# W&I Market Claims Study

An independent market-wide review of W&I claims from European insurers

2024 EDITION

Building on our first independent market claims study of European insurers, released in 2023, the 2024 study captures data from 22 insurers and covers an 8-year period.

The HWF data set is broad, unique and independent. It presents an overview of the W&I market which isn't available elsewhere.

# Foreword

The W&I insurance market has historically lacked an objective data set which parties to M&A transactions can rely on when considering W&I insurance. We think the objective data presented in our report makes it far more useful to clients than other reports in the market. HWF's role in producing this study wasn't to enhance our own reputation, but to present clear facts to allow parties to make their own judgements.

Our data shows a record uptake of policies in the first six months of 2024. Against a backdrop of an M&A market which has been relatively subdued, the claims market has remained active in both volume of claims and settlements being made. This activity has also brought an increasing expectation that the role of a broker does not stop with the placement of a policy, but should extend to a sophisticated claims function that can support clients in their recovery efforts.

**David Wall**
Co-Head of Private Equity

# Contents


Introduction & Methodology 04
Key Takeaways 05
Claims Study 06
HWF Claims Advocacy 13
Calculating Loss in W&I Claims 15
About HWF 19
Participating Insurers 21

# Overview

**HWF is delighted to release its second annual independent W&I Market Claims Study (the 'Study').**

The 2023 edition of this study (the '**2023 Study**') was the first independent review of the state of the W&I claims market outside of North America, utilising a data set from 16 leading insurers to present clients with objective evidence of the utility of W&I insurance.

The 2024 edition builds on the success of its predecessor. Our data pool is growing as we now have 22 insurers providing claims data across more than 15,000 W&I policies placed since 2016. The result is increased visibility on the uptake of W&I insurance and the reliance parties place on it when transacting as well as providing evidence that a path to recovery exists in the event of a claim.

The Study is released against a backdrop of increasing deal volumes in a highly competitive transactional risk market where increased competition has pushed pricing to near-historic lows. At the same time, claim numbers are steadily increasing and payment rates remain high, leading to market sentiment that pricing will need to harden to support payment rates.

A robust claims market is therefore of critical importance to maintain confidence in the W&I market. The Study validates that confidence. It provides objective evidence of a functioning claims market, with notifications and payments being made across geographies, sectors and transaction sizes within relatively short timeframes.

# Why is the HWF Study unique?

**In short, our data pool is growing, allowing us to refine our findings and provide an increasingly accurate picture of the W&I claims market. Key differentiators between the Study and other reports are:**

| | Non-HWF reports | HWF Study |
|---|---|---|
| Data collection | Generally limited to author's own claims data | Independent third party engaged to collect data and report to HWF on an anonymised basis<br><br>Anonymised data overlayed with commentary from HWF based on its own claims data |
| Review period | 12 months | 1 January 2016 – 30 June 2024 |
| W&I policy reference pool | Variable. Maximum c.500 – 750 | 15,080 |
| Insurers | Other reports are generally limited to the author's own claims data | 22 insurers participated<br><br>Seven have been operating for the entire review period, another seven have been operating for at least five years |
| Jurisdictions | Data from European insurers in respect of transactions in all jurisdictions outside of North America | |

# Key Takeaways

### Long-term Data Insights

22 insurers, 8 year lookback period, 15,080 policies

The eight-year lookback period across 22 insurers and 15,080 policies provides a comprehensive market view, supporting robust trend analysis, reliability in findings and confirmation on the ability to recover in the event of a claim.

### Notification Rate

11.64%

This is the percentage of policies with a notification (whether open or closed). Insurers received claim notifications on 11.64% of policies, demonstrating a high level of sustained claims activity and reliance by insured parties across the lookback period.

### Policy Paid Rate

4.32%

This is the percentage of policies with a paid claim. That is a material number of payments on a product that responds to unknown and unforeseen risks, particularly as parties will have undertaken material diligence. In a W&I market which is experiencing historically low pricing, an increase in rates to reflect this material payment rate should be expected.

### Closed Notification Payment Rate

53.10%

This is the percentage of closed notifications which resulted in a successful claim. Over half of the closed claim notifications resulted in a paid claim, a material rate in light of the already high notification rate. If notification rates continue to increase, it is a reasonable assumption that payments out will also increase and, in turn, pricing will need to increase to support those payments.

### Prompt Claim Settlements

72.56% of claims paid within 18 months

A significant portion of paid claims were settled within 18 months, demonstrating efficiency in the claims processing and payment timeline. 24.37% of claims are paid within 6 months of notification, showing that insurers are in the business of paying good claims promptly.

### Financial Sponsors Benefit

63.95% of successful claims paid to Financial Sponsors

Financial Sponsors received 63.95% of successful claim payments, highlighting that well-advised professional investors remain active users and beneficiaries of W&I insurance.

### Third Party Claims / Fraud / Non-disclosure

49.67% of claims

W&I insurance exists to protect against unknown and unforeseen risks. The basis of almost 50% of claims by definition couldn't be discovered by due diligence. An insurance policy which reacts to such claims remains invaluable to mitigate risk.

### Low Rate of Subrogation

1.85% of successful claims

Subrogation against sellers following a claim is rare, occurring in just 1.85% of successful claims, suggesting limited recovery action by insurers post-payout.

22
insurers

8 year
lookback period

15,080
policies placed

11.64%
Notification Rate

4.32%
Policy Paid Rate

53.10%
Closed Notification Payment Rate

72.56%
of claims paid within 18 months

63.95%
of successful claims paid to financial sponsor buyers

49.67%
Third party claims/ fraud/non-disclosure

1.85%
Subrogation Rate

Claims
Study

# Use of W&I Insurance: An Update

The 2023 Study was based on 10,162 policies from 16 insurers. The addition of six new insurers combined with the high deal volume over the last 12 months has increased our data pool to 15,080 W&I policies, allowing us to refine our base data and report an increasingly accurate position on the claims market.

## W&I policies

Fig. 1

In the 2023 Study, we reported that only 486 W&I policies had been placed in the period 1 January 2023 – 30 June 2023, however, the number of total policies placed for the year were 2,247, evidencing a high transaction volume in the second half of 2023.

That increased activity has continued, with 1,540 policies placed between 1 January 2024 – 30 June 2024. Aligning with this increased activity, HWF has placed 37% more policies between 1 January 2024 - 30 June 2024 than in the corresponding period in 2023. If this activity continues we expect 2024 to see placement of c. 2,750 W&I policies, marking a record year of policy uptake.

> With the addition of six new insurers and a highly active market over the past 12 months, our expanded data pool underscores a continued reliance on W&I insurance.
>
> **DAVID WALL** CO-HEAD OF PRIVATE EQUITY

## Transactions using W&I insurance by EV

Fig. 2

As a result of the foregoing, the insurers participating in the Study for the first time are largely focused on the SME space, a segment of the market which has seen a number of new entrants and rapidly increased appetite for deals. As such, the percentage of policies placed in our data set for transactions with an EV of less than £50m has increased from 25.44% to 34.50% in the 2024 data. That proportion also tracks the last 12-18 months where there have been fewer larger deals in the market following macro economic uncertainty.

The proportion of deals in excess of £1 billion EV using W&I insurance has decreased from 6.82% in the 2023 Study to 5.60%, meaning that c.845 policies in our data set have been placed on deals of that size.

At the time of writing we have seen a return of larger deals to the market in line with a general uptick in activity of sponsor clients, so expect this proportion of large deals to increase going forwards.

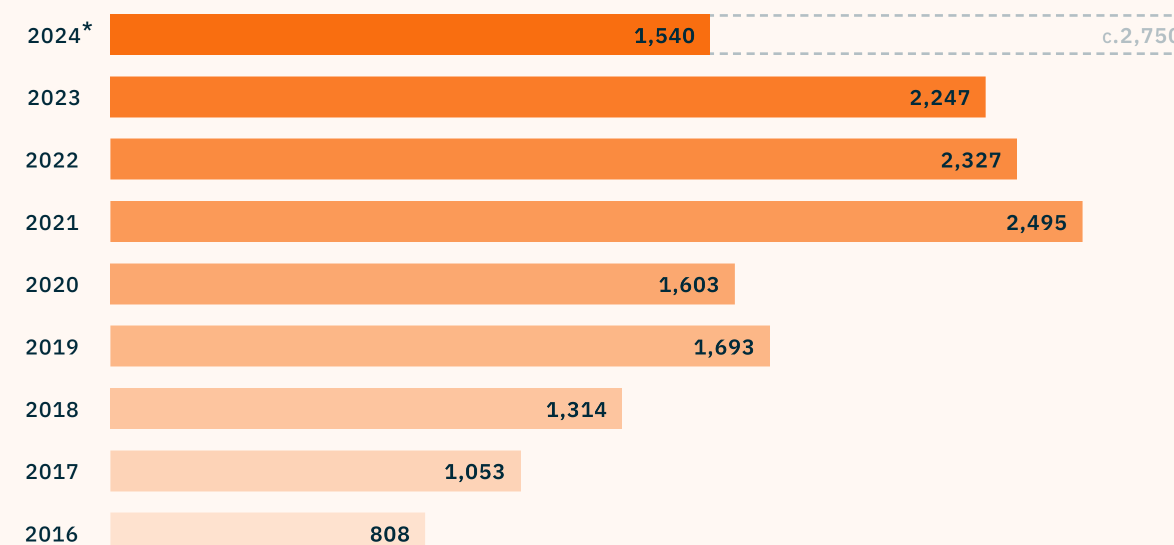
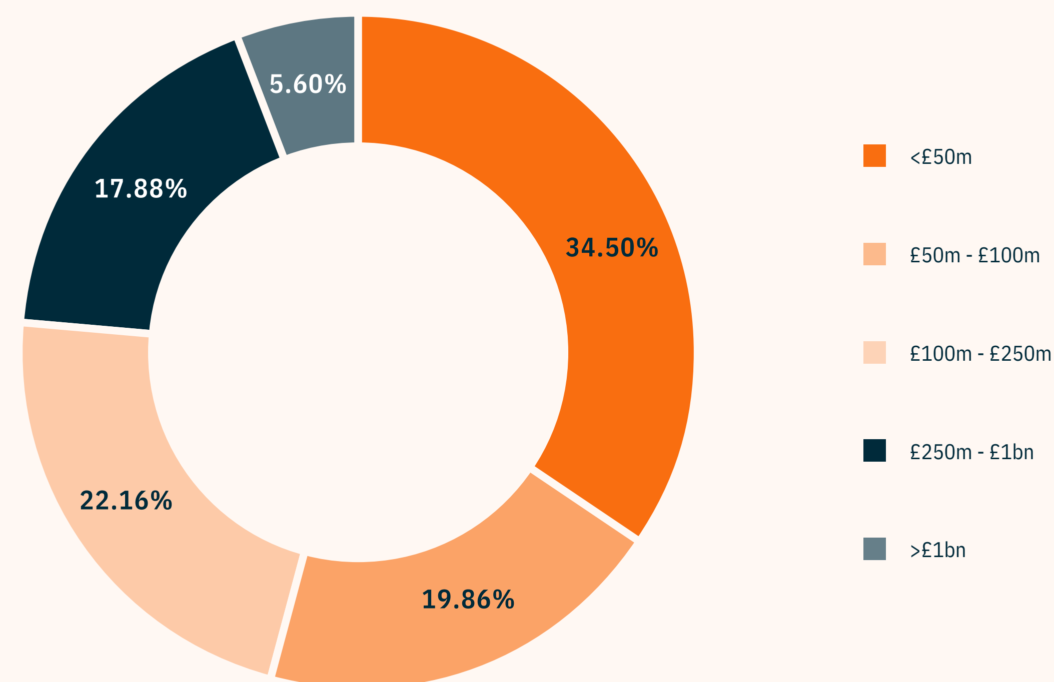



Fig. 1 W&I policies

Fig. 2 Transactions using W&I insurance by EV



## Target jurisdictions

Fig. 3

Our data set still shows a very broad uptake of W&I insurance across jurisdictions. Several of the insurers participating in the Study for the first time are focussed on continental European transactions, meaning the proportion of policies placed in Western Europe has increased in our data set from 19% to 25.50%. HWF's own data for the same period aligns with this, with HWF deals in Western Europe accounting for 28.67% of total deals.

Reflecting that insurer focus, the proportion of policies placed in the MEA region has decreased from 3% to 2.70%. This gives a slightly misleading impression as looking across the data set we can see that uptake of W&I policies in the MEA region was minimal in earlier years and has increased rapidly since 2022. HWF's own data shows that 5.02% of policies that we have placed have been in the MEA region, illustrating our historic activity and expertise in the region prior to establishing our office in Dubai in 2022.

Whilst the proportion of policies in the Rest of World (excluding North America) category has decreased slightly from 13% to 12.86%, the HWF data shows interesting developments. There has been an increased appetite, in particular, for South American jurisdictions over the last 12 months which has resulted in significant policies being placed for operational businesses in Chile, Peru and Uruguay.

> Whilst established jurisdictions with familiarity with W&I remain active, growth in uptake in Southern Europe and the Middle East and Africa over the last 12 months is exciting as the market continues to mature.
>
> **ADRIAN FURLONGE** PARTNER

## W&I policies placed by sector

Fig. 4

The prevalence of W&I insurance in historically stable sectors remains noteworthy, with 36.34% of policies placed across the Real Estate and Energy & Infrastructure sectors in our data pool. During the same period, HWF's own policy data aligns with this trend, with 40.50% of our policies placed in the Real Estate and Energy & Infrastructure sectors. This high uptake is unsurprising, as W&I insurance is well suited to these sectors as cover is broad, pricing is low and there are often no management teams to stand behind any liability.

Noteworthy changes from the 2023 Study are a decrease in the proportion of policies placed in the Financial Services sector from 8.54% to 7.51%, reflecting the fact that certain SME insurers added to our data pool do not cover Financial Services targets. HWF's own data for policies placed during this period shows that 6.45% of the policies we have placed have been in the Financial Services sector. Despite this decrease in the proportion of policies placed in the sector, in real terms the number of policies placed in the Financial Services sector remains material, and appetite amongst those insurers with relevant sector expertise remains strong.

Fig. 3 Target jurisdictions

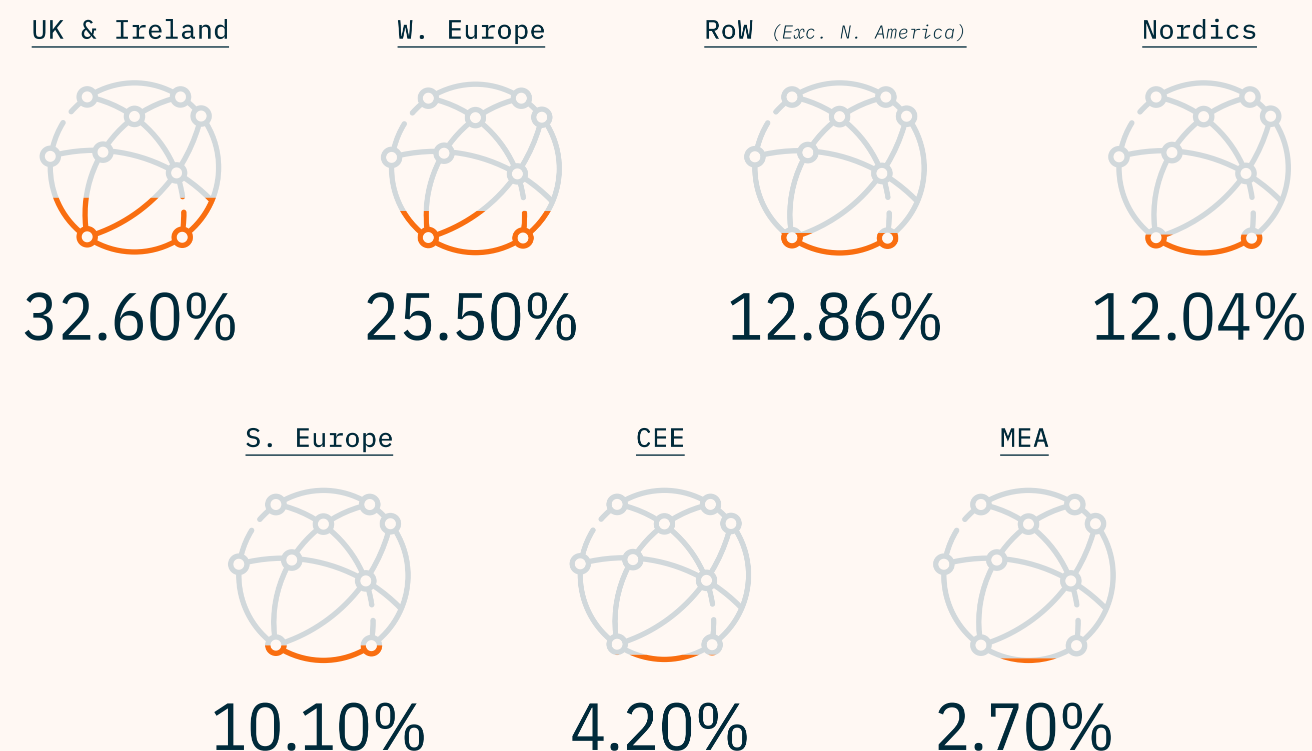
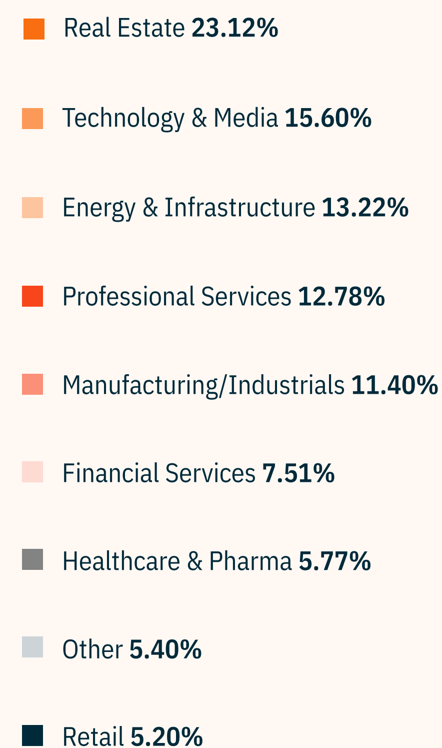



Fig. 4 W&I policies placed by sector

- Real Estate **23.12%**
- Technology & Media **15.60%**
- Energy & Infrastructure **13.22%**
- Professional Services **12.78%**
- Manufacturing/Industrials **11.40%**
- Financial Services **7.51%**
- Healthcare & Pharma **5.77%**
- Other **5.40%**
- Retail **5.20%**



# Notifications and Payments

## Policies with notifications

Our 2023 Study showed claims on 11.32% of policies across the data set. Despite the addition of 6 new insurers in the Study and the increased policy count, the refined data shows a stable notification rate of 11.64%.

This consistency underlines both the strength of the data set and the established practice of insured parties to make claims.

The updated data shows notifications for 2022 at 11.13%, a material increase on the 2023 Study when that rate was 7.40%.

The reporting in the 2023 Study only captured notification on policies placed during H1 2023, with notifications at that time on 5.84% of policies placed. The full year data set for 2023 shows notifications have been received on 9.85% of policies placed during the period, a figure that is sure to rise as claim periods remain open.

## Policies with paid claims

Our 2023 Study showed a 5.48% payment rate across the review period. The addition of new insurers and an additional year of data has allowed us to further refine that number; across the review period we can now confirm that there were paid claims on 4.32% of policies. Whilst this is a reduction compared to the headline figure in the 2023 Study, it is still a significant number, particularly in light of the pricing of W&I insurance, as a product, averaging at 1.35% across the period.

It is likely that we will see the payment rates increase for the periods 2022 and 2023 where claim periods are still live for business warranty claims. In particular, policies placed in 2023 currently have a payment rate of 1.55% and HWF's own data reflects an increase in claim numbers over the last 18-24 months with a material proportion of claims for 2023 still open (60.16%). Assuming spurious claims were closed off promptly, it is reasonable to assume we will see an increase in the payment rate for policies placed in 2023 over the next year.

For example, for the years 2018 and 2019, where the vast majority of notifications are now closed (only 16.13% and 18.88% of policies for those years still have open notifications), the policy paid rate is much higher than 4.32%: 8.31% for 2018 and 7.96% for 2019. Therefore, we can reasonably expect that when the years 2020 - 2023 reach these same levels of closed notifications then the policy paid rate is likely to be meaningfully higher than 4.32%, and potentially closer to a paid claim rate of 7 - 8%.

## Closed notifications with successful claims

To calculate the proportion of closed notifications resulting in a successful claim, we divide the aggregate number of paid claims across the review period by the aggregate number of closed notifications. This is a slightly crude measure as it doesn't account for the volume of notifications in each year of the review period and the high proportion of notifications remaining open in later years, but the data shows us that across the review period 53.10% of closed notifications have resulted in paid claims (which includes, for the avoidance of doubt, claims beneath the policy excess which were notified to erode that excess for future claims). This broadly aligns with the rate of 63.78% which the data from the 2023 Study reported.

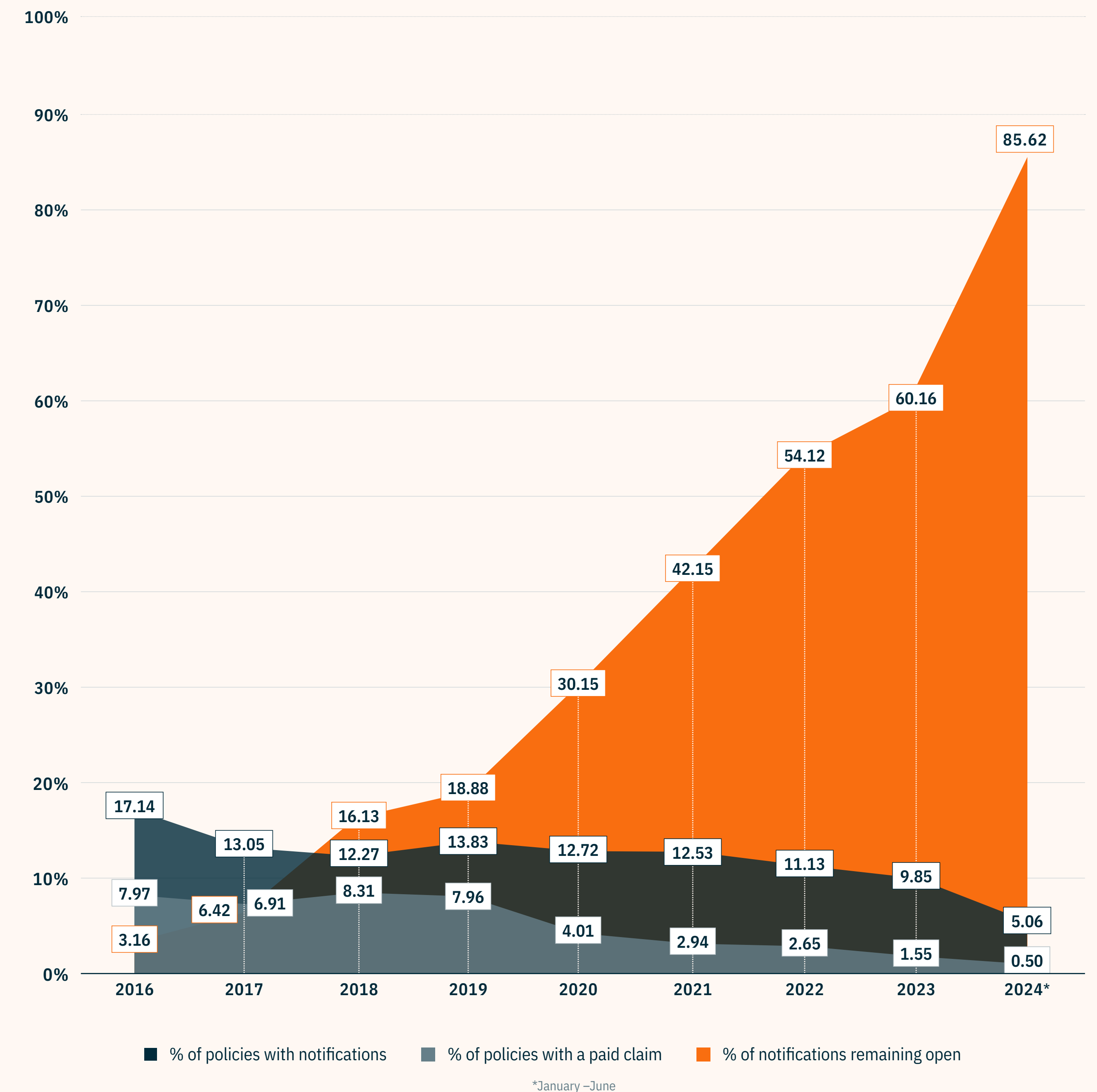
The implication of this rate is that parties are recovering under W&I policies on slightly over one in two notifications. Given it is much more customary in an insured deal to notify an insurer of a potential claim at an early stage when it is often unclear whether a loss has actually been suffered in order to comply with policy notification requirements (which is evidenced in the data as in 40.45% of notifications there is no quantum specified), this is a material recovery rate.

It is also noteworthy that HWF has seen a material uplift in the number of notifications being made on W&I policies over the last 18-24 months. Going forward, it will be interesting to see how the notification-to-paid-claims rate develops and any corresponding hardening of W&I rates.

## Notifications still open

As per the 2023 Study, it is no great surprise that historical claims are more likely to have settled. We have seen large drops in the open notifications for 2016 – 2020. It's also noteworthy that open notifications in the period 2022 – June 2024 average out at 66.63%, broadly showing that notifications are being dealt with and closed off where possible. That trend aligns with the findings elsewhere in this Study that claims are being settled quickly, with 72.56% of claims paid out within 18 months of notification.

> W&I policies offer a material recovery rate with slightly over one in two notifications resulting in payment.
>
> **ALEX HARDING** HEAD OF CLAIMS



## Claim notification and payment timing

Fig. 6 & 7

The updated data is broadly in line with the 2023 data set, however, it is noteworthy that the proportion of claim notifications received within 3 months of policy inception has increased from 8.82% to 11.05%, which aligns with the higher claim notification volume we have seen at HWF over the last 18-24 months. The majority of claim notices, 55.97%, are received within 12 months of policy inception.

It's also noteworthy that the proportion of claim notices received more than 24 months from policy inception has increased from 12.46% in the 2023 Study to 15.38% in the current data set. We are seeing a move in the W&I market to offer coverage of general warranties for three years rather than two years as standard, so going forward we may see another increase in service of notifications in the post-24 month category.

Data from HWF's own claims between 1 July 2023 – 30 June 2024 shows a relatively consistent notification rate in the first 12 months after a policy has incepted, with 14% of notifications made less than three months from policy inception, 16% in the period 3-6 months from inception and 11% 6-12 months from inception.

The data shows that 55.37% of successful claims are paid out within 12 months of notification, with 72.56% of claims paid within 18 months. This is a material benefit of an insured claim over an uninsured claim in which sellers are incentivised to avoid claim payment. HWF's own claims experience over the last 12 months aligns with this timing with 71% of successful claims paid out within 12 months.

## Claim notification and payment quantum

Fig. 8 & 9

The 2024 data follows the same trend as the data from the 2023 Study; the majority of notifications, 40.45%, do not specify a quantum. The largest proportion of notifications which do specify a quantum, 33.68%, fall between the excess and 50% of the policy limit. A significant proportion of notifications, 5.82%, are notifications below the excess and are made in order to erode the policy excess.

This aligns with data from HWF's own claims in the 12-month period ending on 30 June 2024, where 59% of notifications did not specify a quantum and 27% of notifications were between the excess and the 50% of the policy limit.

The data also shows that the vast majority, 57.02%, of successful notifications result in payments between the excess and 50% of the policy limit. Full policy limit payments are less common, but still material at 4.97% of successful notifications.

The data on payment quantum is new to the Study. The data shows that in 23.24% of successful notifications, the quantum falls below the excess, meaning the excess is eroded but no cash payment is made. Whilst this appears high, in reality the data spans an eight-year period during which average policy excess levels have dropped from c.1% of EV to a market where a 0.25% of EV is now common (and nil excess policies are now frequently offered on operational deals). The data for more recent years therefore shows a lower proportion of claim payments falling below the excess level.

## Claims by financial sponsors

Fig. 10

Financial sponsors are highly sophisticated in doing deals and typically are well advised in the event of a claim. In HWF's experience, financial sponsor claims are thoroughly analysed and well positioned, with underlying analysis to support the alleged breach. This approach is typically helpful in a claim scenario, with all parties focused to understand the basis of a claim and move to settlement discussions as quickly as possible.

HWF also see financial sponsors relying more heavily on us as claims advocates (see page 13 for details). By bringing HWF in as a claims advocate and having us use our sector expertise, we materially influence the analysis and positioning of claims and can deploy our own commercial leverage with insurers to the benefit of sponsor clients.

As a result of the above, whilst the Study data shows that 41.02% of claims are made by financial sponsors, payment to sponsors account for 63.95% of all payments.

Fig. 6 Claim notification timing

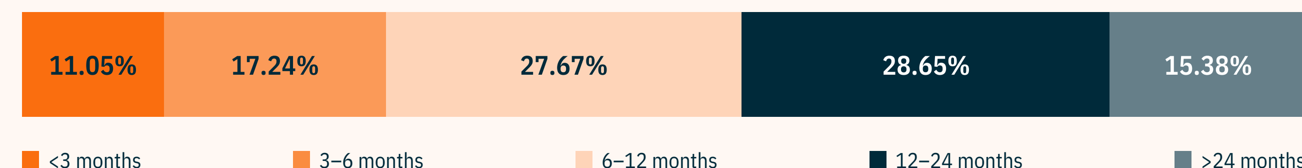
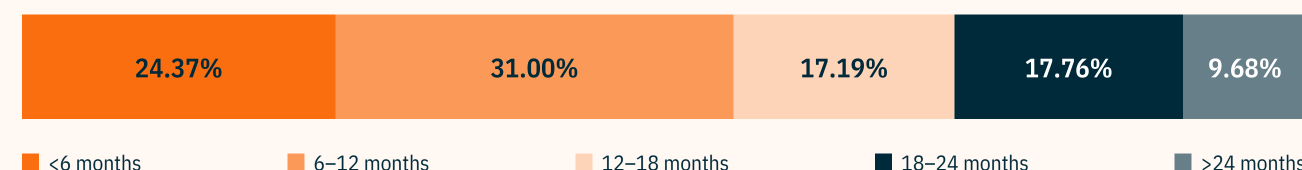



Fig. 7 Claim payment timing




> Adoption of W&I insurance by financial sponsors has been instrumental to the growth of the W&I market. We also see financial sponsors invest more heavily in the claims process and lean more on HWF to utilise our commercial leverage and secure settlements.
>
> **DAVID WALL** CO-HEAD OF PRIVATE EQUITY

Fig. 8 Claim notification quantum

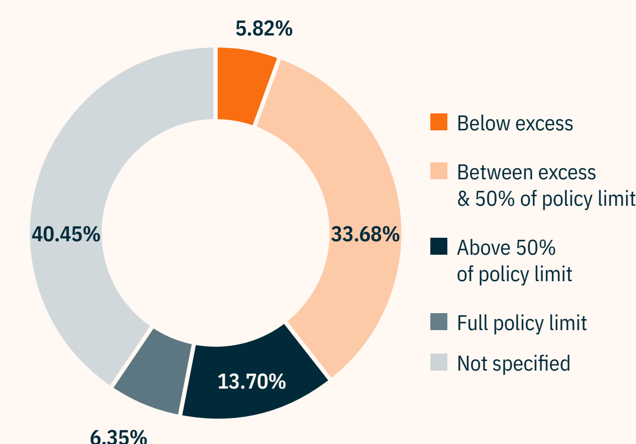



Fig. 9 Claim payment quantum

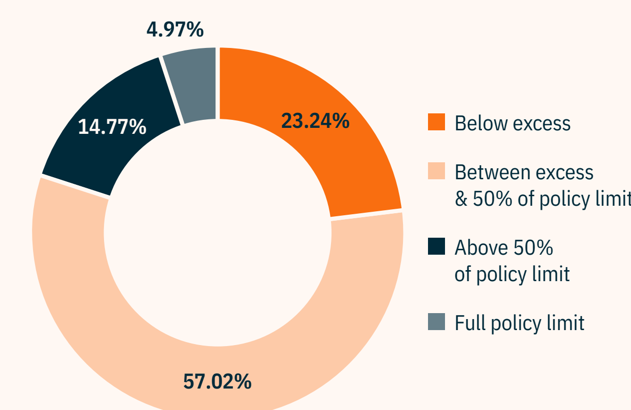
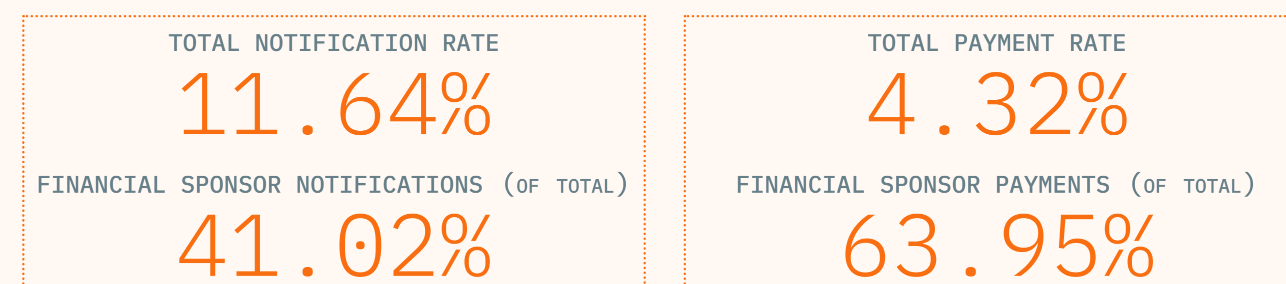
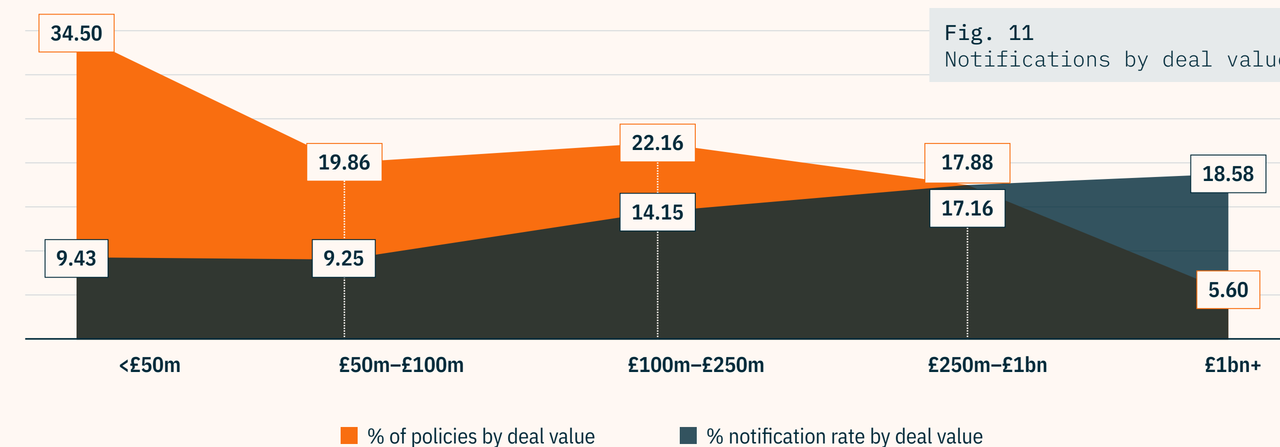



Fig. 10 Claims by financial sponsors



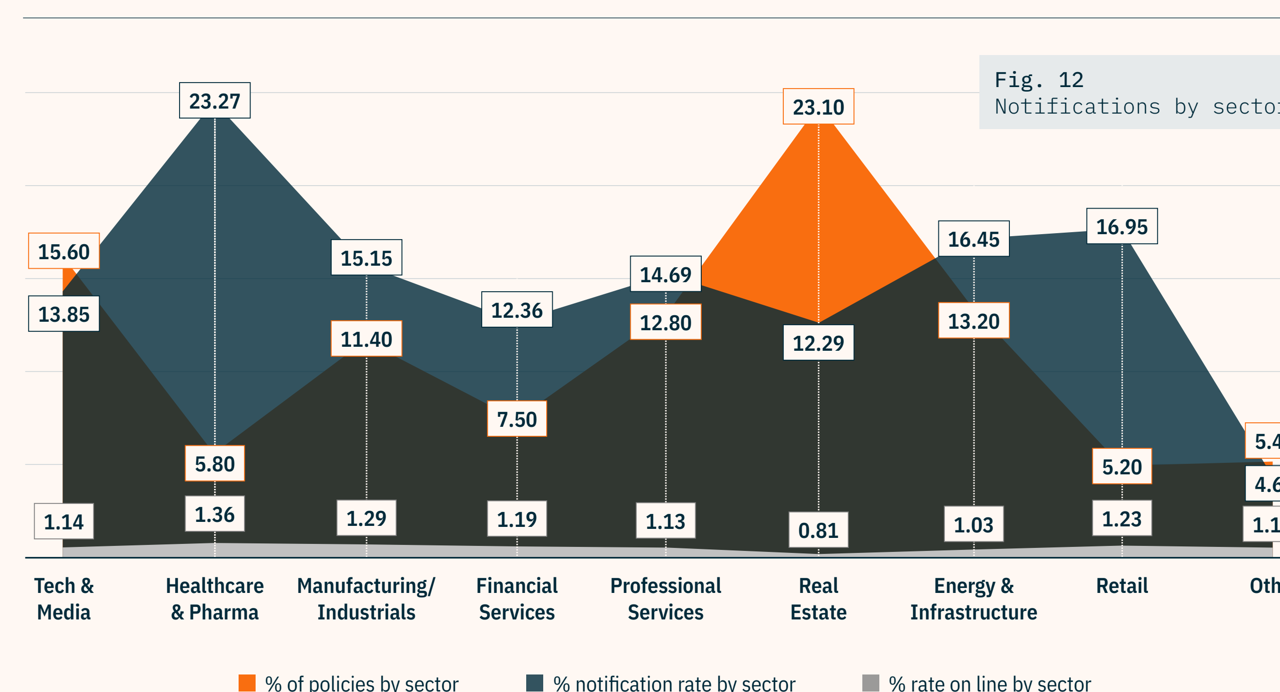



## Notifications by deal value

Fig. 11

The data on notifications by deal value follows the expected narrative; there are more notifications on larger deals. The data now shows that on policies placed on deals with an EV in excess of £1 billion, there is a 18.58% notification rate. That is a material proportion of large cap deals making notifications, particularly when compared to deals with an EV of less than £1 billion where notifications are received, on average, on 11.40% of policies placed.

> The data shows a clear correlation between deal size and the likelihood of notification. A near-20% notification rate on transactions exceeding £1 billion is material.
>
> ALEX HARDING HEAD OF CLAIMS




## Notifications by sector

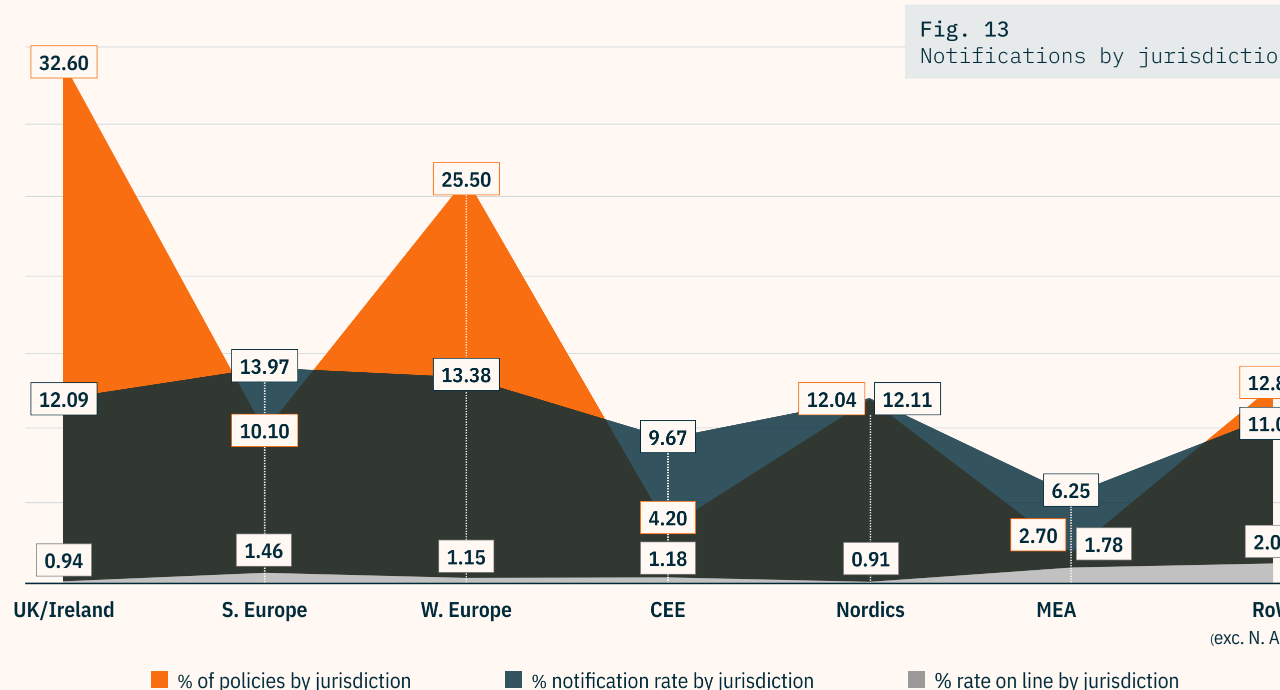
Fig. 12

The notifications on Healthcare and Pharmaceuticals and Retail sector policies are noticeably disproportionate to the number of policies placed in those sectors. The data on rates on line across the review period is new to the Study this year, and shows that the high notification rates in the Healthcare & Pharmaceuticals and Retail sectors have fed through to higher average rates on line across those sectors.

The data also shows a high notification rate in the Energy &Infrastructure sector which runs contrary to the common view of the sector. The average rate on line data is towards the lower end on the risk spectrum at 1.03%, but the high notification rate would suggest a hardening of rates in the sector may be expected.

Equally, the Real Estate sector looks much less of a risk for insurers as the notification rate is materially below the policy placement rate for the sector, which is borne out in the rate on line data as the average rate for Real Estate sits at 0.81%.

At the time of writing the Study, driven by increased competition in the W&I market, we are seeing historically low rates on line across sectors. Whilst this is favourable for insured parties, the rates are becoming detached from the risk profile and claim volumes. In the short term, we might expect insurers to defend claims more robustly to mitigate their losses, whilst in the medium term, a rate hardening is inevitable as insurers adjust to meet greater claim payment volume.




## Notifications by jurisdiction

Fig. 13

When compared to the percentage of policies placed in each jurisdiction, the W&I market sees an outsized proportion of claims in Southern Europe (13.97%), the CEE (9.67%) and MEA (6.25%). Excluding the RoW category, those jurisdictions in turn see the highest average rates on line across the jurisdictions covered by the Study.

The data for the MEA is particularly interesting. As arguably the most rapidly evolving market for transactional risk products, HWF's experience closely mirrors the market data; HWF's own claims data in the 12-month period ending on 30 June 2024 shows a notification rate in the MEA region of 6.82%. As the market matures, we expect policies placed in the MEA to increase materially. It will be interesting to see if the notification rate remains stable.

## Types of breach

Fig. 14

The core warranties claimed against are those with the most broad application. Most notifications, therefore, relate to Financial Statements / Accounts (20.93%) and Tax (19.46%), with Compliance with Laws also showing a material number of claims (7.89%).

Data from HWF's own claims in the 12-month period ending on 30 June 2024 also displays that the vast majority of notifications relate to breaches of Financial Statements / Accounts (35%), Tax (16.67%) and Compliance with Laws (20%) warranties. It is noteworthy that in that 12 month period there has been a significantly higher proportion of notifications alleging breaches of Financial Statements / Accounts and Compliance with Laws warranties compared to the market data pool.

Claims relating to Trading Arrangements (inc. Material Contracts) are relatively low at 8.36%. Across the review period, HWF's experience is that a high degree of claims activity is linked to material contract claims. We would have expected this number to be more significant, but do see a number of material contract claims framed as breaches of Financial Statement / Accounts warranties which may explain the discrepancy.

> Our key takeaway from the 2023 Study holds true this year: most claims arise from risks that cannot be identified through due diligence.
>
> REBECCA WYNNE PARTNER

## Notifications: Fraud, non-disclosure and third party claims

Fig. 15

A key takeaway from our 2023 Study was the importance of W&I insurance to respond to claims where risks, by their nature, could not be diligenced. The enlarged data set for 2024 confirms that conclusion. The data confirms that 38.54% of notifications relate to third party claims whilst 11.13% relate to seller fraud / non-disclosure. That gives an aggregate of 49.67% of notifications relating to matters which could not have been uncovered through diligence, an increase from 43.75% in the 2023 Study.

## Subrogation

Fig. 16

A key focal point for any seller in a W&I insurance-backed transaction is ensuring an appropriate waiver of an insurer's rights of subrogation against the seller (aside from a customary carve out for fraud). An obvious question raised by the relatively high proportion of claims relating to seller fraud / non-disclosure (11.13%), is what percentage of paid claims then lead to an insurer exercising its right of subrogation against sellers.

Our data shows this is quite rare, with only 1.85% of paid claims between 2016 – 2024 resulting in an insurer exercising its right to subrogate. Whilst insurers have not confirmed the proportion of such claims which resulted in recovery from sellers, we know from insurer discussions that recovery is rare (and HWF has not seen an insurer subrogate against a seller on claims we have been involved in), and the real benefit to the prospect of subrogation appears to be in driving disclosure so that sellers run a clean transaction process.

Fig. 14 Types of breach

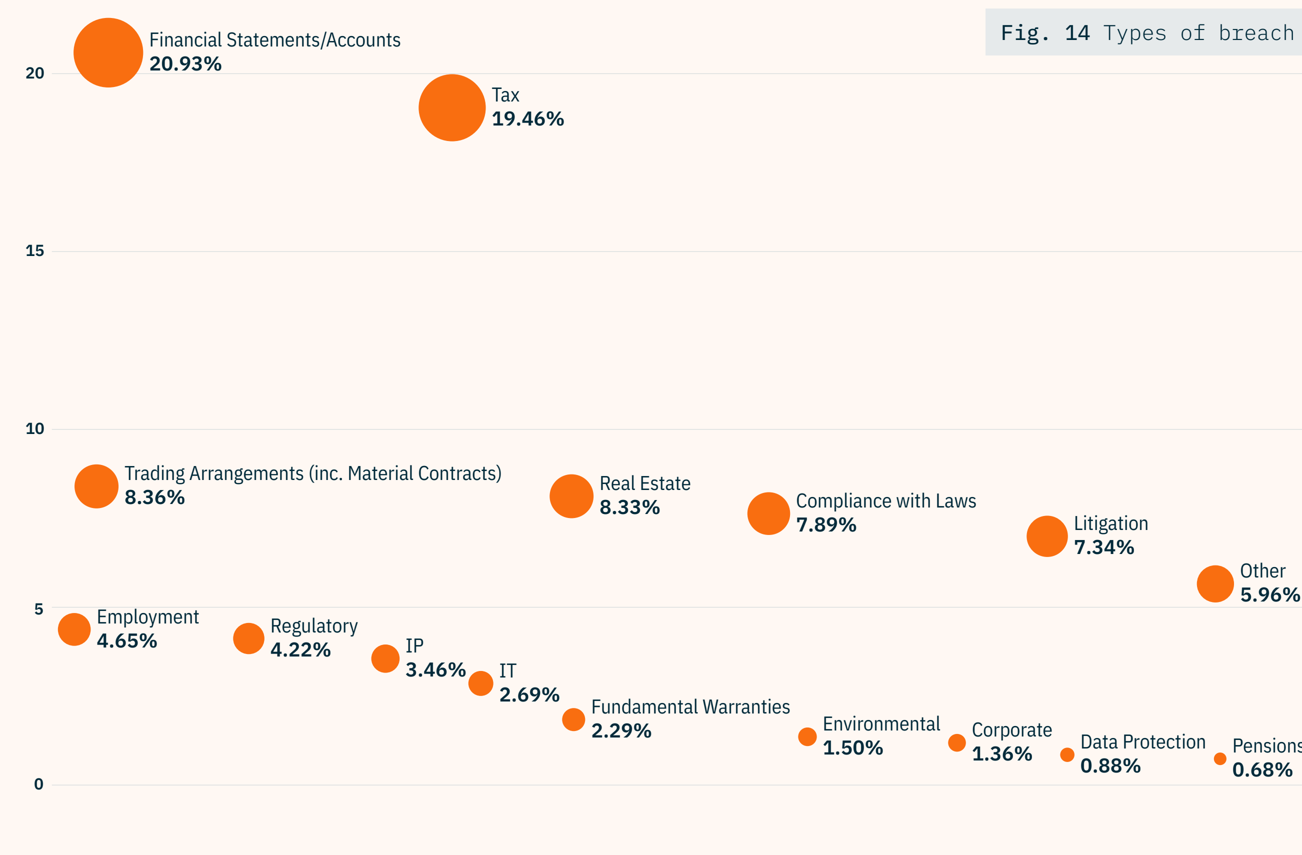



Fig. 15
Fraud, non-disclosure and third party claims

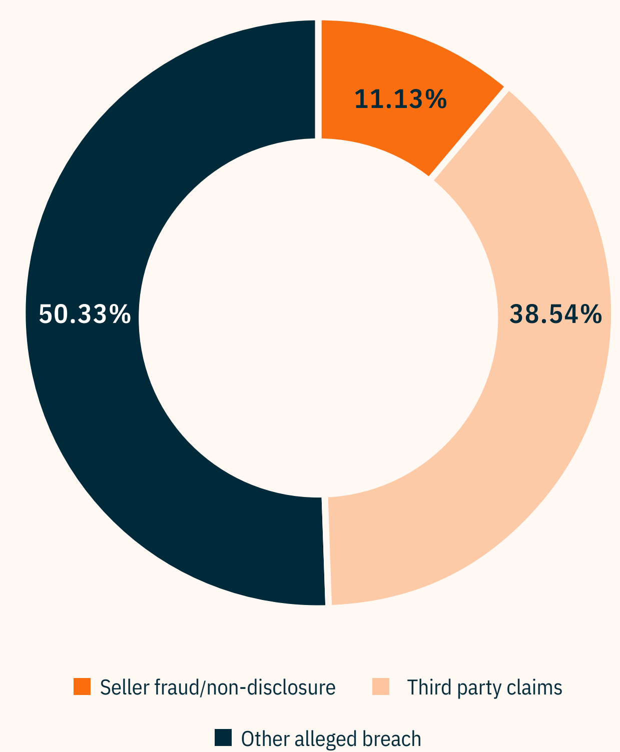
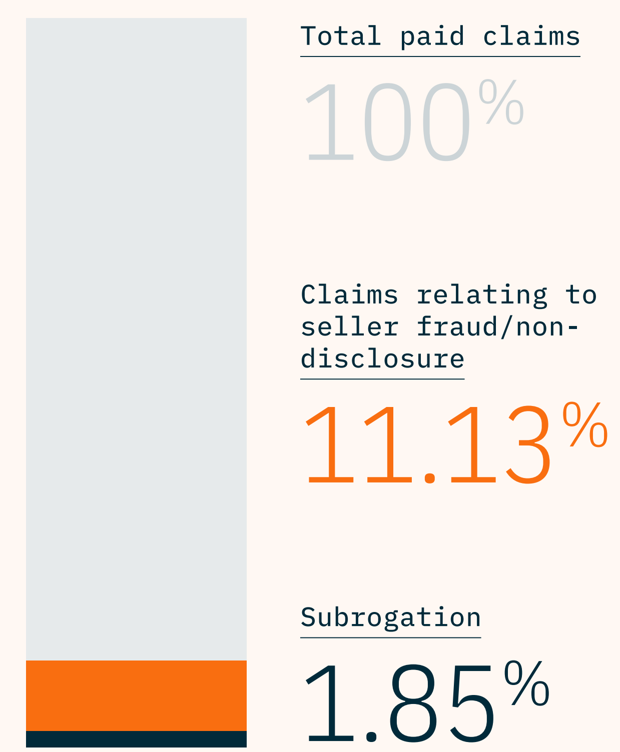



Fig. 16 Subrogation



Claims
Advocacy

# HWF Claims Advocacy

HWF is able to act as claims advocates for policyholders.* If a claim arises, HWF is available to assist in every step of the claims process, from notification to settlement. As claims advocates, we are able to negotiate on a client's behalf directly with insurers, allowing us to leverage our commercial relationships to deliver practical results.

Our daily experience of working with insurers on both insurance placements and claims processes can be an invaluable asset for lawyers dealing with a claim.

## The process

When a policyholder thinks that there might be a claim for loss under the policy, it is sensible to involve us as soon as possible. We can assist by:

- Assessing, alongside the legal advisers, whether a claim should be made;
- Preparing the initial claim notice;
- Sharing information between the insured and the insurer;
- Using our relationships with the insurers to help negotiate the best outcome for the insured.

## Outcomes

During 2024 we have obtained a number of settlements for insureds on favourable terms which would not have been possible but for our involvement.

HWF's role can often be the difference between getting a claim paid quickly and parties getting stuck in months of legal and expert arguments. HWF is often able to articulate the commercial merit of an insurer paying a claim promptly because of our ongoing professional relationship. In technical negotiations, HWF is also often able to use the role of 'broker' to stand back and find common ground between the parties to facilitate a solution.

In several examples this year, HWF has led settlement discussions between insurer and insured precisely because of our trusted industry expertise and our ability to speak to both sides candidly.

**HWF does not provide legal advice and only provides claims advocacy pursuant to the Financial Conduct Authority rules and English law.*

# Claims Advocacy Case Studies

## Unanticipated Management Fees in Italian Solar Plant Acquisition

1

- The target business owned a solar power plant in southern Italy.
- Six months after completion the buyer received various invoices from a third party claiming to provide management services to the target business and being entitled to monthly fees.
- After a short internal investigation, the insured discovered that the target had entered into this contract with the third party but that this had not been disclosed by the seller.
- The insured buyer wished to terminate the contract as soon as possible to prevent further costs being incurred. With the assistance of HWF, the insurer was able to quickly review the details of the claim and confirm *within 24 hours* that the insurer did not object to the buyer entering into the proposed settlement with the third party immediately to mitigate its losses, and would not rely on this point in due course once it had concluded its coverage review.

**Despite there being some difficult questions over coverage under the policy, the insurer and insured wanted to resolve the matter quickly and so the insurer proceeded to pay over 60% of the third party settlement amount within 3 months of the claim notice.**

## Under-invoiced VAT for UK Catering Business

2

- The insured buyer acquired a large catering business in the UK.
- Following the acquisition, a review was undertaken of the VAT position of the group and it was discovered that one of the subsidiary companies had under-invoiced the amount of VAT applicable on its supplies to its clients over a four year period and consequently under-declared its output VAT to HMRC.
- The additional VAT liability was covered under tax warranties and the tax indemnity under the SPA and W&I policy.

**HWF worked closely with the insured to get the insurer to agree to pay a loss of £2.1 million to satisfy the tax liability, with parties agreeing that if the insured received the additional VAT back from the clients it should initially have invoiced, such amounts would be returned to the insurer.**

# Calculating Loss in W&I Claims

# Calculating Loss in W&I Claims: An Overview

**Many parties to M&A transactions are now very familiar with the advantages of warranty and indemnity insurance, which gives a buyer recourse to A-rated insurers and allows the seller to achieve a clean exit. However, the issue of how damages are calculated for a claim for breach of warranty under a SPA and therefore how 'Loss' is determined under a W&I policy is often less clear. This article is a summary of the position under English law.**

The basic structure of W&I insurance is that the policy will pay any damages which the buyer is contractually entitled to claim against the seller under the SPA for a breach of warranty, or the policy will pay an amount that the buyer is entitled to claim from the seller under the tax indemnity. In this way the 'Loss' payable under a W&I policy is intended to be 'back to back' with the entitlement to damages or an indemnity that is available under the SPA.

Consequently, issues of what loss is payable in W&I claims often turn on a damages assessment for breach of warranties in the SPA.

This article sets out a brief summary of the basic position on what damages are available for breach of warranties in a SPA and discusses a number of issues which we have seen arise in the last 12 months in the calculation of loss in W&I claims.

## Overview of damages in breach of warranty claims

### Warranties and indemnities

Warranties are contractual statements or assurances concerning various matters related to the target company or business. A 'disclosure letter' will be provided by the seller to the buyer limiting the scope of the warranties by disclosing relevant factual matters which, if not disclosed, would be a breach of warranty. In the event that the warranty is later proved to be incorrect (beyond the scope of what was disclosed), the buyer has a contractual claim for breach of warranty.

A claim for breach of warranty, like any breach of contract, is determined in accordance with the common law principles for breach of contract; depending on the nature of the warranty, this may involve a comparison between (i) on the one hand, the value of the target's shares based on the warranted position and (ii), on the other hand, either the actual value of the shares given the breach or, in some situations, the price that would have been paid but for the breach. The SPA may set limitations on recovery, such as a cap on the value of claims that can be brought.

By contrast, an indemnity is a contractual promise to reimburse the buyer in respect of a particular type of liability in the event that it occurs and, in general terms, allows the buyer to recover its loss on a 'pound for pound basis' (although again, the parties would be free to cap recovery in the SPA).

Under an indemnity, the indemnified party does not need to prove that a breach of contract occurred – the requirement is to show that the specified event has occurred. Further, as an indemnity creates a contractual obligation on one party to compensate the other party for a defined loss or damage, it is often regarded as a debt claim and therefore the usual common law rules relating to damages, such as remoteness and mitigation, do not apply.

Indemnity clauses can, therefore often cover a wider range of losses including indirect or consequential losses and costs and expenses.

### Breach of warranty: contractual damages[1]

The general principle of contractual damages is that if one party has breached its contract, the other party is entitled to be compensated for the loss that it has suffered as a result of that breach. The classic formulation of damages for breach of contract is that the party sustaining the loss should be put in the same situation as if the contract had been performed.

For breach of warranties in share purchase agreements, this measure of damages depends on whether the warranty is a 'warranty of quality' or a 'warranty of reasonable care'.

The majority of warranties in SPAs are warranties of quality. Warranties of quality are warranties of fact that the shares are of particular quality, e.g. specific figures are correct, the company has a certain amount of assets or the company has complied with the law.

Warranties of reasonable care are warranties not that particular numbers or forecasts are true, but that they have been prepared with reasonable care and diligence. For example, a seller could warrant to the buyer that it has calculated future cashflow projections honestly and carefully. Breach of a warranty of reasonable care does not mean that the relevant figures are false, but that had the figures been prepared with more care, different figures would have been presented.

It is worth noting that the warranty that accounts were prepared on a 'true and fair' basis looks like a warranty of reasonable care but the case law makes clear that it is treated as a warranty of quality.

### Warranties of quality - valuation

For breaches of *warranties of quality*, in order to put the buyer in the position it would have been if the warranty had not been breached, the measure of damages is the difference between the value of the shares of the company as warranted (i.e. if the warranty had been true) and the actual value of the shares based on the real position (because the warranty was false). This 'warranty true vs warranty false' calculation is assessed on the basis of a hypothetical, reasonable willing buyer and a hypothetical, reasonable willing seller, rather than being bound by the parties' subjective views.

The 'as warranted' value of the shares is a question of fact to be established and can be subject to expert evidence. Given that the claimant bought the shares on the basis that the warranties were true, the purchase price of the shares is usually very good evidence of the warranted value of the business and that is usually the end of the enquiry. However, it is open for either side to prove that the 'as warranted' value was more or less than the price actually paid for the company.

Calculating the *actual* value of the shares (i.e. the position as a result of the breach of warranty) is usually a matter for expert evidence. However, the valuation methodology used by the parties at the time of transaction (even if it is 'unconventional', see discussion below regarding *Finsbury Food v Axis* [2023] EHWC 1550 (Comm)) is likely to be relevant in assessing the actual value of the company and the amount of damages.

> **Expert view**
>
> One of the primary obstacles to expeditious claims resolutions is inflated loss arguments being made by insureds, with insurers' primary goal being to establish the objective position on loss. Provision of contemporaneous valuation documentation early in the claims process can be key to insurers being able to swiftly determine the correct position on loss.
>
> **ALEX WHITE**
> **HEAD OF CLAIMS (INTERNATIONAL), RYAN TRANSACTIONAL RISK AND TRANSACT RISK**

### Warranties of quality - date of assessment

The standard rule for a sale of shares is that damages are assessed at the date of the acquisition.

So if the measure of damages is the difference between the 'as warranted' value and the actual value at the date of the acquisition, the usual position is that a court does not look beyond that date to consider subsequent events to take account of the consequences of the breach of warranty. In other words, if subsequent knowledge after the acquisition shows that the business would not have actually suffered any loss, the general position is that the buyer's losses are not reduced to take account of those later events. The reason for this is that by the time of purchase, the die has been cast and the parties have contractually allocated their risk at the time of the purchase, including the risk that the shares could increase or decrease in value after the purchase, and so any later events which may improve the buyer's position should not be used to discount the damages they are entitled to for a breach of warranty. →

Further, in *Oversea-Chinese Banking Corporation Limited v ING Bank N.V,* it was established that the analysis for a breach of warranty of quality does not include an assessment of what the purchaser would have done if they had known the truth at the time. In that case the purchaser claimed it would have negotiated an indemnity and that should be the basis for loss instead. In other words, a factual causation analysis on what the buyer would have done if they had known the truth is not relevant.

The damages are just based on the difference between what was promised (the warranted value) and the actual position, as opposed to a different series of events which could have occurred if the buyer had known the position.

**Warranties of reasonable care - valuation**

Damages for warranties of reasonable care are assessed differently because a warranty of reasonable care does *not* warrant that the company has any particular quality. The general damages rule for warranties of quality, being the difference between the 'warranty true vs warranty false' values, does not apply.

Instead, based on the general principle for breach of contract that damages are intended to put the claimant in the position in which they would have been in had the defendant complied with the contract, the measure is the difference between the price paid and the price that would have been paid had reasonable care been taken (i.e. had the warranty been complied with by taking reasonable care).

> "The general damages rule for warranties of quality, being the difference 'warranty true vs warranty false' values, does not apply"

To make that assessment the *actual* reasonable forecast, projections or information which are the basis for the warranty must be identified. Regard will be had to how the purchaser in fact formulated the price and how the negotiations went. Thus, in *Macquarie Internationale Investments and Triumph Controls UK Ltd v Primus International Holding Co* [2019] EWHC 2216 the Court adopted a discounted cash flow calculation but using the correct figures, as that was the method the parties had actually used in negotiations.

If the same price would have been paid anyway, even if reasonable care has been used, for example because of the relative unimportance of the particular numbers or because of the desire of the purchaser to buy the company irrespective of the warranty, then there may be no loss caused by the breach of warranty.

Therefore, in theory, a key distinction between 'warranties of quality' and 'warranties of reasonable care' is that a causation analysis is generally not relevant for warranties of quality (as described above, the damages are just based on the difference between what was promised, it does not matter what the buyer would have done if they had known the warranty was false), whereas for 'warranties of reasonable care' factual causation is relevant and the question is posed: would the buyer have bought the business at the same value or at all if reasonable care had been used?

## Issues in calculating loss in W&I claims

**Causation in *Finsbury Food***

Notwithstanding the paragraphs above, it is to be noted that in Finsbury Food the Court did not appear to draw a clear distinction between 'warranties of quality' and 'warranties of reasonable care' when undertaking a causation analysis.

The Court considered causation, and rejected the claim on the basis that the buyer would have bought the business in any event (i.e. causation of loss was not established), even though the warranties in question were not obviously 'warranties of reasonable care'. There is no discussion in that case of whether or not they were reasonable care warranties, and strictly speaking since the Court had already dismissed the claim on the basis there was no breach of warranty, the decision in relation to causation is not binding. However, given the judge appeared to apply a causation test regardless of the type of warranty, when considering the loss arising from a warranty of quality, it would be prudent as a precaution to consider what the causal position would have been in reality even in relation to these warranties.

For example, if you have cases with similar features to Finsbury Food – where the seller needed to be convinced to sell at a certain offer price, or where the buyer would have purchased 'at any price' due to specific features of the target company, the buyer may still need to show that it would not have purchased the company for the same price if it had known the warranty was false.

**Contemporary valuation of target**

In addition to the above points on factual causation, one of the key comments by the judge in *Finsbury Food v Axis* in 2023 (even if not binding) was that the *contemporaneous* valuation methodology for the target company might be preferred as the basis for the damages assessment when looking at the 'warranty true' vs 'warranty false' position (as opposed to assuming that the court should use an EBITDA multiplier valuation to assess loss).

Given the relatively limited case law in this area, there is of course some risk that this comment from the decision in Finsbury Food is followed, at least in negotiated settlements, and the contemporaneous valuation methodology for the target company may be preferred as the basis for the damages assessment.

It is usually advantageous for a claimant to assert that they based their valuation of the company on an EBITDA multiple, and the effect of the breach of warranty was a recurring impact on earnings, such that, as a result of the breach, the difference between the 'as warranted' value of the business and actual value of the company is the difference that the value of the breach would make in the EBITDA multiple valuation.

For example, at trial Finsbury claimed more than £3 million from insurers as the alleged difference between the 'as warranted' value of the target company and the actual value of the company on the basis of a EBITDA multiplier calculation. Finsbury insisted that this was the true basis on which it had valued the company.

However, the judge noted that the evidence showed that the buyer did not use this valuation method at the time of the transaction. Instead, the parties assessed the value of the company at the time on a *1x sales* basis and as a result treated the purchase price as fixed at £20 million.

The judge concluded that had he found that there was a breach of warranty, he would have calculated any loss not using the EBITDA multiple method, but using the method the parties relied on at the time of the transaction. As a result the purchase price would have been adjusted by the amount of the reduction in sales (i.e. the contemporary valuation methodology), which would only ever have been £300,000 (much less than the £3 million in damages claimed by the buyer).

### Expert view

On more and more claims we are seeing a tendency for insureds to focus on the impact of a given breach on one selected (not always contemporaneous) valuation model. For most types of target business it is rare for a buyer to focus solely on one valuation approach, yet it is often difficult or impossible to engage insureds in discussion regarding the impact of a breach on different modelling approaches or inputs. A broader acceptance of multi-model valuation approaches will be key to the further maturing of the W&I claims process.

**TOM HAVERS**
PARTNER,
C LEWIS & COMPANY

The key point on damages arising from the *Finsbury Food* judgment is that when the buyer is making a claim under a W&I policy, it should carefully consider the contemporaneous valuation models for the company that were used, as this may affect the amount that is able to be recovered.

We understand from conversations with insurers that increasingly contemporaneous valuation models are being provided by claimants at first request. Reviewing these models at an early stage is clearly helpful for insurers in the claims process.

When there is limited contemporaneous evidence, a challenge for the insurer can be establishing what the basis for the purchase price actually paid was, and whether it can rely on a 'reverse engineered' valuation to work out the actual value of the business as a result of the breach. This is also a challenge for policyholders, who bear the primary burden of proving their loss. →

### Losses from breach of accounting warranties

W&I claims for breaches of the accounts warranties in SPAs are very common and calculating damages for a breach of these warranties can be challenging.

In particular, revenue claims have been prevalent in the last 12 months, including incorrect revenue recognition in the accounts and undisclosed customer churn.

In the context of breach of accounting warranties, establishing what the warranted accounts actually reported in relation to the apparent misrepresentation can be difficult. The accounts will frequently be fairly high level and may not address the granular detail of the specific business areas which may have been the subject of the misrepresentation. Expert input is therefore often required to assess what value should be put on the apparent misrepresentation in the accounts. First, an expert will need to establish (by reference to e.g. sales figures, accounts records) what the accounts actually reported in relation to the apparently misrepresented aspect. Second, the expert then needs to provide a view on what – if there had been no misrepresentation – the accounts *should* have reported. Again, the expert will need to look at the underlying data such as sales figures.

> "The accounts will frequently be fairly high level and may not address the granular detail of the specific business areas"

A view may then need to be reached on *how* wrong the reported position was. For example – and taking into account the relevant accounting regime that the warranted accounts were prepared in compliance with – should the vendor have been recording a loss in the accounts? these questions will feed in to establish the *prima facie* difference between what was and what should have been reported.

Finally, (and as already noted in the discussion on *Finsbury Food*) these points will need to be taken together to assess the basis for the purchase price actually paid. Is there cogent evidence for this? Is there a way to feed in the analysis on what was missing from the accounts to work out whether this had an effect on the valuation agreed between the buyer and seller?

On this point, we are noticing more accounting records claims where there is insufficient targeting of *where* alleged errors/misstatements actually sit in the accounting records, and *how* the relevant records (once actually identified) were actually relied upon in valuation.

The key point is that a lack of clear evidence on these points makes it very difficult to establish the difference between the 'as warranted' value of the business and the actual value as a result of the breach.

### How claims are working in practice...

Whilst we have highlighted here the theoretical position as to whether the breached warranty is one of 'quality' or 'reasonable care' and the distinction between causation and valuation, often in practice many claims processes do not actually focus on these distinctions.

Instead the focus often boils down just to *reasonableness* of claimed valuation adjustments – i.e. simply was the buyer reasonable in its original basis of valuation, and is it reasonable to assume it would have continued to follow this basis of valuation in the warranty false counterfactual (i.e. if it had known that the warranty was breached at the time of the transaction).

This approach conflates warranties of quality / reasonable care and also causation / valuation, but is becoming the more common approach in dealing with negotiated claims settlements.

[1] *Damages for breach of warranties in share purchase agreements: an overview, Adam Kramer KC*

## Expert view

Alongside the Finsbury Food decision, for those purchasing W&I insurance it is worth bearing another recent judgment in mind. In Project Angel Bidco [2024] EWCA Civ 446 the Court of Appeal declined to interfere with the language of a policy which, on the one hand, appeared to cover breaches of anti-bribery warranty breaches but, on the other, excluded them.

The result was that the claim was not covered. This serves to emphasise how important it is, at the underwriting stage, to ensure that there are no obvious areas for a later dispute over the types of breach that will be covered.

**THOMAS PANGBOURNE**
PARTNER,
INDEMNITY LAW

Participating
Insurers

This Study wouldn't have been possible without the co-operation of the 22 participating insurers. We are grateful for their involvement to allow the Study to be produced.

One participant wished to remain anonymous, however, those insurers set out opposite did participate in the Study: