELENA GUIMARÃES/ANA LUISA FUCCI, "Utilização de Seguros", cit., pp. 53-66; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", pp. 548-549.

[67] CHRIS PEARSON/DAVID WHEAR, *Buy-side warranty and indemnity insurance - Key issues for buyers*, Norton Rose Fulbright, 2015, available at nortonrosefulbright.com/knowledge/publications/133972/buy-side-warranty-and-indemnity-insurance. The W&I Insurance has increased in popularity in Portugal over the last 5-10 years.

[68] In the Spanish insurance market, PÉREZ CARRILLO, "Aproximación", cit. 260; CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., pp. 19-20.

[69] ENGRÁCIA ANTUNES, "A empresa", cit., p. 782, footnote 147; JOSÉ FERREIRA GOMES, *M&A*, cit., p. 66; RITA CARRILHO DA CUNHA, "Dos mecanismos", cit., pp. 296-297; ANA PERESTRELO DE OLIVEIRA, *Desvinculação*, cit., p. 349. From an eminently practical perspective, our analysis, "O seguro de Representations & Warranties e a aquisição de empresas", *in GA&P Analyses*, 2016, available at ga-com/wp-content/uploads/2018/07/o-seguro-de-representations-warranties-e-a-acquisicao-de-empresas-2.pdf. More recently (2023), two more comprehensive papers were published — CHEN CHEN, "O seguro de *Warranty & Indemnity*: da perspetiva do comprador", *in RDS*, XVI(1), 2023, pp. 35-63; and, MARIA ELISABETE RAMOS, "M&A Insurance", *in VII Congresso – Direito das Sociedades Revista*, Coimbra, Almedina, 2023, pp. 397-416.

Although it does not constitute a remedy for everything that involves corporate acquisitions[70], it is undoubtedly a sophisticated *tailor-made* insurance policy, negotiated and concluded according to the circumstances of each acquisition[71], acting as a risk mitigation device[72], based on a negotiation process between the Insurer, Seller and/or Buyer (as applicable), which is intended to be swift and effective given the often tight timescales for the acquisition of a controlling shareholding.

Like other contracts, the insurance contract, and specifically the W&I Insurance, is governed by the principle of freedom of contract (article 11 of the Portuguese Insurance Act, approved by Decree-law 72/2008 of 16 April, as amended from time to time, hereinafter, RJCS).

The contractual freedom of the parties is symptomatic of the multiple forms that the W&I Insurance negotiation process can take. In fact, the contractual freedom to enter into a negotiation process is based on party autonomy and can be of varying complexity and extent, without prejudice to the fact that practice has demonstrated the existence of an increasingly standardised process, which justifies the increasingly frequent use of this type of insurance.

Under the terms of article 1 RJCS, which presents the typical content of the insurance contract (and not a definition), "*(...) the insurer covers a specific risk of the policyholder or another party, obliging himself to fulfil the agreed benefit* ["*prestação convencionada*"] *in the event of the occurrence of the random event* [i.e, "*sinistro*", as defined in article 99 RJCS[73]] *provided for in the contract, and the policyholder obliges himself to pay the corresponding premium*".

The insurance contract has been defined by the doctrine as a "contract by which one party, for a consideration, bears an economic risk of the other party or of a third party, and undertakes to provide the counterparty or the third party with the appropriate means to suppress or mitigate the actual or potential negative consequences of the occurrence of a certain event"[74], a definition with which we agree and which we follow closely.

Portuguese scholars refer to the insurance contract as a social and legally typical contract. The W&I insurance is no exception[75]. Moreover, all economic activity is related to insurance, either

[70] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., p. 54.
[71] MURAD M. DAGHLES/THYL N. HAßLER, "Warranty & Indemnity-Versicherungen im Rahmen von Unternehmenstransaktionen", *in GWR*, 22, 2016, pp. 455-457, 456.
[72] NICK HUMPHREY, *Key issues in insuring an M&A deal*, Norton Rose Fulbright, 2021, available at lexology.com/library/detail.aspx?g=4ec09a3e-72a1-4aa4-8ade-c734f8e88fea; ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., p. 52.
[73] As per article 99 RJCS: "The claim [sinistro] corresponds to the total or partial verification of the event that triggers the risk coverage provided for in the contract". *See* MARIA INÊS DE OLIVEIRA MARTINS, *Contrato de seguro e conduta dos sujeitos ligado ao risco, Coimbra, Almedina, 2018*, p. 49 *et seq.*.
[74] MARGARIDA LIMA REGO, *Contrato de Seguro e Terceiros* — Estudo de Direito Civil, Coimbra, Coimbra Editora, 2010, p. 66*; idem,* "O Contrato e a apólice de seguro", *in Temas de Direito dos Seguros* (Coord. Margarida Lima Rego), Coimbra, Almedina, 2013, pp. 15-37; *see* ROMANO MARTINEZ, *Direito dos Seguros*, Lisbon, Principia, p. 51*; idem,* "Article 1", *in* AAVV, Lei do Contrato de Seguro Anotada, 2nd Ed., org. Pedro Romano Martinez, Coimbra, Almedina, 2011, pp. 39- 41; JOSÉ VASQUES, *Contrato de Seguro*, Coimbra, Coimbra Editora, 1999, p. 94; JOSÉ CARLOS MOITINHO DE ALMEIDA, *O contrato de seguro no direito português e comparado*, Lisbon, Livraria Sá da Costa Editora, 1971, pp. 19-24; MARIA ELISABETE RAMOS, *O Contrato de Seguro entre a Liberdade Contratual e o Tipo*, Coimbra, Almedina, 2021, p. 51 *et seq.*; ENGRÁCIA ANTUNES, *Direito dos Contratos Comerciais*, Coimbra, Almedina, 2009, pp. 683-684;.
[75] MARIA ELISABETE RAMOS, "M&A Insurance", cit., p. 399*; idem, O Contrato de Seguro*, cit., p. 11: "The insurance contract, it must be recognized, is not an invention of the legislator, but the result of centuries of business practice that has shaped its socially typical characteristics.".

directly or indirectly, and is carried out using distinct types of insurance[76], as is the case of the W&I Insurance.

The validity of the insurance contract does not depend on the observance of special formalities (merely consensual contract, article 32 (1) RJCS and art. 219 Portuguese Civil Code in force), without prejudice to the fact that the Insurer must formalize the contract by means of an insurance policy (*apólice*), which must be signed and dated by the Insurer[77].

We understand that the W&I Insurance comprises the typical content of the insurance contract set out in article 1 RJCS (*parties, risk, interest, premium*): by means of the W&I Insurance, an entity (the *Seller*, in relation to the warranties and indemnities it provides and agrees to pay to the Buyer in case of breach, or the *Buyer*, who trusts the accuracy, completeness and correctness of the warranties contractually given by the Seller, and therefore in their non-falsity) takes out the W&I Insurance with a third party (*Insurer*) to cover the loss (*claim*) in its own sphere (*Buyer-side W&I Insurance, in which the Buyer is the Policyholder and Insured*) or that of another party (*Seller-side W&I Insurance, in which the Seller is the Policyholder*) for a fee (*premium*) — hence, its potential *bipolarity*.

Therefore, the *Insurer* covers the *risk* of the total or partial occurrence of the event or events (*claim*) included in the risk covered by the insurance contract, generating damage, in a specific legal sphere (Seller or Buyer, as applicable), by receiving a *payment* (*premium*).

Interest and risk are two fundamental pillars of the insurance contract. Although we can affirm the intrinsic link between risk and interest, the fact is that these realities are distinct, *i.e.* to ascertain that a certain interest is insurable, it must be threatened by a certain risk.

LIMA REGO refers to risk and interest (arts. 43 and 44 RJCS), as the "two structuring elements of the contractual relationship of insurance"[78] and as "the operative ideas of the insurance contract"[79]. Risk and interest do not constitute the object of the insurance contract, either *immediate* (they are not legal effects) or *mediate* (they are not the goods provided by the contract, what is provided by the insurance contract is the *coverage* of the *risk*), but rather external realities, which are prior to the insurance contract[80].

Both the policyholder (Buyer or Seller, as applicable) and the Insurer, when entering into a W&I Insurance, will have to agree on the exact definition of the risk. The *risk* (uncertain event, "possibility of a future harmful event" [81]), an essential element of the contract, is transversal

[76] ROMANO MARTINEZ, *Direito dos Seguros*, cit., p. 24.
[77] According to article 35 RJCS (*Consolidation of the contract*), 30 days after the date of delivery of the policy without the Policyholder having invoked any disagreement between what was agreed and the content of the policy, only disagreements that result from a written document or other durable medium can be invoked.
[78] LIMA REGO, *Contrato de Seguro*, cit., p. 6.
[79] *Ibidem*, 167. In Spanish law, on the subject of risk and interest, see FERNANDO SÁNCHEZ CALERO, *Ley de Contrato de Seguro*, 2nd Edition, Navarre, Aranzadi, 2001, p. 120 et seq. and p. 435 *et seq*.
[80] MARIA ELISABETE RAMOS, *O Contrato de Seguro*, cit., p. 124. *See* MARIA INÊS DE OLIVEIRA MARTINS, *Contrato de seguro*, cit., p. 29.
[81] ENGRÁCIA ANTUNES, *Direito dos Contratos*, cit., p. 705; *see* LUÍS POÇAS, *O dever de declaração inicial do risco no contrato de seguro*, Coimbra, Almedina, 2013, p. 86 *et seq.*; MARIA ELISABETE RAMOS, *O Contrato de Seguro*, cit., pp. 86-94; MENEZES CORDEIRO, *Direito dos Seguros*, Coimbra, Almedina, 2013, pp. 481-491; LIMA REGO, "O Risco e as suas vicissitudes" *in Temas de Direito dos Seguros*, cit., pp. 275-297.

to the insurance contract, covering both its formation and its contractual content, as well as the inherent vicissitudes[82]. Some doctrine believes that the significant ideological justification for insurance lies in covering the risk, embodied in a certain interest[83].

It is based on this specific definition of the risk that the Insurer will take the decision to contract, but it is also from the moment of the decision to contract that the obligations between the parties will be established, be it the amount of the premium to be borne by the policyholder or, ultimately, the agreed coverage limits. The Insurer, as a financially rated insurer[84], assumes the cover of the risk to the Buyer or the Seller, as the case may be. Thus, in the most typical example (*Buyer-side policy*), the risk covered is the risk of damage to the Buyer as a result of the falsity of the warranties provided by the Seller in the SPA, after completion of the transaction which, in practice, as we have mentioned, are subject to intense pre-contractual negotiation between Buyer and Seller[85]. Covering the risk of falsity of the warranties provided by the Seller in the SPA is the object of the W&I Insurance subscribed by the Buyer[86].

However, it will be up to the Insurer to provide all the required clarifications and to inform the Policyholder of the conditions of the contract, namely the scope of the risk it proposes to cover (article 18 (b) RJCS), taking into account the information provided by the Policyholder and the ascertainment of the facts by the Insurer as a result of the due diligence carried out by the Insurer within the scope of the W&I Insurance.

As per the Preamble to the RJCS, "[n]o insurance is valid without a legitimate interest". Article 43(1) RJCS, which is an absolute imperative rule (*ex vi* article 12(1) RJCS), states that "*[t]he insured must have an interest worthy of legal protection in relation to the risk covered, otherwise the contract will be void*". Supervening loss of interest culminates in the termination of the insurance contract (Article 110 RJCS) — thus, such is the importance that the national legislator attaches to the interest that the "eventuality of supervening loss of interest" is considered to be the reason for the termination of the insurance contract. The legal reference to "interest" implies that the interpreter is referring to a process of concretization to be carried out on a case-by-case basis[87].

In Seller-side W&I Insurance, the *insurable interest* relates to the integrity of the insured's assets, in the sense of protecting them, since it is precisely these assets that are subject to the risk of the obligation to compensate third parties; the interest is measured between the insured and their assets (active and passive)[88].

[82] Preamble of the RJCS.
[83] MENEZES CORDEIRO, *Direito dos Seguros*, cit., p. 487.
[84] ALENA WATCHHORN/RICHARD WINBORN, "Covering the Risk, Warranty and indemnity insurance", *in PLC Magazine*, 2008, pp. 43-51.
[85] DEMIRBILEK/WALKER, "Strategische", cit., p. 37; CHRIS PEARSON/DAVID WHEAR, *Buy-side*, cit..
[86] PÉREZ CARRILLO, "Aproximación", cit., p. 260.
[87] MENEZES CORDEIRO, *Direito dos Seguros*, cit., p. 513.
[88] PEDRO MIGUEL S.M. RODRIGUES, *O interesse no contrato de seguro*, Master's Thesis, Lisbon, FDUL, 2011, pp. 33-34. *See* MENEZES CORDEIRO, *Direito dos Seguros*, cit., pp. 492-513; MARIA ELISABETE RAMOS, *O Contrato de Seguro*, cit., pp. 95-109; FRANCISCO LUÍS ALVES, *Direito dos Seguros. Cessação do Contrato. Práticas comerciais*, Coimbra, Almedina, 2015, pp. 61 and 67.

If we analyse the interest inherent in the Buyer-side W&I Insurance, the RJCS sets out that "(...) the interest concerns the conservation or integrity of an insured thing, right or asset" (article 43(2) RJCS), and there is interest to the extent that economic benefits can be derived from the asset that is to be insured and which, with its devaluation, perishing or deterioration, will result in damage. The insured (Buyer) is given the opportunity to insure an asset that is exposed to a risk, and the interest refers to the special relationship that a particular person has with such asset, in which the material realisation of a risk will result in losses[89].

Under the terms of the RJCS, the no premium no cover principle applies, *i.e.* if the Policyholder does not pay the premium, the Insurer is not obliged to cover the damage in the event of a claim (article 51 RJCS), except in the case of large risks insurance, where it will not apply unless the parties so stipulate (articles 58 and 59 RJCS). Payment of the premium triggers the effects of the insurance contract[90]. The payment of the premium constitutes another feature of the insurance contract set out in article 1 RJCS.

In the case of the W&I Insurance, it is customary practice to pay the insurance premium upfront, *i.e.* the Insurer receives the full amount of the premium at the closing of the transaction when the W&I Insurance is perfected (*one time premium*)[91]. It should be noted that the payment of the premium is largely negotiated or reflected in the purchase price of the target company, and the payment can be shared between the parties as far as both the Seller and the Buyer generally benefit from the W&I Insurance[92].

The calculation of the premium is intrinsically linked to the risk covered by the Insurer, based on a proportional relationship between the premium and the risk covered, and is variable in the W&I Insurance, namely depending on the underlying acquisition transaction, the respective complexity, scope and duration of the coverages, the type of industry involved, the geographical scope of the business being purchased, the quality of the Policyholder's advisors[93] and the scope of the audits conducted by them, the quality of the information provided by the Policyholder[94].

Thus, far from being an exact science, there are several factors which, in this form of insurance, influence the amount of the premium to be paid by the Buyer or the Seller, as the case may be, including: the size of the transaction, the amount of cover, the limits to the warranties

[89] PEDRO MIGUEL S.M. RODRIGUES, *O interesse,* cit. *See* JOSÉ VASQUES, *Contrato de Seguro*, cit., p. 74, who states that the insurable interest "consists of the fact that the expected legitimate profit is not frustrated, the interest thus residing in the protection of a future value, affected by the occurrence of any of the acts preventing its normal formation".

[90] See MARGARIDA LIMA REGO, "O Prémio", *in Temas de Direito dos Seguros*, cit., pp. 191-212; MARIA ELISABETE RAMOS, *O Contrato de Seguro*, cit., pp. 110-119.

[91] Typically, the premium amount can range from 2-4% of the policy's maximum coverage, and buyer's insurance can be more expensive. In Germany, TIM KAUFHOLD, "Stapled Insurance bei Private Equity-Transaktionen in Deutschland", *in BB*, no. 7, 2016, pp. 394-396, 395, refers to 1-2.5%. In Spain, PÉREZ CARRILLO, "Aproximación", cit., p. 266, refers to 1-3% — which is the same situation in Portugal.

[92] TERESA A. BEAUFAIT/ANSHU S. K. PASRICHA, *Nuts & Bolts of Representations and Warranties Insurance*, Koley Jessen, 2015, available at koleyjessen.com/assets/htmldocuments/wp-content/uploads/Client-Alert-Nuts-Bolts-of-Representations-and-Warranties-Insurance.pdf; SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1841.

[93] KLAUS MARINUS HOENIG/SEBASTIAN KLINGEN, "Die W&I-Versicherung", cit. 1248; JOSÉ LUIS LUCEÑO OLIVA, "El seguro", cit. 431; ABRAHAM J.B. CABLE, "Comment on Griffith's", cit., p. 93.

[94] PÉREZ CARRILLO, "Aproximación", cit., p. 266.

provided in the SPA (including *first euro* or *deductible*), the existence of *caps* (maximum ceiling of indemnity by the Seller), thresholds, the limitation periods for claims, the credit worthiness of the parties involved, the law applicable to the SPA, whether or not the warranties are limited to the Seller's knowledge, or subject to other qualifiers that circumscribe the content of the warranty, the quality of the due diligence.

Bearing in mind the potential *bipolarity* it can assume, W&I Insurance can consist of either a Buyer-side policy or a Seller-side policy, depending on whether it is the former or the latter that enters into the insurance contract, respectively[95]. The W&I Insurance underwritten by the Buyer (Policyholder and Insurer) is the one that has been most popular in the national and international market[96] and therefore this study is mainly focused on the Buyer-side W&I Insurance.

With regard to the W&I Insurance taken out by the Seller (Policyholder), we are of the opinion it is non-mandatory *third party liability insurance* ("*seguro de responsabilidade civil*")[97], non Life to which both articles 137 to 145 RJCS and article 8 paragraph m) of the Insurance Activity Act (*Regime Jurídico de Acesso e Exercício da Atividade Seguradora e Resseguradora*, approved by Law 147/2015, dated 9 of September, as amended from time to time - *Lei da Atividade Seguradora*, hereinafter LAS) apply. The damage to be considered for the purposes of the principle of indemnity ("*princípio indemnizatório*")[98] is that set out in article 128 RJCS, setting aside a compensation of a value greater than the amount of the *damage* suffered by the Insured prohibiting the Insured from profiting at the expense of the Insurer[99].

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[95] PÉREZ CARRILLO, "Aproximación", cit., p. 267; MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 455.

[96] In Spanish law, GUILLERMO DEL RÍO, "El funcionamento", cit., p. 276; in German law, GOLO MEVEN, *Die Warranty & Indemnity Versicherung*, Karlsruhe, Verlag Versicherungswirtschaft GmbH, 2021, p. 4; FLORIAN METZ, "Grundzüge der W&I-Insurance beim Unternehmenskauf", *in NJW*, 63(12), 2010, pp. 813-815, 814; KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung", cit., p. 377; CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang", cit., p. 143; MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 457; THOMAS GRÄDLER/SVEN FRITSCHE/ANDREA BEILBORN, "Warranty & Indemnity-Versicherungen bei Unternehmenstransaktionen - Echter Mehrwert oder kurzfristige Modeerscheinung?", *in GWR*, 2018, pp. 464-467; SUSAN GÜNTHER/VOLKER JUNGE, "Schutz vor Steuerrisiken durch W&I Versicherungen - aktuelle Trends", *in WCLF Tax und IP Gesprächsband*, Wiesbaden, Springer Gabler, 2016, p. 188; MARKUS WEBER, "W&I Insurance, Kapitel 9. Der Unternehmens- und Beteiligungskaufvertrag", *in Handbuch Unternehmenskauf*, 9th ed, Köln, Otto Schmidt, 2019, pp. 907-916, 908; MARTIN FREY/PETRA HANSELMANN, "Warranty & Indemnity Insurance und Private Equity", *in Private Equity VI*, Zurich, Europa Institut, 2018, available at bakermckenzie.com/-/media/.pdf.

[97] In German law, KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung", cit., p. 377; KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity", cit., p. 52; FRANZ EINIKO/CHRISTINA KEUNE, "Warranty", cit., p. 1374; GREGORY WALKER/THOMAS MANNSDORFER, "Gewahrleistung", cit., p. 208; FLORIAN METZ, "Grundzüge", cit., p. 814; CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang", cit., p. 144; MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 455; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1476; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 662; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 475; MARKUS WEBER, "W&I Insurance", cit., p. 908; GOLO MEVEN, *Die Warranty*, cit., p. 42. In Spanish Law, GUILLERMO DEL RÍO, "El funcionamiento", cit., p. 276; GUILLERMO SAN PEDRO MARTÍNEZ/GUILLERMO DEL RÍO, "El seguro", cit., p. 490; JAVIER GOIZUETA VELASCO, "El seguro de M&A", cit., p. 402; JOSÉ LUIS LUCEÑO OLIVA, "El seguro", cit., p. 430; CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 21; PÉREZ CARRILLO, "Aproximación", cit., pp. 261-262. In Portugal, CHEN CHEN, "O seguro de *Warranty & Indemnity*", cit., p. 47; MARIA ELISABETE RAMOS, "M&A Insurance", cit., p. 407.

[98] On the principle of indemnity (*princípio indemnizatório*), *see* FRANCISCO RODRIGUES ROCHA, *Do princípio indemnizatório no seguro de danos*, Coimbra, Almedina, 2015. According to the author, pp. 81-83, "the indemnity principle cannot be explained using the rules for calculating indemnity in civil liability, firstly because, unlike the latter, it does not presuppose full compensation for the damage, but only that the insurer's payment does not exceed the actual damage"; FILIPE ALBUQUERQUE MATOS, "Princípio do indemnizatório e seguros de danos: Algumas questões", *in Julgar*, n.º 43, jan. 2021, available at julgar.pt/principio-do-indemnizatorio-e-seguros-de-danos-algumas-questoes/; ARNALDO COSTA OLIVEIRA, "Article 128", *in* AAVV, *Lei do Contrato de Seguro Anotada*, cit., pp. 438-441.

[99] LIMA REGO, *Contrato de Seguro*, cit., p. 252.

The W&I Insurance taken out by the Buyer qualifies as *first party loss insurance* ("*seguro de danos patrimoniais*")[100], non-Life, in which articles 123 to 136 RJCS apply and which can be classified as miscellaneous financial loss insurance ("*perdas pecuniárias diversas*"), as set out in article 8, paragraph p) of the LAS. Thus, the insured is "the person in whose sphere the damage is sought", the person whose sphere is relevant for the calculation of the amount of compensatory damages[101].

Under the Buyer side policy, the claim to be made by the Buyer directly to the Insurer does not require (unlike the Seller's W&I Insurance), the existence of a judicial court decision, it being sufficient to demonstrate a justified breach of the Seller's warranties[102].

In case of breach of warranties by the Seller under the SPA the subrogation ("*sub-rogação*")[103] to the Buyer's rights *vis-à-vis* the Seller constitute a typical clause in the W&I Insurance subscribed by the Buyer.

Under the terms of the RJCS, the Insurer who has paid the indemnity is subrogated, to the extent of the amount paid, to the rights of the Insured (Buyer) against the third party responsible for the claim (Seller), and the Policyholder/ Insured shall be liable, up to the limit of the indemnity paid by the Insurer, for any act or omission that impairs the rights of the Insurer (article 136 RJCS).

However, typically, the Insurer's waiver of the right of subrogation is agreed, or rather imposed, by the Seller on the Buyer, with repercussions on the amount of the insurance premium (given that the waiver could mean an increase in risk for the Insurer, which will not be overlooked), in which case the Seller itself benefits from the Buyer's W&I insurance, with

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[100] In German law, GOLO MEVEN, *Die Warranty*, cit., p. 53; GREGORY WALKER/THOMAS MANNSDORFER, "Gewahrleistung", cit., p. 208; MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 455; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1476; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., pp. 662-663; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty", cit., p. 475; MARKUS WEBER, "W&I Insurance", cit., p. 908; FRANZ EINIKO/CHRISTINA KEUNE, "Warranty", cit., p. 1374; KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung", cit., p. 378. In Spanish law, GUILLERMO DEL RÍO, "El funcionamento", cit., p. 276; GUILLERMO SAN PEDRO MARTÍNEZ/GUILLERMO DEL RÍO, "El seguro", cit., p. 492; JAVIER GOIZUETA VELASCO, "El seguro de M&A", cit., p. 492; JOSÉ LUIS LUCEÑO OLIVA, "El seguro", cit., p. 430; CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 23; PÉREZ CARRILLO, "Aproximación", cit., pp. 261-262. In Brazilian law, MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", cit., pp. 556-557. In Portugal, CHEN CHEN, "O seguro de *Warranty & Indemnity*", cit., p. 48; MARIA ELISABETE RAMOS, "M&A Insurance", cit., p. 407.

[101] LIMA REGO, *Contrato de Seguro*, cit., pp. 48 and 606. Although the damage occurs in the sphere of the target company, it is true that it is reflected in the appropriation of the value of the investment made by the Buyer (Insured) in the target company.

[102] In this sense, MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 455; KLAUS MARINUS HOENIG/SEBASTIAN KLINGEN, "Die W&I-Versicherung", cit., p. 1245; CAROLIN VAN STRAELEN/BERND DREIER/JANNIK REVERS, "Warranty & Indemnity-Versicherung", cit., p. 476; MARKUS WEBER, "W&I Insurance", cit., p. 908; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", p. 557, footnote 37; FRIEDRICH SOMMER/FELIX WINTER/THORSTEN KNAUER, "Gewährleistungsversicherungen bei M&A-Transaktionen", *in Corporate* Finance, Vol. 10, No. 3/4, 2019, pp. 118-123, 119, state that a claim by the Buyer in the context of the Seller's W&I Insurance presupposes a binding court decision (*eines rechtskräftigen Urteils*); in a different vein, MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 663, the authors argue that although the requirement for a court decision may be provided for in the Seller's W&I Insurance, this is not obligatory and would have the effect of depriving the Insurer of the possibility of settling claims, which it considers justified, without costly and time-consuming legal disputes, and would also be contrary to the interests of the Seller itself. The authors, cit. p. 664, agree that in the case of the Buyer's W&I insurance, it is sufficient for the Buyer to submit a justified claim regarding the breach of the Seller's guarantees, with the Insurer thus assuming the Buyer's litigation risk (*Prozessrisiko des Käufers*).

[103] On subrogation in insurance contracts, *see* FRANCISCO RODRIGUES ROCHA, *Do princípio,* cit., p. 145 *et seq.*; MENEZES CORDEIRO, *Direito dos Seguros*, cit., pp. 755-756.

subrogation *only* operating in situations of wilful misconduct ("*dolo*") or fraud ("*fraude*") on the part of the Seller[104].

In addition, in the W&I Insurance executed with the Buyer, as a rule, the wilful misconduct of the Seller is covered by the insurance policy, a distinctive element of the W&I Insurance concluded with the Seller, a situation that has justified the greater number of policies subscribed by the Buyer.

The RJCS, considering the "size of the policyholder and the risk covered"[105], sets forth a bipartite vision between so-called *mass* and *large risk* insurance. As opposed to insurance that covers mass risks under which the contracting party, as the weaker party, benefits from a significant panoply of rules of absolute imperativeness (which cannot under any circumstances be overridden by an agreement to the contrary – article 12 RJCS) and rules of relative imperativeness (which can be overridden by contractual clauses if and as long as they set out a more favourable regime for the policyholder, Insured or beneficiary – article 13 RJCS) it shall be considered *large risk insurance* and therefore exempt from complying with certain legal requirements to the extent certain requisites set out in article 5(2) of the LAS are verified, as follows: risks relating (*inter alia*) to the classes of insurance referred to in Article 8 (m) [civil liability] and (p) [miscellaneous financial loss insurance]*, provided* that the following two amounts are exceeded for the Policyholder: *i*) Total statement of financial position: € 6,200,000*; ii*) Net turnover (within the meaning of Decree-Law no. 158/2009, of 13 July, as amended): €12,800,000*; iii)* average number of employees during the financial year: 250.

Thus, in *large risk* insurance, legal rules with *relative* imperativeness can be waived by the parties (art. 13 (2) RJCS), and it is also possible to agree otherwise regarding article 59 (*cover*) and 61 (*non-payment*) RJCS (*ex vi* art. 12 (2) - absolute imperativeness), thus leaving the parties free to stipulate the regime that seems most appropriate to each specific situation[106].

W&I insurance can only tend to be seen, although not intrinsically, as a contract that falls under the heading of large risk insurance. It should be remembered that this type of insurance is associated, at least as a rule, with high value transactions, the policyholders of which will in most cases be investors with a prominent level of sophistication, endowed with high negotiating skills. In fact, classification as *large risk* insurance has the undeniable advantage of allowing negotiations between Buyer and Insurer to take on a configuration that we would

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[104] *See*, in German law, CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang", cit., p. 144; THOMAS GRÄDLER/SVEN FRITSCHE/ANDREA BEILBORN, "Warranty", cit., p. 464; PETER RATZ/TOBIAS KILIAN, "W&I-Policen – maßgebliche VVG-Bestimmungen, Auslegungsfragen und Haftungsrisiken", *BB*, n.º 4, 2021, pp. 202-214; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", cit., p. 37.

[105] Maria ELISABETE RAMOS, *O Contrato de Seguro*, cit., p. 45, points out that the policyholder of the so-called large risks "is an entity with negotiating power similar to that of insurers and with the installed capacity to obtain sufficient information on the applicable legislation, the situation of the markets and the risk in question", which is why, according to the author, "contractual freedom in large risk insurance is broader", without the need for measures to protect the policyholder; ENGRÁCIA ANTUNES, *Direito dos Contratos*, cit., p. 689, notes that large risk insurance will apply when the policyholder is a "large collective entity, especially a medium or large company that covers the risks of its activity". According to LIMA REGO, *Contrato de Seguro*, cit., p. 131, nr. 267, large risks "are those likely to give rise to large sums of money being paid by the insurer, being irrelevant the degree of probability of the risk occurring and the lesser or greater intensity of its possible consequences; FRANCISCO LUÍS ALVES, *Direito dos Seguros*, cit., pp. 47-49.

[106] JOANA GALVÃO TELES, *Liberdade contratual, e seus limites - imperatividade absoluta e imperatividade relativa*, *in Temas de Direito dos Seguros*, cit., pp. 103-115.

call *freer*, different from the legal impositions of the RJCS closely related to the protection of consumers, considered to be the most unprotected party in the business relationship.

The Buyer, as a legal entity, is not a consumer for the purposes of *W&I* Insurance. It is also true that *W&I* insurance is a highly negotiated contract between the Buyer and the Insurer, a situation that does not occur in typical consumer relations, where only the specific conditions ("*condições particulares*") of the policy are actually negotiated. We are of the opinion that the parties negotiating W&I insurance cannot, unless the legal requirements are verified, waive the full verification of the requirements imposed by the LAS regarding the classification of insurance as *major risks*, and consequently have to respect the applicable rules of absolute and relative imperativeness. It should be noted, however, that under the terms of Article 5(3) of the LAS, if the policyholder (Buyer) is part of a group of companies for which consolidated accounts are drawn up and the legal criteria laid down in Article 5(2) of the LAS (above identified) are applied on the basis of these consolidated accounts, in practice translates into an opening granted by the legislator with regard to the application of the major risks regime, precisely in situations where the Policyholder alone does not fulfil them.

The W&I Insurance must indicate the respective cover period (article 37(1)(e) RJCS). The occurrence of a claim within this period (*occurrence basis*) will trigger the payment to be made by the Insurer. As a rule, the cover period for the W&I Insurance begins with the closing of the transaction, but nothing prevents the parties from agreeing that it begins with the signing of the SPA. Typically, in Seller's W&I Insurance, the terms of the policy reflect the designated survival periods (expiry dates, agreed between the parties, within which the risks covered must occur) of the warranties set out in the SPA. The Buyer-side policy tends to extend these periods. W&I Insurance has the undeniable advantage of temporarily extending the validity periods of the warranties agreed between the parties in the SPA, providing cover beyond the expiry dates stipulated in the SPA (survival periods), giving additional comfort to the Buyer who sees the possibility of the risk of breach of warranties being covered for a longer period by virtue of taking out this insurance.

The so-called deductible clauses ("*cláusulas de franquia*"), as clauses that delimit the liability of the benefit to be provided by the Insurer, are permitted by the RJCS, which sets forth that the parties may set deductibles, compensation scales ("*escalões de indemnização*") and other contractual provisions that condition the value of the benefit to be provided by the Insurer (article 49(3) RJCS). The deductible can be defined as the amount that is *deducted from* the amount to be paid by the insurer, which can consist of either: (*i*) a certain amount (determined value) to be deducted from the total amount to be paid, a percentage (variable amount over the amount due) which, once calculated, is deducted, or a combination of both, a value below which the insurer will have nothing to pay, in order to steer the insured towards a prudent stance (*absolute deductible or deduction*); or (*ii*) it may occur that the Insurer sets forth a deductible in order to avoid covering small claims, agreeing that it will not cover damage up to a certain amount; if the damage exceeds the amount established in the deductible, the

insurer assumes the benefit in its entirety, i.e. pays the benefit in full (*relative or simple deductible*)[107].

Like a basket (minimum level at which a claim for compensation can be exercised) set out in a typical limitation of liability clause in an SPA, the deductible is also common in W&I Insurance, according to the principle that the Buyer (Policyholder) must suffer some loss before the insurance cover operates (*skin in the game*). As a rule, in the W&I Insurance a deductible is agreed with the Insurer, in line with the amounts agreed in the SPA (*de minimis*, *baskets*), thus reducing the Insurer's liability, which will not, of course and as a rule, be total[108]. Typically, the deductible is set as a *rule of thumb* at between 0.25% and 2% of the value of the transaction[109], although always subject to negotiation.

The coverage (indemnity limit) of W&I Insurance will operate in the case of claims that exceed the value of the deductible and up to the coverage limit set out in the policy, which is usually between 10-30% of the value of the Transaction. This percentage may vary depending on the warranties being covered, i.e., general warranties or fundamental warranties, with the Insurer's compensation limit for the latter being higher, given its importance in the SPA's economy. This is a matter for negotiation in the underwriting process.

Clauses excluding certain risks are no exception in the W&I Insurance. Strictly speaking, they are clauses delimiting the risk to be assumed by the Insurer which, in the case of representations and warranties, will be analysed analytically as to whether they can be covered.

ROMANO MARTINEZ states that exclusion clauses aim to define the object of the contract, its content and extent, under the freedom of contract in terms of freedom of modelling; they are not irresponsibility clauses when, in essence, what the parties aim to do is to specify it in a rigorous manner:(*i*) the content of the performance (*prestação*) to be provided by the insurer, or (*ii*) to mark the limits of the contractual relationship, with the express exclusion of a certain obligation[110].

Typically, the W&I Insurance does not provide cover for risks known to the Buyer or fairly disclosed issues contained in the Data Room, due diligence report or disclosure letter attached to the SPA, which may result in liability (even if only remotely), but generally only covers risks that are completely unknown (*unforeseeable risks*) and which are the object of the warranties provided by the Seller[111]. Thus, by only covering risks not known to the Buyer in the Buyer's W&I policy, the risk of the information made available to the Buyer for analysis during the due

[107] FRANCISCO RODRIGUES ROCHA, *Do princípio indemnizatório,* cit., p. 78, footnote 363; ROMANO MARTINEZ, *Direito dos Seguros*, cit., p. 111.
[108] KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung", cit., p. 380.
[109] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., p. 53. In Portugal, in the case of acquisitions of real estate assets, no deductible is generally applicable.
[110] ROMANO MARTINEZ, *Direito dos Seguros*, cit., p. 95. *See* ANA SERRA CALMEIRO, *Das Cláusulas Abusivas no Contrato de Seguro*, Coimbra, Almedina, 2014, 27, pp. 37-38.
[111] GUILLERMO DEL RÍO, "El funcionamento", cit., p. 277; regarding typical exclusions (*Standard-Ausschluesse*), KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity", cit., pp. 711-712; THOMAS GRÄDLER/SVEN FRITSCHE/ANDREA BEILBORN, "Warranty", cit., p. 465.

diligence will be considered, in parallel with what generally happens in the SPA, as a risk assumed by the Buyer, and will therefore not be covered[112].

In terms of exclusions, in order to determine the risks covered, the W&I Insurance also excludes, as a rule, and in line with insurance market practice in this type of insurance, practically non-negotiable with the Buyer[113]: (i) transfer-pricing and secondary tax liability; (ii) wilful misconduct or fraudulent behaviour on the part of the Policyholder or Insured[114]; (iii) leakages, purchase price adjustments provided for in the SPA; (iv) forward looking warranties, i.e. warranties about the future development of the company's business, including the impossibility of the target company achieving certain financial projections[115]; (v) pension fund contribution shortfalls[116]; (vi) prohibited insurances, such as those resulting from criminal, administrative offenses or disciplinary liability[117]; (vii) contractual obligations (*covenants*); (viii) environmental issues (asbestos always excluded and other contamination matters potentially covered, subject to specific environmental due diligence); (ix) pending litigation; (x) damages derived from acts of bribery, money laundering or corruption; (xii) modifications to the SPA without the agreement of the insurer[118]; (xii) wilful misstatement of risk by the Purchaser as policyholder.

To the extent the policyholder has carried out a professional and responsible due diligence, the scope and analysis of which coincides with the matters covered by the warranties provided by the Seller in the SPA, the W&I Insurance will cover all undetected, unknown or undisclosed matters.

Transactional risk, *i.e.* the risk that could not be negotiated, either because it was unknown to the Buyer or because the Seller incorrectly disclosed it, will be covered by the W&I Insurance[119]. Similarly, from a negotiating point of view, there is nothing to prevent any information known to the Policyholder (or which has even been *fairly disclosed*) and included in the due diligence report, the impact or underlying risk of which is not material to the transaction as a whole or is subject to different interpretations, from being covered by the Insurer. These are business issues, analysed on a case-by-case basis between the Buyer and the Insurer.

[112] ANDREAS HOGER/JOHANNES BAUMANN, "Der M&A-Vertrag bei Abschluss einer W&I-Versicherung", *in NZG*, 2017, 811-817, 816; KLAUS MARINUS HOENIG/SEBASTIAN KLINGEN, "Die W&I-Versicherung", cit., p. 1246.
[113] CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1478.
[114] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., pp. 52-53.
[115] TIM KAUFHOLD, "Stapled Insurance", cit., p. 395; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", cit., p. 568.
[116] PÉREZ CARRILLO, "Aproximación", cit., p. 266.
[117] Article 14 RJCS (*Prohibited insurance*) [absolute imperative rule]. On the topic, see JOÃO DE MATOS VIANA, "Seguros Proibidos", *in Temas de Direito dos Seguros*, cit., pp. 117- 129.
[118] ANGELO BORSELLI, "Insurance in M&A", cit., p. 205, footnote 26.
[119] *Ibidem.*

4.2. The Insurer's audit

The W&I Insurance, like any other insurance contract, is a contract concluded *uberrima bona fides*, since both parties (Policyholder and/or Insured and Insurer) are bound to act in accordance with a "utmost good faith" standard[120]. This standard is manifested, in practical terms, in the duties of information between the Policyholder and/or the Insured and the Insurer. The information and declarations provided by the Policyholder and/or the Insured, both in the case of the W&I Insurance subscribed by the Buyer and the Seller, are of vital importance to the Insurer, since it is precisely on the basis of these declarations that the Insurer will be able to assess the risk to be covered and, ultimately, decide, on the basis of its freedom of contract, whether or not to cover it.

The RJCS sets forth a panoply of pre-contractual information duties within the scope of the insurance contract, which are the responsibility of both the Insurer (articles 18 to 23 RJCS), and the Policyholder and/or Insured (articles 24 to 26 RJCS). Accordingly, under the terms of the RJCS, the Policyholder and/or Insured are subject to pre-contractual information duties, set out in the so-called *initial risk declaration*[121] (article 24 RJCS), based on the completion of a *questionnaire* submitted by the Insurer to the Policyholder and/or Insured (Buyer or Seller, as applicable), which must be carefully analysed by the Policyholder[122].

Before concluding the contract, the Insurer must explain to the Policyholder/Insured the aforementioned duty, as well as the regime of non-compliance, under penalty of incurring in civil liability, under the general terms (article 24(4) RJCS). This legal requirement has the merit of making the Policyholder and/or the Insured aware of the content of the contract to be concluded, thus enabling them to determine the relevant circumstances for a full assessment of the risk, based on the Buyer's co-operation. Likewise, the "policyholder or the insured is obliged, before the contract is concluded, to declare accurately all the circumstances that he knows and reasonably ought to have as significant for the insurer's assessment of the risk" (article 24(1) (2) RJCS).

The Insurer will analyse the answers given by the Buyer and its advisors in the so-called *Tranche I Underwriting Questionnaire*, which consists of a broad set of questions that will enable the Insurer to gain a general understanding of the Transaction in progress. The so-called *Tranche II Underwriting Questionnaire* consists of a questionnaire drafted by the Insurer

[120] ENGRÁCIA ANTUNES, *Direito dos Contratos*, cit., pp. 686-687. On the other hand, LIMA REGO, *Contrato de Seguro*, cit., p. 441, sees no reason for this requirement, given the provisions of Articles 227(1) and 762(2) of the Portuguese Civil Code regarding the principle of good faith. See MARIA INÊS DE OLIVEIRA MARTINS, *Contrato de seguro*, cit., p. 166 *et seq*.; LUÍS POÇAS, *O dever de declaração inicial*, cit., p. 153; JOSÉ VASQUES, *Contrato de Seguro*, Coimbra, Coimbra Editora, 1999, PP. 160-162.

[121] LUÍS POÇAS, *O dever de declaração*, cit.*; idem, Problemas e Soluções de Direito dos Seguros*, Coimbra, Almedina, 2019, pp. 9-38; JOANA GALVÃO TELES, "Deveres de Informação das Partes", *in Temas de Direito dos Seguros*, cit., pp. 213-273; JÚLIO MANUEL VIEIRA GOMES, "O dever de informação do (candidato a) tomador do seguro na fase pré-contratual à luz do Decreto-Lei n.º 72/2008, de 16 de Abril", *in Estudos em Homenagem ao Professor Doutor Carlos Ferreira de Almeida*, org. José Lebre de Freitas *et al*, Vol. II, Coimbra, Almedina, 2011, pp. 387-445.

[122] It is worth recalling article 24(2) RJCS, according to which the initial risk declaration shall also apply to circumstances that are not requested to be mentioned in any questionnaire provided by the Insurer for this purpose.

and designed to ask questions regarding the analysis carried out by the Insurer and its advisors of the materials collected during the *due diligence* process.

Only after an audit has been completed by the Insurer and an underwriting process has been carried out in accordance with the parameters set by the Insurer, will the Insurer be in a position to present, in a binding manner, the terms and conditions applicable to the W&I Insurance, in the form of a contractual proposal.

In order to determine the risk to be covered *(Risikopruefung)*[123] by the W&I Insurance, the Insurer, equipped with consultants, initiates its own due diligence, which is autonomous and separate from that carried out by the Buyer, which will culminate in an audit report of the Insurer itself. The audit to be carried out by the Insurer is purely confirmatory of the audit already carried out by the Buyer (*primary diligence*), in a logic of *secondary review*, not carrying out a complete and independent audit[124]. In essence, the Insurer carries out a due diligence on the due diligence previously carried out by the Buyer, even though it is a secondary investigation process.

Thus, all areas relating to the target company (for example, corporate, insurance, regulatory, litigation, commercial contracts, personal data) that have not been investigated by the Buyer (due diligence gaps) are excluded from the W&I Insurance coverage, including those matters analysed on a sample basis that, in the opinion of the Insurer, have not been sufficiently analysed in view of the risk that is intended to be covered. It may occur that the criteria underlying a sample-based analysis of the target company are not, in the Insurer's view, adequate to mitigate the underlying risk. The Insurer's lack of visibility into a specific area of the target company that the Buyer simply ignored or did not analyse with due diligence will not be covered by the W&I Insurance. This will be a natural incentive for the Buyer to carry out the responsible due diligence. With the W&I Insurance, the warranties provided by the Seller in the warranties clause must be documented and properly analysed by the Buyer.

To this extent and given the coverage of warranties sought by the Buyer with the purchase of the W&I Insurance, the intervention of the Insurer in this process translates, in practical terms, into the imposition of upfront *reinforced and enhanced duties of diligence* on the Buyer, especially since the acquisition of a controlling shareholding is at stake[125].

Therefore, and as a prerequisite for the confirmatory audit to be carried out by the Insurer, the latter will require the Buyer to have carried out a responsible audit of the target company and matters not covered by this audit will naturally not be covered by the W&I Insurance. This is therefore a fundamental requirement for the Insurer to take out the W&I Insurance.

[123] KLAUS GROSSMANN/ULRIKE MÖNNICH, "Warranty & Indemnity", cit., pp. 712-713.
[124] CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 25; SEAN J. GRIFFITH, "Deal Insurance", cit., pp. 1864 and 1893.
[125] ABRAHAM J.B. CABLE, "Comment on Griffith's", cit., p. 96.

It will be essential for the Insurer, in order to mitigate the risk of fraud and moral hazard[126], as well as opportunistic behaviour on the part of the Buyer, to ensure that all documentation relating to the business of the target company to be acquired has been duly disclosed, that the directors of the target company have had the opportunity to review the warranties clause provided in relation to the target; in the event of breaches in relation to the target company, that these are conveyed by the Seller to the Buyer; that access to the Data Room took place in an orderly and complete manner; that the SPA negotiation process took place under normal market conditions (*arm's length negotiation*) and that the questions submitted to the Seller in the Q&A were answered in an appropriate manner. Finally, the existence of a *disclosure letter*, in the context of the SPA, which carves out the warranties provided by Seller, disclosing what is deemed necessary[127].

4.3. The (parallel) process of negotiation with the Insurer – the interface between the SPA and the W&I Insurance

With the W&I Insurance in the context of the company acquisition transaction underway, a negotiation process with the Insurer is started in parallel with the negotiation process between the Buyer and the Seller, in order to ascertain whether the latter will cover the risk of breach of warranties still under negotiation between the Buyer and the Seller.

The W&I Insurance appears as an *additional contractual structure* that the parties (typically the Buyer to the extent as previously referred Buyer-side W&I Insurance is the most frequent in the market) negotiate with the Insurer, involving a set of stages and documents which, although as a rule are increasingly standardised, nevertheless follow the specificities inherent to the respective insurance market in each jurisdiction.

In this way, the Insurer is also entering into a negotiation process, in accordance with the rules of good faith, which will take place at a time when the negotiations between the Seller and Buyer of the target company have not yet been finalised, although they are usually already at a final stage.

Is there an optimal time to start the negotiation process with the Insurer?

In the absence of a mathematical answer to this question, we are of the opinion that the Insurer's (parallel) participation in the transaction in progress should take place as soon as

[126] On the subject see, MARIA INÊS OLIVEIRA MARTINS, "Risco moral e contrato de seguro", *in Estudos em homenagem ao Prof. Doutor Aníbal de Almeida*, Coimbra, Coimbra Editora, 2012, pp. 637-676; MARIA INÊS DE OLIVEIRA MARTINS, *Contrato de seguro*, cit., p. 138; LUÍS POÇAS, *Problemas*, cit., pp. 58-61.
[127] CHRIS PEARSON/DAVID WHEAR, *Buy-side*, cit.

possible (*work on deal time*)[128], to avoid delays in the completion of the acquisition, but above all to allow the Insurer to review the due diligence materials in due time[129].

The Insurer's (parallel) intervention in the negotiation process for the acquisition of a company takes place at a stage when the due diligence report carried out on the target company has already been finalised (or at least is in an almost final version or close to it) and the other due diligence materials can be made available. The SPA (albeit in *draft form*) will also be at an advanced stage in the negotiations and available for the Insurer to analyse.

The W&I Insurance usually accompanies the SPA negotiations *pari passu*, at least at an advanced stage, but certainly before they are finalised. It should be noted that the W&I Insurance and the intervention of the Insurer do not have the effect of obscuring the negotiation process of the SPA between Seller and Buyer regarding the set of warranties, which should be carried out on a standard market basis, such as the negotiation of the liability regime associated with them in the event of a breach by the Seller — on the contrary, the warranties will have to be negotiated as if the W&I Insurance was not purchased[130].

On the other hand, there is nothing to prevent preliminary contacts from being made with the Insurer before these negotiations mature, *i.e.* from a preventive perspective and in anticipation of the W&I Insurance underwriting, the Policyholder should initiate preliminary contacts with the respective insurance broker in order to gauge the availability of the insurance market to underwrite the desired risk.

So, what impact does the negotiation process with the Insurer, with a view to (future) underwriting of the W&I Insurance, have on the inter-party negotiation process inherent in the acquisition of the controlling shareholding in the target company?

We have mentioned that the W&I Insurance is a mechanism that facilitates the negotiation process between Buyer and Seller. At first glance, we can already see that the Insurer's intervention boosts the quality and depth of the investigation to be carried out by the Buyer (Policyholder) in the respective interaction with the Seller, in terms of the due diligence process, with the W&I Insurance acting as a strategic instrument to both facilitate and speed up negotiations with the Seller[131].

In fact, the negotiation of the W&I Insurance, under the terms mentioned above, can significantly ease the typical tensions surrounding the negotiation of representations and warranties during the negotiation process, allowing for more expeditious negotiations, with the

[128] PÉREZ CARRILLO, "Aproximación", cit., p. 262; CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 24; GUILLERMO DEL RÍO, "El funcionamento", cit., p. 284; SUSAN GÜNTHER/VOLKER JUNGE, "Schutz", cit., p. 188; CHRISTIAN HENSEL/CHRISTINE NAMISLO, "Die W&I-Versicherung", cit., p. 1476; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 665.

[129] ANDREAS TÜXEN/MORITZ MENTZEL, "Die Veräußererhaftung", cit., p. 53; KAI HASSELBACH/GEORG REICHEL, "Die Gewährleistungsversicherung", cit., p. 379.

[130] GUILLERMO DEL RÍO, "El funcionamento", cit., pp. 281-284; GUILLERMO SAN PEDRO MARTÍNEZ/GUILLERMO DEL RÍO, "El seguro", cit., p. 489; MURAD M. DAGHLES/THYL N. HAßLER, "Warranty", cit., p. 457; THOMAS GRÄDLER/SVEN FRITSCHE/ANDREA BEILBORN, "Warranty", cit., p. 465; HELENA GUIMARÃES/ANA LUISA FUCCI, "Utilização de Seguros", cit., p. 58.

[131] PÉREZ CARRILLO, "Aproximación", cit., p. 268; FRIEDRICH SOMMER/FELIX WINTER/THORSTEN KNAUER, "Gewährleistungsversicherungen", cit., p. 119.

inherent reduction in time spent and costs associated with legal or financial advisors, without prejudice, however, to the possibility of increasing due diligence costs, should the Insurer consider it necessary to delve into any matter provided for in the representations and warranties and which investigative work carried out by the Buyer has proved insufficient to ensure coverage in the W&I Insurance[132].

Naturally, taking out the W&I Insurance, given the specific circumstances of each transaction, may not be the right solution for all situations.

For example, in situations where the Buyer does not want a third party (Insurer) to arbitrate the award of compensation, preferring instead the escrow mechanism to cover the Seller's liabilities under the SPA, as it believes this to be a more liquid guarantee; in cases where the Buyer, given the high confidentiality of the transaction in progress, does not wish to deliver the due diligence report to the Insurer; in cases where the parties believe that the intervention of the Insurer will require additional due diligence, such as the need to provide documentation, carry out, if requested by the Insurer, a complementary audit of the target company and keep the Insurer informed of the progress of the transaction; finally, in situations where the payment of the W&I Insurance premium is not justified to the extent that the Buyer is comfortable with the warranties negotiated between the parties and with the degree of compliance shown by the target company on the basis of the due diligence carried out[133].

After carrying out due diligence, the Insurer and the Buyer need to agree on the exact harmonisation (*genaue Abstimmung*) of the content of the SPA with the W&I Insurance, insofar as, although these two contracts legally exist independently[134], they are materially linked and should be interconnected as much as possible in order to exclude subsequent difficulties of interpretation and possible gaps at the level of the W&I Insurance.

The (*draft*) SPA, together with the documents related to the due diligence carried out by the Buyer, constitute as above referred the starting point for underwriting the W&I Insurance.

An instrument to mitigate moral hazard in terms of the W&I Insurance is the possibility for the Insurer, exclusively for the purposes of the W&I Insurance, to conform, reformulate and adapt the warranties clause contained in the SPA, considering the information provided by the Buyer regarding the results of the due diligence.

Without prejudice to the full application to the W&I Insurance of the back-to-back principle with the SPA[135], in the sense that it aims to mirror (as far as possible) and establish a parallel with that stipulated by the parties in terms of the warranties provided by the Seller (and associated indemnity clauses), it is no less true that the Insurer will tend, in the underwriting

[132] CARMEN REINA SANTOS/PAULA DE BIASE/FÁTIMA NÚÑEZ DE AYSA, "La nueva era", cit., p. 22.
[133] *Ibidem*, 23.
[134] CHRISTOPH ALLMENDINGER/MICHAEL COHEN, "Zum Deckungsumfang", cit., pp. 143, 148; ANDREAS HOGER/JOHANNES BAUMANN, "Der M&A-Vertrag", cit., p. 817; MICHAEL JAKOBS/ALEXANDER FRANZ, "Können", cit., p. 665; MARCELO VIEIRA VON ADAMEK/ANDRÉ NUNES CONTI/GIULIA FERRIGNO, "O seguro W&I", cit., pp. 562-563.
[135] TERESA A. BEAUFAIT/ANSHU S. K. PASRICHA, *Nuts & Bolts*, cit.; FRIEDRICH SOMMER/FELIX WINTER/THORSTEN KNAUER, "Gewährleistungsversicherungen", cit., pp. 118-123.

process, to exclude, as previously referred, unsuitable risks in the context of the W&I Insurance.

It should be noted that warranties provided by the Seller that are very comprehensive, or not supported by documents in the Data Room (even if not mentioned in the due diligence report, but which as a whole, including the SPA disclosure letter, form part of the so-called disclosed information) will increase the risk of the Seller breaching the warranties, with the inherent activation of the policy[136], a scenario that the Insurer will endeavour to prevent.

Thus, for the purposes of the insurance policy, the Insurer may establish limitations to the warranties provided by the Seller that will only be covered in relation to circumstances documented in writing, and may even impose time limits and materiality elements[137].

It should be noted that in the context of the due diligence carried out by the Buyer, it is common practice for the negotiating parties to set materiality limits for the matters being analysed, in the sense that only contingencies exceeding a certain value are identified, and to this extent the analysis of information which impact in terms of risk falls below a certain amount is disregarded. It may occur that the Insurer requires (and modifies for the purposes of the W&I Insurance in order to ensure coverage) that the Seller's warranties to be covered by the W&I Insurance have materiality limits in line with those considered by the parties for the purposes of due diligence, ensuring that all relevant documentation has been analysed in accordance with this criterion[138].

The warranties, as the Seller and Buyer know them in the SPA, are subject to rigorous scrutiny by the Insurer with the W&I Insurance, who may modify them for the purpose of the policy[139] by introducing knowledge or materiality qualifiers for the purposes of accepting the respective cover. The content of the warranties clause can therefore be adapted and updated for this specific (parallel) negotiating scenario — there should be as direct a relationship of proportionality as possible between the warranties provided by the Seller and the investigation carried out by the Buyer in respect to the matters contained therein.

To this extent, and as a result of its internal risk analysis, the Insurer has the right, in the policy text, to introduce modifications and reformulations to the guarantees to be provided by the Seller, conforming to the risk it wishes to assume. For this purpose, it is used the so-called *warranty spreadsheet*, a document in which the warranties are listed, under the terms of the *SPA*, with the respective indication of coverage for the purpose of the policy (*covered*, *not covered*, *partially covered*), which constitutes an annex to the W&I Insurance.

[136] ALENA WATCHHORN/RICHARD WINBORN, "Covering the Risk", cit., p. 50.
[137] ANGELO BORSELLI, "Insurance in M&A", cit., pp. 206-207; DANIEL W. GERBER *et al.*, *Mergers and Acquisitions*, cit. 32.02[3].
[138] GUILLERMO DEL RÍO, "El funcionamento", cit., p. 283.
[139] SEAN J. GRIFFITH, "Deal Insurance", cit., p. 1892: "insurers do not offer loss-prevention or loss mitigation services in connection with RWI. Although RWI underwriting generally begins before the acquisition agreement is finalised, insurers often do not typically comment on acquisition agreements. They do not mark-up drafts, and where they to do so, their comments would likely not be taken. (...) They are looking for exclusions, not trying to help the transacting parties prevent or mitigate loss".

This is without prejudice to the fact that the content of the warranties in the SPA remains intact, *i.e.* unchanged[140].

This is a particular and interesting *technique*, since the Insurer is a third party in the Buyer/Seller relationship and does not interfere directly in the negotiation process, in the *due diligence* carried out, nor does it comment directly on the *SPA*, and finds fertile ground here to adapt the warranties to the results of its own internal analysis.

To summarise, the Buyer's knowledge and understanding of the Insurer's *modus operandi* throughout the underwriting process, with the reformulation of warranties by the Insurer being an illustrative example, will enable the Buyer, throughout the due diligence process, to ensure that the investigation of the target company is as rigorous as possible, although we are aware that the Insurer's underwriting criteria, even if the due diligence carried out is exhaustive across the board, will always be applied, depending on the quantity and, above all, the quality of the information provided by the Buyer to the Insurer.

In our opinion, taking out the W&I Insurance and the intervention of the Insurer imposes a new negotiating paradigm on the negotiating parties, of which they should be aware upfront, precisely because it shapes the traditional negotiating canons and the *modus operandi* between Seller and Buyer in different ways, not only in terms of due diligence and the scope of the investigation to be carried out, but also in terms of the quality of the information conveyed between the negotiating parties and the negotiation of the warranties.

In a transactional context without the presence of the W&I Insurance, the extent and incidence of the warranties provided by the Seller is, as some scholars have already stated[141], inversely proportional to both the quantity and quality of the information on which the Buyer based its decision to contract (in other words, the warranties are intended to cover aspects not detected by the Buyer). With the presence of the W&I Insurance, the *modus operandi* will necessarily have to be different, i.e. the warranties provided by the Seller will have to be proportionally aligned with the quality and quantity (and respective analysis) of the information gathered by the Buyer in the due diligence carried out on the target company.

The Seller's co-operation in this process, even though it does not initiate contact with the Insurer, is particularly important, by mitigating the information asymmetry between Seller and Buyer and allowing the Insurer to have the necessary comfort in the W&I Insurance underwriting process.

[140] ABRAHAM J.B. CABLE, "Comment on Griffith's", cit., p. 100: "[i]nsurers do not dictate the wording of the reps for which they assume liability. They may police the outer boundaries by excluding or writing out some individual reps".
[141] CASTRO RUSSO, "Due Diligence", cit., p. 113.

5. Conclusions

1. The pre-contractual phase in M&A transactions is characterised by information asymmetry between Buyer and Seller making necessary for the negotiating parties to set up mechanisms to allocate negotiating risks, providing the negotiating process with legal certainty and security and, consequently, promoting its predictability and transparency.

2. The W&I Insurance, a complex and sophisticated type of insurance contract, emerged on the international insurance market in the context of company acquisitions, where it is used as an instrument to mitigate transactional risk. In Portugal, this insurance began to take its first steps in the last decade and has since attracted growing interest.

3. The *due diligence* carried out by the Buyer and the negotiation of the *warranties clause* between the negotiating parties is the basis for the potential subscription of the W&I Insurance.

4. The due diligence process, the intense negotiation of the warranties clause to be included in the SPA and the indemnity mechanisms negotiated between the parties may not be sufficient to meet the needs of the Buyer and the Seller after the acquisition of the target company.

5. The negotiation of the warranties clause raises issues (scope, time limits, damages and indemnity limits, withholding of the price or the constitution of an *escrow* to cover the Seller's liabilities) which, at the end of the day, may not be overcome during the negotiation process.

6. Under the terms of party autonomy, freedom of contract and good faith, the W&I Insurance is therefore an instrument that facilitates the negotiation process for the acquisition of a controlling shareholding between Buyer and Seller, insofar as it enables negotiation issues associated with the Seller's liability in the SPA to be overcome, thereby reducing the negotiating parties' exposure to transactional risk.

7. The W&I Insurance is compliant with the requisites set out in article 1 RJCS and is, therefore, construed as an insurance contract under the terms of the law, given its typical content (parties, interest, risk, premium) and subject to its legal regime.

8. The W&I Insurance can consist of either a Buyer's policy or a Seller's policy, depending on whether the former or the latter is the Policyholder — the W&I Insurance underwritten by the Buyer is the most popular in the national and international market.

9. Regarding the W&I Insurance taken out by the Seller, we qualified it as a non-mandatory *third-party liability insurance* ("*seguro de responsabilidade civil*"). In the case of the W&I Insurance taken out by the Buyer, it qualifies as voluntary *first party loss insurance* ("*seguro de danos patrimoniais*"), non-Life, which can be classified as miscellaneous financial loss insurance ("*perdas pecuniárias diversas*").

10. Highly sophisticated, the W&I Insurance requires particularly careful negotiation by the parties involved in the acquisition negotiation process. The assumption for the insurer's decision to take out the W&I Insurance is that the negotiation process for the acquisition of a controlling shareholding was conducted between the Seller and Buyer under standard market

conditions, namely that due diligence was carried out and the warranties clause was negotiated as if the parties were not considering taking out insurance.

11. It consists of an insurance product which aim is to mitigate information asymmetry (between Seller and Buyer, between Policyholder — Seller or Buyer — and the Insurer), enhancing the quality and depth of the investigation to be carried out by the Buyer in its interaction with the Seller, at the level of the due diligence process, acting as a strategic instrument both to facilitate and speed up negotiations with the Seller.

12. The intention by the negotiating parties to take out the W&I Insurance should be agreed at the very beginning of the negotiation process (in our opinion in the Letter of Intent itself), as it will shape the course of the traditional negotiation process between Buyer and Seller in this type of operation in very specific ways.

13. The W&I Insurance typically excludes known risks by the Buyer from the scope of cover (contained in the data room, due diligence report or disclosure letter attached to the SPA). In other words, the risk of the information made available to the Buyer for analysis during the due diligence will be considered, in parallel with what occurs in general in the SPA, as a risk assumed by the Buyer, and will therefore not be covered.

14. The Insurer will likewise tend to exclude risks that are inappropriate in the context of the policy — fraud or wilful misconduct on the part of the Policyholder or Insured. Adjustments to the purchase price, risks not legally insurable, contractual obligations, environmental issues, pending litigation and modifications to the SPA without the Insurer's agreement are also excluded as a rule.

15. Whilst it is true that, as part of a *due diligence* exercise between Seller and Buyer, the latter aims to identify, as far as possible, contingencies affecting the target, with the areas of risk identified having an impact on the price to be paid for the acquisition and the warranties required of the Seller, it is no less true that, from the Insurer's point of view, the latter wants to ensure that the Buyer has in fact carried out an adequate and complete due diligence and has not released itself from carrying out this exercise by relying on the contracting of the W&I Insurance.

16. The audit carried out by the Insurer constitutes in practical terms in the imposition of *enhanced* due diligence duties on the Buyer. The Insurer will not carry out an independent audit of the target company; rather, it will validate and confirm the Purchaser's conclusions contained in the respective audit report based on the information received for underwriting purposes, thus not initiating an *ex novo* audit process, which would not be compatible with the time taken to finalise the transaction in progress.

17. However, comprehensive and complete Seller's warranties may not work against the due diligence exercise to be carried out by the Buyer. The cost and duration of the due diligence that may be the basis of an insufficient due diligence will not be justification for the Insurer to agree to cover warranties of the Seller that are not duly supported in that investigation process.

18. The Insurer's parallel participation in the transaction should take place as soon as possible in the negotiation process, in order to avoid delays in finalising the acquisition.

19. Without prejudice to the application (to the fullest extent possible) of the *back-to-back* principle with the SPA, *i.e.* the alignment between the contractual solutions agreed between the negotiating parties and those contained in the W&I Insurance, the latter, although functionally linked to the SPA by its very configuration, is a differentiated and autonomous instrument.

20. The taking out of the W&I Insurance and the intervention of the Insurer triggers a new negotiation model between the negotiating parties because not only it changes the scope and in-depth of the due diligence exercise but also the quality of the information exchanged between the negotiating parties and the negotiation of the warranties clause, intrinsically linked to it.

21. The W&I Insurance is not a magic formula suitable for any and all company acquisition processes, since the complexity of the interests involved is extremely varied and not always easy to reconcile; however, it can act as an effective and compromise solution between the parties.

22. The W&I Insurance is an instrument that mitigates transactional risk, contributing to the optimisation of the negotiation itinerary, based on a detailed delimitation of risks between the negotiating parties (Buyer, Seller, Insurer) apporting seriousness, efficiency and transparency, and promoting a favourable environment in business relations, bringing legal certainty and security, as well as predictability.

23. The W&I Insurance is a robust insurance product and a facilitating mechanism for transactions to acquire a controlling shareholding, which can be used strategically and can benefit both Buyer and Seller.

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