APRIL 2023

M&A INSURANCE SPECIALISTS

Mind the Gap: Bring Down Mechanic

LIVA

INTRODUCTION

In the next instalment of LIVA's 'Mind the Gap' series, we will examine the importance of including a suitable bring down disclosure mechanism ("**Bring Down Mechanic**") in the sale and purchase agreement ("**SPA**") on insured transactions.

IS A BRING DOWN MECHANIC REQUIRED?

A Bring Down Mechanic will be relevant where there is a split signing and closing, and warranties are given at signing ("**Signing Warranties**") and then repeated at closing ("**Closing Warranties**").

Importantly, whether a Bring Down Mechanic is required by the insurer will depend on several factors.

Firstly, what is the nature of the Closing Warranties?

- Where the Closing Warranties are purely fundamental in nature (generally speaking, this covers: (i) title to the shares in the target; (ii) capacity to enter into the transaction documents; (iii) maintenance of records; and (iv) insolvency), we would not expect the insurer to require a Bring Down Mechanic. The insurer will instead rely on customary searches performed by the buyer's lawyers at closing.

- Where the Closing Warranties are both fundamental and general in nature, the insurer will likely require a Bring Down Mechanic in respect of the general warranties only.

Secondly, what is the period of time between signing and closing?

- Subject to the nature of the transaction, the insurer may not require a Bring Down Mechanic where the gap between signing and closing is relatively short – generally speaking, insurers will waive the requirement of a Bring Down Mechanic where the gap is fewer than 7 – 10 business days. This is particularly true on real estate and renewable energy transactions, where the risk of an interim breach between signing and closing is relatively low (as such, some insurers may be willing to waive the requirement even where the gap between signing and closing exceeds 7 – 10 business days).

FORM OF BRING DOWN MECHANIC

The form of the Bring Down Mechanic required will depend on, in part, the jurisdiction(s) involved.

1. **Disclosure Letter (UK Transactions):** it is customary for insurers to require both a signing disclosure letter and a closing disclosure letter, whereby the seller is obliged to disclose any fact, matter or circumstance to the buyer that would constitute a breach of the Signing Warranties (pursuant to the signing disclosure letter) and the Closing Warranties (pursuant to the closing disclosure letter). The SPA should include drafting stating that the seller warrants that the Closing Warranties are true, accurate and not misleading by reference to the facts, matters and circumstances existing at closing, in addition to the obligation to provide a closing disclosure letter.

2. **Bring Down Certificate (European Transactions):** it is customary for insurers to require a bring down certificate in lieu of disclosure letters, which is given by the seller at closing (and operates in a similar fashion to a closing disclosure letter). The SPA should therefore include an obligation on the seller to provide a bring down certificate and should also include drafting stating that the Closing Warranties are true, accurate and not misleading at closing.

3. **SPA Drafting:** where neither a closing disclosure letter nor a bring down certificate is provided, some insurers may be comfortable with appropriate drafting in the SPA in lieu. Drafting stating that the seller warrants that the Closing Warranties are true, accurate and not misleading at closing is alone unlikely to be sufficient. Instead, the wording will need to impose a contractual obligation on the seller to disclose to the buyer any fact, matter or circumstance that would constitute a breach of the Closing Warranties during the interim period between signing and closing (i.e. an additional obligation on the seller beyond simply stating that the Closing Warranties are true, accurate and not misleading). In doing so, while a disclosure letter / bring down certificate is not being provided, the obligation imposed on the seller – and the end result for disclosure purposes – is the same). We have set out precedent wording below, which achieves this:

> *"The seller shall review the closing warranties given at closing and shall, not later than two (2) business days prior to closing, notify the buyer in writing: (i) of any facts, matters or circumstances of which it is aware that have occurred after the date hereof, which would constitute a breach of any of the closing warranties; or (ii) that it is not aware of any such facts, matters or circumstances."*

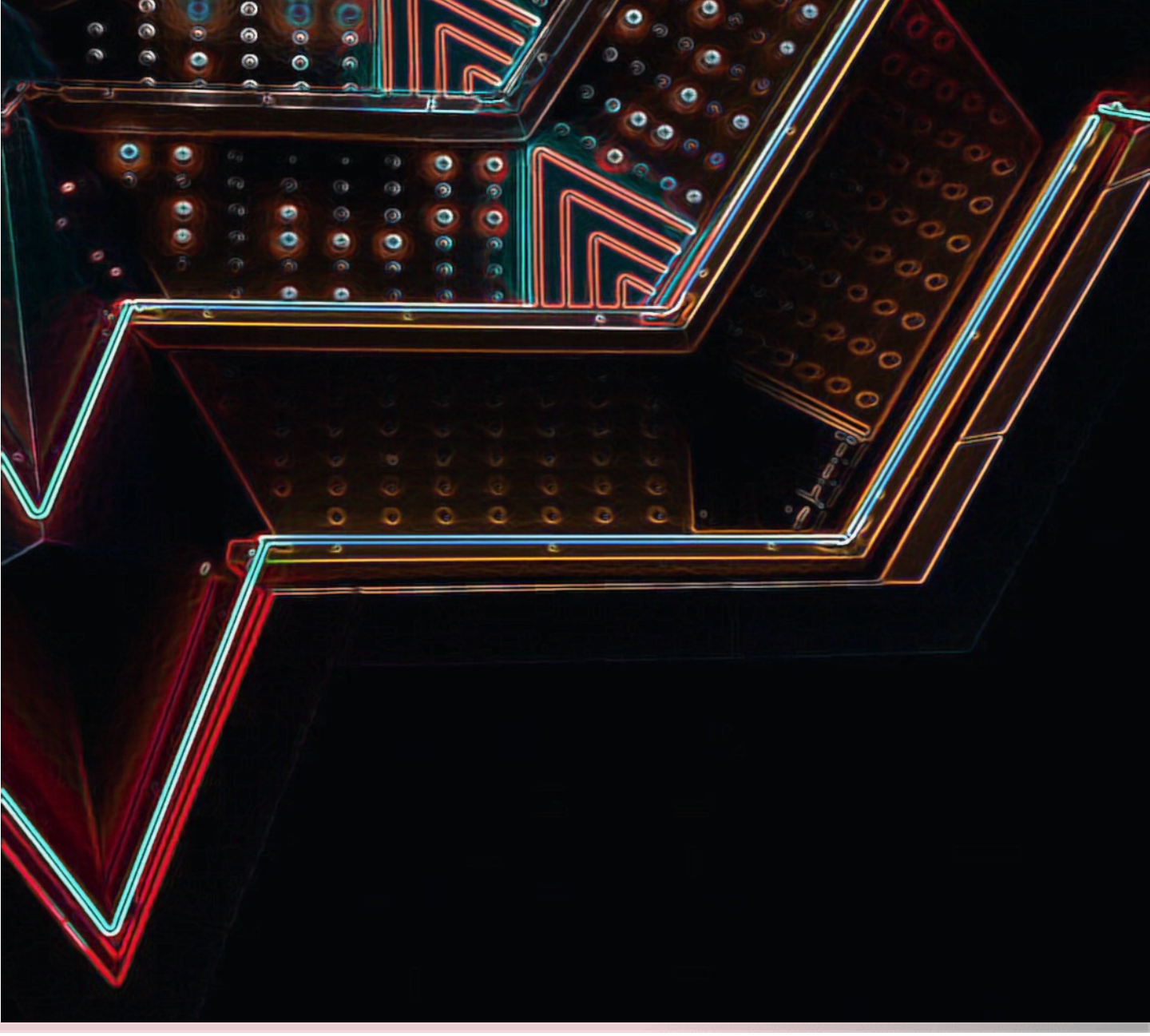
THE PRACTICAL CONSEQUENCES ON INSURED TRANSACTIONS

To the extent that any new fact, matter or circumstance is fairly disclosed by the seller to the buyer via the Bring Down Mechanic, then this will fall within the actual knowledge of the buyer and the buyer will be prevented from bringing a claim against the policy under the Closing Warranties. Where this happens, the buyer may be able to: (i) seek an adjustment to the purchase price; (ii) enforce an existing relevant indemnity from the seller; and/or (iii) delay closing until the matter is resolved. Subject to the severity of the breach and the existence of material adverse change (MAC) provisions in the SPA, the buyer may wish to abort the transaction entirely.

Whatever the measure, to the extent commercially possible, the buyer and its advisers should try to ensure that the SPA provides the necessary breathing space for the buyer to take practical steps to ensure it is not materially prejudiced by the subject matter of any interim period disclosures.

One alternative solution is to seek a warranty and indemnity policy which includes "**new breach cover**". Whilst not widely available, new breach cover protects the buyer from breaches of warranties that occur during the interim period irrespective of disclosures from the seller or actual knowledge acquired by the buyer in the interim period.

Insurers typically charge an additional premium of 10% – 30% and the cover will usually last for 30 – 60 days (although insurers may be comfortable extending this period depending on the transaction). Where the client is considering new breach cover, it is important to raise this as early as possible with LIVA to ensure that an appropriate insurer is selected for the transaction.



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