Warranties, Indemnities, Liability & Insurance

Key legal issues, practical sessions and case studies

4th October 2012
Welcome & Introduction

Stuart Borrie, Partner
9:40 am - Warranties & Indemnities
10:15 am - Limitations on Liabilities
11:30 am – Workshop – Negotiating warranties
  1:30 pm – Insurance – Coverage & M&A Insurance
  2:30 pm – Workshop – Negotiating limitations of liability
  3:45 pm – Workshop – Negotiating Indemnities
  4:25 pm - Concluding remarks
Warranties & Indemnities

Oliver Pilkington, Senior Associate
What are warranties?

• Contractual statements giving assurances from a seller/supplier to a purchaser/customer about the nature of the assets/goods/services being purchased.
Example – supply agreement

The Supplier warrants to the Customer that:

(a) the Supplier will perform the Services with reasonable care and skill and in accordance with generally recognised commercial practices and standards;

(b) the Services will conform with all descriptions and specifications provided to the Customer by the Supplier; and

(c) the Services and Deliverables will be provided in accordance with all applicable legislation from time to time in force.
Examples – share purchase agreement

- **Debts**

  “All of the debts shown in the Accounts have realised (or will realise within a period of 3 months from their due dates) their full value in the ordinary course of collection less any specific provision for bad or doubtful debts included in the Accounts.”

- **Litigation**

  “The Company is not (directly or through any person for whose acts or defaults it may be liable) engaged whether as a defendant or claimant or otherwise in any litigation or arbitration or prosecution or other legal proceedings nor are any such proceedings pending, anticipated or threatened and there are no facts or circumstances which may give rise to any such proceedings.”
The purpose of warranties

1. To provide contractual protection where the law does not offer protection.

2. To apportion risk between the parties.

3. To encourage a seller/supplier to disclose known problems to a purchaser.
Disclosure

• A supplier/seller may not be sued for breach of warranty if the relevant matter has been effectively disclosed.

• What is “fair disclosure”?
  • Daniel Reeds Ltd v EM ESS Chemists Ltd [1995]
  • New Hearts Ltd v Cosmopolitan Investments Ltd [1997]
  • Infiniteland Ltd v Artisan Contracting Ltd [2005]

“fairly disclosed (with sufficient details to identify the nature and scope of the matter disclosed)”
The effect of knowledge

• Breach of warranty v misrepresentation

• Knowledge-saving clauses
  
  “Save for those matters fairly disclosed in the Disclosure Letter, no information of which the Purchaser or any of its agents or advisers has knowledge (whether actual, constructive or imputed) and no investigation or report made or prepared by, on behalf of or for the benefit of the Purchaser shall affect or limit any claim by the Purchaser under the Warranties or reduce any amount recoverable thereunder.”

• Refusal to accept disclosure?

• Anti-sandbagging clauses
  
  “The Purchaser confirms that, as at the time of entering into this Agreement, it has no knowledge of any fact, matter or circumstance which is likely to lead to any claim against any of the Sellers under the Seller Warranties.”
Whole agreement clauses

Three main parts:

1. Entire agreement statement
2. Non-reliance statement
3. Exclusion for fraud
1. Entire Agreement Statement

“This Agreement contains the whole and only agreement between the parties relating to the subject matter of this Agreement and supersedes all previous agreements between the parties (whether written or oral) relating to the matters dealt with in this Agreement.”

An entire agreement statement will not:

• Exclude claims for misrepresentation
• Exclude implied terms
2. Non-reliance statement

“Each party agrees and acknowledges that, in entering into this Agreement, it is not relying on any representation, warranty, undertaking, covenant or assurance of any nature whatsoever (whether or not in writing) made or given by any person (whether or not a party to this Agreement) which is not expressly set out in this Agreement and waives all remedies and rights of action which, but for this Clause, might otherwise be available to it in respect of any such representation, warranty, undertaking, covenant or assurance.”

- Removal of key element required for misrepresentation
- Contractual estoppel
UCTA

• A non-reliance statement will always be capable of being an ‘exclusion’ and therefore subject to UCTA.

• If UCTA applies, it must be ‘reasonable’ to include the non-reliance statement (otherwise ineffective).
3. Fraud exclusion

“Nothing in this Clause shall have the effect of limiting or excluding any liability for, or remedy in respect of, fraud.”

- Thomas Witter
- General Insurance v Chase Manhattan Bank
What is an indemnity?

• A promise to repay the other party to a contract in respect of a particular type of liability should it arise.

• Warranties v indemnities
Indemnities

• Usually appropriate for specific and identified risks:
  • Environmental issues
  • Doubtful book debts
  • Product liability claims
  • Third party guarantees

• US approach to warranties
• Duty to mitigate?
• Remoteness?
Limitations on Liability

Stuart Grey, Senior Associate, Stuart Borrie, Partner & Jennifer Lovesy, Senior Associate
What happens if there are no limits/exclusions?
Two types of loss can be recovered:

- Direct
- Indirect/consequential
- What does that mean?
Hadley v Baxendale [1854] 9 Exch 341 laid down that a claimant could recover subject to the rules of remoteness

- Loss arising naturally, that is, according to the usual course of things, from the breach (“first limb”)
- Loss in the contemplation of both parties at the time they made the contract as the probable result of the breach (“second limb”)

When might there be no limits?
There are likely to be no limits if:

- There is no written contract
- You fail to incorporate limitations
- The limitations are unenforceable
All clear?

- Clear instructions from your commercial team?
- Clear understanding of the commercial deal?
- Dangers of advising on liability clauses in a vacuum.
- There is no certainty in a limitation clause.
What do suppliers typically want to exclude/limit?

In IT/outsourcing contracts, suppliers typically want to:

- exclude all indirect loss (including tortious loss)
- exclude all loss of profit and other economic loss
- limit direct loss to the annual fees paid
What cannot be excluded or limited?
Contracts cannot exclude liability for:

- death and personal injury arising from negligence
- fraud
- fraudulent misrepresentation
- warranties as to good title
What other restrictions are there?
UCTA ‘reasonableness’ test:

Unreasonable terms will be unenforceable in:

- Contracts with consumers
- Business to business – in particular, on standard terms
Common Law

1. An exclusion which deprives a party of an effective remedy may be void.

2. The more unusual the clause, the clearer it needs to be.

3. Contra Proferentem.
Limits of liability

- MarkerstudylInsurance v Endsleigh[2010] EWCH 281 (Comm)
  - There were a number of claims handling agreements
  - M said E had acted in breach of these agreements, causing extensive losses, which were the basis of M’s claim for £14m
Consequential loss

- Article 13.1 of the Fifth Contract:
  - "Neither party shall be liable to the other for any indirect or consequential loss (including but not limited to loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss) arising out of or in connection with this Agreement."

- M said – this exempted E from liability for indirect or consequential loss only

- E said – it exempted them from indirect or consequential loss and also for direct loss of the types described in brackets

- Who was right?
Decision

- M won – so the clause only covered indirect or consequential loss
  - “including but not limited to” was a strong pointer that the particular named types of loss were just examples of excluded indirect loss
  - Clause 13.2 provided the limits for direct loss
  - The words are not clear enough when describing the named types of loss to include direct as well as indirect loss
Should this person be warranting at all?

- Is the warranty beyond the warrantor’s reasonable knowledge?
- Does the warrantor benefit sufficiently from the contract to bear the burden of the warranty?
Extent and scope of the warranty

- Warrant of what will happen in the future
- Is the warranty so wide that:
  - it is outside market practice
  - it could “warrant the world”
    - warrantee’s business risks
    - changes in the sector
    - changes in the economy
“All information that is material to the Buyer has been fully and specifically disclosed by the Seller to the Buyer.”
Unfair Contract Terms Act 1977
- Cannot exclude or restrict liability for death or personal injury
- Implied term under Sale of Goods Act 1979 as to title cannot be excluded or restricted
- Implied term as to correspondence of goods with sample quality or fitness for purpose can only be excluded if it is reasonable
- Exclusion allowing rendering of contractual performance substantially below what was reasonably expected has to be reasonable
- Negligence liability exclusion has to be reasonable
- Guidelines on reasonableness (who should have insured, strength of bargaining position, knowledge of term etc)

UCTA does not apply to insurance, IP, shares, land

Additional protection for consumers under the Unfair Terms in Consumer Contracts Regulations 1999
Exclusions within the warranty itself

- Materiality
- Knowledge of the warrantor
  - “so far as the seller / supplier is [actually] aware”
  - Knowledge of the buyer / customer
Exclusions from liability for breach of warranty

- **Amount**
  - In M&A minimum amount of a claim (the higher of say 1% and a rounded de-minimis)
  - In M&A basket of claims totalling X required to bring a claim (the higher of say 5% and a rounded de-minimis)
  - Maximum amount of one year’s fees under a commercial contract (e.g., software licence or outsourcing contract) and 25% to 100% of the consideration in M&A
  - Specific areas may be segregated / placed in a basket
Exclusions from liability for breach

- Time for notifying the claim for a sale contract (not services) in M&A for commercial warranties, 18 months / 2 years / 3 months after 2 audit cycles of target and 6 years for tax warranties and time for bringing the claim (within say 9 months)

- Less of a focus in commercial contracts
Exclusions from liability for breach

- Either implied by law in commercial contracts or expressed in some M&A contracts - loss derives from post warranty event
  - change of law
  - what the warrantee did
  - the warrantee did not mitigate
- Warrantee must pursue other remedies first in M&A
  - insurance
  - conduct of claim
Negotiation Workshop on Warranties

Jeremy Davis, Partner
You are advising the Supplier of Goods and Services under a commercial contract. How would you amend the following warranties?

- The Supplier represents and warrants to the Customer that the Supplier will perform the Services with reasonable care and skill and in accordance with best commercial practices and standards in the industry for similar services.
The Supplier warrants to the Customer that the Goods will conform with all descriptions and specifications provided to the Customer by the Supplier.
The Supplier warrants to the Customer that the Services will be provided in accordance with all applicable legislation from time to time in force, and the Supplier will inform the Customer as soon as it becomes aware of any changes in that legislation.
How can the Supplier limit the remedies of the Customer?
The Seller shall repair or replace, at the Seller’s option, and at the Seller’s sole expense, such product and return the same, at the Seller’s expense, to the Buyer.

If the Seller is unable to repair or replace such product in accordance with the requirements of the relevant specifications, the Seller shall, upon the Buyer’s request, accept the return of such product, and refund in full any amounts paid by the Buyer therefor.
You are advising the Customer under a commercial contract for the supply of Goods and Services. How would you amend the following warranties?

- The Customer is a company duly incorporated existing and in good standing under the laws of England and Wales.
The Supplier warrants to the Customer that it shall use reasonable endeavours to meet any performance dates specified in the Project Plan, but any such dates shall be estimates only and time for performance by the Supplier shall not be of the essence of this Agreement.
Compliance with Law

- So far as the Supplier is aware, it has conducted its affairs and dealt with its assets in accordance with all applicable legal and administrative requirements in all material respects.
Trading

- The Supplier has not manufactured, sold or supplied goods or supplied any services which were or are or may become in any respect faulty or defective or the subject of negligence claims or which did not or do not comply in any respect with any warranties, indemnities or representations expressly or impliedly made by the Supplier.
Licences

- The Supplier has obtained all material Licences necessary for carrying on its business in the places and in the manner in which it is currently carried on and all such Licences are in full force and effect, have been fully complied with and are not limited in duration or subject to onerous conditions.
Insurance

- There are no outstanding claims under any of the Supplier's insurance policies and there are no circumstances which are likely to give rise to any such claim.
Insurance Coverage & M&A Insurance

Frank Thompson, Senior Associate, K&L Gates and Helen Dawson-Hunt of Marsh
Transactional Risk Solutions
Marsh’s Transactional Risk Team

• Part of Marsh’s Private Equity and Mergers & Acquisitions (“PEMA”) practice

• c. 20 individuals worldwide specialising in transactional risk insurance, 7 based in London

• Backgrounds such as law and investment banking as well as insurance

• Remit is to advise, structure and execute bespoke insurance solutions which enhance or facilitate M&A transactions
### Transactional Risk Solutions

#### “Transactional Risk insurance solutions…”

- Broader coverage
- Reduction in generic exclusions i.e. removal of generic exclusions for product liability/environmental/management accounts
- Tax deed coverage expanded
- Focus on full coverage position for warranties

#### … cover what is required by clients”

- Warranty and indemnity 1–2%
- Specific tax issue 2–6%

#### … now attach at low levels”

- 1% as standard
- Less than 1% possible

#### … are regularly paying claims”

- Economic climate precipitated more claims notifications, more payments by insurers
- Increased insurer competition means greater pressure to pay

#### …fit with the transaction process and timeline”

- Mirrors transaction timetable / workflow
- Dedicated broking and underwriting teams, ex-M&A lawyers
- Increased competition on deliverability and coverage as well as pricing
- Insurers’ external legal reviews often not required
Transactional Risk Solutions
Structuring Cover

- Insurance is used to protect from or mitigate two types of risk typically arising out of M&A transactions:

  - **Cover for unknown and unforeseen loss – in M&A transactions**
  - Warranty and indemnity insurance
  - Protects against liabilities arising from breaches of the warranties or calls under the tax covenant
  - Can be placed for the seller or the buyer

  - **Cover for identified / known risks – M&A/ Non-M&A drivers**
  - e.g. tax indemnity insurance, litigation buyout, environmental
  - Stand-alone policies (possibly attaching to the target) which protect against identified matters
  - Can be wrapped around indemnities or used where parties are unable to agree on a contractual remedy (e.g. seller reluctant to provide escrow)

- Non-M&A drivers
Transactional Risk Solutions
Insuring Identified Issues

• Insured party:
  – Seller/buyer (if the seller provides an indemnity to address the issue); or
  – Target (if no indemnity provided by the seller)

• How it works:
  – If the identified issue crystallises or the indemnity is triggered, the insurance responds directly to the insured
  – Can be a stand-alone policy for one identified issue or part of a wider warranty and indemnity policy

• Common insurable issues:
  – Tax
  – Third party litigation
  – Environmental
  – Some commercial indemnities
Transaction Risk Solutions

Warranty and Indemnity Insurance: Motivations for use

**Deal Pressures**
- High/Low warranty cap
- Private equity involvement

**Commercial Decisions**
- Clean exit
- Maintain strong relationship with management

**Acquisitions**
- New/unfamiliar jurisdiction or industry
- Concerns about strength of seller’s financial covenant
- Enhance bidder status
- Best practice risk management/corporate governance
- Concerns over unknown risks, e.g. tax liabilities

**Disposals**
- Enables sale proceeds to be distributed
- Reduce impact of contingent liabilities on future plans
- Reluctance to retain proceeds in escrow
- Board sign-off of recourse package
- Seller taking higher warranty cap in order to optimise transaction value
Warranty and Indemnity Insurance
Buyer-side Insurance

• Insured: the buyer

• How it works:
  – Responds to the buyer’s losses resulting from the warrantors’ breaches under the SPA
  – Trigger for policy responding is loss suffered by the buyer as a result of a breach of insured warranties / call on the tax covenant, irrespective of certain limitations in SPA
  – Buyer suffers a loss and claims directly against the policy; loss is paid directly to buyer
  – Key exclusion: knowledge of buyer (including information provided by due diligence documents)
Warranty and Indemnity Insurance
Buyer-side Case Study (top-up cover)

Frequently policies placed in the name of the buyer are initiated by a seller seeking a clean exit.

Mechanics of cover

- Seller introduced buyer-side policy as a means to exit with limited financial liability
- Large German listed corporate buying for c. €350m from PE, and requiring €38m recourse against the warranties
- Policy structure €30m buyer-side policy in excess of €8m (the seller’s cap)
Warranty and Indemnity Insurance
Buyer-side Case Study (parallel cover)

Cover can also be structured parallel to the warrantors’ contractual liability to provide alternative recourse against the (insurance)

Mechanics of cover

- Large European corporate making a significant Russian acquisition for circa €120m
- Selling corporate warranting to full €120m
- Buyer concerned about strength of financial covenant of seller and enforceability
- Policy structure €120m buyer-side policy in excess of €1m
Warranty and Indemnity Insurance
Seller-side Insurance

• Insured: the warrantors

• How it works:
  – Responds to agreed contractual liability in the share purchase agreement (“SPA”)
  – Trigger for policy responding is breach of insured warranties/call on the tax covenant
  – Buyer claims against warrantors as per SPA, warrantors claim against policy
  – Insurer and warrantors work together to defend a claim
  – Key exclusion: knowledge of warrantors
Mechanics of cover

- Transaction value £45m
- Management team of a small PE backed company asked to give warranties when PE exited
- Management happy with the warranties but wanted to protect themselves against potential claims arising from a breach
- Policy structure £4.4m seller side policy excess of £600,000
Specific Risk
Non M&A Driver

- UK client with overseas property owning subsidiary
- Wanted to wind up subsidiary and distribute funds to UK shareholders
- Large unexpected profit in overseas subsidiary from sale of UK property
- Opinion that UK taxes not payable on profit
- Insured c £10m potential tax liability inc. interest. Small policy excess
- Client able to distribute to shareholders and windup overseas subsidiary
Transactional Risk Solutions
What makes a deal insurable?

• W&I:
  • Balanced negotiations and warranties – as if uninsured
  • Warrantors – skin in the game?
  • Thorough disclosure
  • Motivation and Diligence

• Tax/ Specific Matters:
  • Establish likelihood and quantum
  • Advisors view
Transactional Risk Solutions
Warranty and Indemnity Insurance - Market Standard
Exclusions

• Knowledge of warrantors (insurance is intended to provide cover for unknown issues materialising)
  – Impact for seller-side and buyer-side:
    - Seller-side: severability can provide protection for innocent sellers
    - Buyer-side: cover available for fraud by seller

• Forward-looking warranties (insurance is intended to catch historical, not speculative, liabilities)

• Criminal fines and penalties/punitive damages (carve-out for some tax penalties)

• Deficiency in pension schemes (if relevant, i.e. the insurance will not act as a financial guarantee)

• Post-close consideration adjustments

• Hard to diligence/ caution: - Transfer pricing; Bribery and corruption; Environmental
Current Insurance Market

Insurers

• 8 primary insurers - (Standard & Poor's Rating)
  – Allied World Assurance Company Limited (A-);
  – Ambridge Partners LLC – an underwriting agency representing a panel of insurers (min A-);
  – Beazley Furlonge – a managing agent of Lloyd's Syndicates 623 and 2623 (Lloyd's A+);
  – Chartis Europe Limited (A);
  – Chubb Insurance Company of Europe S.A. (AA);
  – HCC Global Financial Products, a subsidiary of HCC Insurance Holdings, Inc. (AA);
  – Pembroke Managing Agency Limited – an underwriting agency representing a Lloyd’s Syndicate (Lloyd's A+);
  – Zurich Insurance Plc (Standard & Poor’s Rating AA-).

• Experienced underwriters
  – Ex corporate lawyers understand M&A transactions
  – 10+ years of experience in the UK market
  – Some in-house underwriting v. external legal review
  – Sophisticated policy wording – each negotiated for specific transaction
Current Insurance Market

Trends

• Acting for sellers seeking clean exits, typically PE’s, banks or other investors

• Acting for a large number of US corporates acquiring overseas targets

• Acting for buyers where the warranty cap offered by the sellers is limited

• Strength of covenant issue/distressed sales.

• Continued buyer interest, 65% of the insurance polices structured as buyer-side policies in EMEA.
Transactional Risk Solutions
Market Overview

• $2.9bn of limit placed into the market by Marsh by 2011, $2.3bn H1 2012
  – 3/4 placed through the European team
  – Average equity value per deal of $300m
  – Structured the largest tower (£260m) for any transaction to date
  – Market capacity for limits up to c. $500m for any one transaction
  – 2011 - 370 enquiries in Europe, resulting in c. 100 bound policies

• Client base: PE and Corporate

• Jurisdictions: Global spread
# Current Insurance Market
## 2011 - 2012 Overview

### 2011

<table>
<thead>
<tr>
<th></th>
<th>EMEA</th>
<th>ASIA PACIFIC</th>
<th>AMERICAS</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limits of insurance placed (US$ millions)</td>
<td>1,716</td>
<td>287</td>
<td>768</td>
<td>2,871</td>
</tr>
<tr>
<td>Seller-side W&amp;I policies (as % of W&amp;I policies placed)</td>
<td>35%</td>
<td>7%</td>
<td>21%</td>
<td>21%</td>
</tr>
<tr>
<td>Buyer-side W&amp;I policies (as % of W&amp;I policies placed)</td>
<td>65%</td>
<td>93%</td>
<td>79%</td>
<td>79%</td>
</tr>
</tbody>
</table>

### 2012 H1

<table>
<thead>
<tr>
<th></th>
<th>EMEA</th>
<th>ASIA PACIFIC</th>
<th>AMERICA</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limits of insurance placed (US$ millions)</td>
<td>1,289</td>
<td>109</td>
<td>896</td>
<td>2,295</td>
</tr>
<tr>
<td>Seller-side W&amp;I policies (as % of W&amp;I policies placed)</td>
<td>35%</td>
<td>45%</td>
<td>22%</td>
<td>34%</td>
</tr>
<tr>
<td>Buyer-side W&amp;I policies (as % of W&amp;I policies placed)</td>
<td>65%</td>
<td>55%</td>
<td>78%</td>
<td>66%</td>
</tr>
</tbody>
</table>
The Policy Wording - Overview

• The words matter!
• Standard wording has improved
• “Flat pack” wordings in deal rooms
• “Back to Back” coverage with the SPA
• The coverage spreadsheet
The Policy Wording - Loss

- How does the policy define “Loss”? Does this dovetail with the SPA?
- Defence costs coverage
- The amount of cover / sublimits
- The policy excess and how it is eroded
- The period of cover
  - Usually tied to the indemnity period
  - Longer periods for tax
The Policy Wording - Claims

• The “claims made” trigger

• The importance of timely notification

• Claims control and other claims conditions
  – Again check corresponding provisions in the SPA

• Claims payment
Transactional Risk Solutions
Claims

• We have observed an increase in claims activity since the beginning of the 2009 economic downturn.

• Insurers are reporting an increase in the claims notifications they are receiving. One has indicated that they saw notifications on around 25% of policies taken out in 2009 (a global statistic excluding the USA). As most claims are notified within the first 12 months of the policy period, 2009 provides a good benchmark of activity.

• One insurer has indicated that:
  – 11% of claims are notified during the first 3 months following inception
  – 19% of claims are notified during the first 6 months following inception
  – 61% of claims are notified during the first 12 months following inception

• Insurers indicate that the majority of claims are focused on financial statements, tax, intellectual property and environmental issues.
Claims
Chartis/AIG Policies written, claims made and alleged breaches worldwide (ex-U.S.) 2002-2010 (provided by Chartis)
Workshop – Limitations on Liability
Possible Insurance Solutions?

• Vendors: Distribution LLP (PE) and Director/Shareholders
• Target: Rapidgrowth Limited (UK HoldCo)
• Buyer: Norisk Inc. (US Corporate)
• Transaction Value: £50 million
• Business: Waste Management and Recycling
• Considerations:
  - Directors staying with business
  - PE’s restriction/ unwillingness to give warranties/ retain liability
  - Cautious overseas buyer getting into new sector
Negotiation Workshop

Limitation of Liability

4th October 2012
Case Study 1: 1(a)

You are the general counsel for a supplier of services. One of your commercial team asks you to have a quick look at the liability clause in an agreement he is about to finalise.

- “Each party’s total aggregate liability per contract year arising out of or in respect of this Agreement shall not exceed a sum equal to £5,000,000 (five million pounds).”

- What concerns might you raise?
1(a) Points to consider

- What are the annual fees? Should there be a link to the fees?
- Should there be an aggregate cap over the whole term?
- Should you carve out the Customer's obligation to pay fees?
- Should ‘contract year’ be defined?
- Should the limit for contract year relate to when a claim is made or when loss is suffered?
- Exclusion of deliberate breach/repudiatory breach?
1(a) Suggested drafting

‘Contract Year’ means a period of 12 months, commencing on the Commencement Date, and on each subsequent anniversary of the Commencement Date.

Under no circumstances shall the maximum aggregate liability of either party for, or in respect of, all loss, cost, damage, and expense, whether in contract (including under any indemnity or warranty), tort (including negligence), misrepresentation (other than fraudulent misrepresentation), equity, breach of statutory duty, strict liability or otherwise at law, in respect of any breach of its contractual obligations arising under this Agreement or for any representation, statement or tortious act or omission (including negligence) arising under or in connection with this Agreement exceed £5,000,000 (five million pounds) in respect of any Contract Year which shall include all claims which relate to any event or series of events which occurred, commenced or had their originating cause or source in such Contract Year.
While you concentrate on the financial caps, you ask a junior member of your team to put together some exclusions. He suggests the following wording:

“Neither party shall be liable to the other party for any indirect or consequential loss or loss of profit, arising out of in connection with this Agreement.”

What amendments might you consider?
1(b) Points to consider

- ‘Indirect or consequential loss or damage’ does not mean ‘loss of profit’.

- Loss of profit can be direct or indirect.

- What about other economic/financial losses?

- Consider the risks of exclusions:
  - commercial risks to the Supplier;
  - enforceability risks.
Neither party shall in any circumstances be liable whether in contract, (including for negligence or breach of statutory duty, howsoever arising), misrepresentation (whether innocent or negligent), restitution or otherwise, for:

(A) any loss (whether direct or indirect) of profits, savings, business, business opportunities, revenue, turnover, reputation or goodwill;

(B) any loss or corruption (whether direct or indirect) of data or information;

(C) any loss (whether direct or indirect) of anticipated savings or wasted expenditure (including management time); or

(D) any indirect or consequential loss or liability.
1(c)

The CFO of your company believes that the contract is high-risk and wants to limit liability as far as possible. He thinks the answer is to use the company’s insurance policies as the first line of defence. You read the Supplier’s insurance policies. One is public and products liability insurance (capped at £5m) and the other is employers’ liability insurance (capped at £5m).

How would you draft a clause referring to the insurance policies and protecting the Supplier?

Please discuss amongst your team for 5 minutes and then nominate a spokesperson to say a few words as to how you would do this.
1(c) Points to consider

- Only liable to the extent of the policies
- Only pay when paid
- Except where liability cannot be legally excluded
- A preamble/recital explaining the background may assist in showing reasonableness
1(c) Suggested drafting

1.1 The Supplier’s maximum aggregate liability to the Customer and the Customer Group for all loss, damage and expense arising under this Agreement shall be limited as follows:

(A) £5 million in respect of losses and damages which are fully covered by and recoverable under the Supplier's public and products liability insurance;

(B) £5 million in respect of losses and damages which are fully covered by and recoverable under the Supplier’s employers’ liability insurance; and

(C) to the extent that any such losses and damages are not fully covered by and recoverable under either such insurance to a sum equal to the amount of fees paid to the Supplier by the Customer under this Agreement (net of value added tax) during the twelve-month period immediately preceding the claim less the Supplier's direct costs incurred in generating the same.
1.2 The Supplier shall not be obliged to make payment of any sums which it is liable to pay pursuant to Clauses 1.1(a) and/or 1.1(b) until the relevant sums have actually been recovered under the insurance policy.

1.3 The Supplier has obtained insurance cover in respect of its liability for claims not exceeding the amounts set out in clause 1.1. The Customer acknowledges that the Supplier's liability is therefore limited accordingly, and the Customer is responsible for making its own arrangements to insure any excess loss.
1(d)

You are now cautious about your exclusion clause being unenforceable.

What exceptions to the exclusion clause do you feel you need to include?

What points might you raise?
1(d) Suggested drafting

1.4 The Supplier does not exclude or limit any liability for:

(A) personal injury (including sickness and death) to the extent that such injury results from the negligence or wilful default of the Supplier or its employees; or

(B) any breach of any obligations implied by section 12 of the Sale of Goods Act 1979 or section 2 of the Supply of Goods and Services Act 1982 [implied terms as to good title]; or

(C) fraud or fraudulent mispresentation; or

(D) any other liability to the extent the same cannot be excluded or limited by law.
The Customer rejects the idea of using insurance cover as the cap on liability and won’t agree to any further limitations.

You are asked to come up with other ideas for limiting liability.

Apparently timely delivery of the Services is going to be a particular problem.
1(e) Points to consider

- Weak obligations – reasonable endeavours etc
- Rectification/Service level credits – where these are the sole remedy
- Entire agreement and non-reliance clauses
- Time limit for claims
- No liability where the Customer fails to provide a Dependency
1(e) Suggested drafting

(A) Any dates quoted for delivery of the Services are approximate only, and the time of delivery is not of the essence.
(B) The Supplier shall not be liable to the extent that any failure to perform the Services is caused by the Customer’s failure:

(i) to provide the Supplier with adequate instructions or any information that is relevant to the supply of the Services; or

(ii) to comply with any of its obligations under this Agreement; or

(iii) to provide any Dependency.
1(e) Suggested drafting

(C) In the event that the Supplier supplies Services which are not to a material extent in compliance with this Agreement, the Supplier shall supply replacement services as soon as reasonably practicable after being notified of any such non-compliance at no additional cost to the Customer. The Supplier shall have no further liability in respect of any such non-compliance (whether in contract, tort or otherwise).
You are asked whether the limitations on liability are watertight. Is there any way they could be defeated? For example, what if the customers of the Customer were to bring a claim?

What points might you raise?
1(f) Points to consider

- Claims based on misrepresentation
- Other documents/oral terms
- Fraudulent misrepresentation
- Third party claims
- Exclusions which are unenforceable
- Own goal (repudiation)
1(f) Suggested drafting

The Supplier will not be liable for, or in respect of (whether in contract (including under any indemnity or warranty), tort (including negligence), misrepresentation (other than fraudulent misrepresentation), equity, breach of statutory duty, strict liability or otherwise at law), any loss of profits, loss of goodwill, loss of opportunity, loss of business, loss of reputation, loss of or corruption to data (whether any of the foregoing losses is direct or indirect) or any indirect or consequential loss or damage or any type of special loss of the Customer as a result of an action brought by a third party in respect of any breach of its contractual obligations arising under this Agreement or for any representation, statement or tortious act or omission (including negligence) of it arising under or in connection with this Agreement even if such loss was in the contemplation of the parties or was wholly foreseeable.
Case study 2: 2(a)

Acting as general counsel for a customer, you are faced with a comprehensive exclusion of liability in the draft agreement provided by the supplier of key outsourced services.

Your commercial team ask you to come up with some areas which they can argue should be unlimited, or subject to higher caps.

What might you suggest?
2(a) Points to consider

The following are often unlimited or subject to a higher cap:

- IP indemnity
- Confidentiality
- Data Protection
- TUPE
- Sometimes: deliberate breach
2(b)

The commercial team feel that all the exclusions in the supplier's draft are against the spirit of the deal, and not what they expected from the bid documents. What about being inclusive?

You are asked for your ideas.
2(b) Points to consider

- Statements made in bid documents should be reflected as representations and warranties in the Agreement.

- In practice, what loss will be suffered if it goes wrong?

- In practice, what loss do you expect to recover?

- Think of specific examples of matters for which the Supplier should assume responsibility.
2(b) Suggested drafting

- The provisions of Clause [●] shall not apply to the following Losses, to the extent that such Losses are suffered or incurred directly by the Client or any member of the Client Group under this Agreement as a result of a breach of this Agreement:

  (A) costs and expenses incurred in connection with obtaining and implementing alternative services equivalent to the Services;

  (B) costs and expenses of external consultancy, internal or external computer time, personnel support and additional operational and/or administrative costs and expenses;
2(b) Suggested drafting (cont’d)

(C) the costs and expenses incurred as a result of dealing with, and any fine imposed by, any relevant regulatory body in connection with any breach by the Client of its regulatory requirements resulting from any breach by the Supplier of this Agreement (including, without limitation, reasonable legal fees);

(D) any errors or omissions that are caused by the Supplier in the performance of its obligations, which may include the consequences of incorrect pricings, valuations or accounting which cause loss to the customers of any member of the Client Group or which result in the requirement for payment of ex-gratia payments to customers of any member of the Client Group to compensate for errors or omissions in accordance with industry practice;
(E) any costs and expenses whether incurred internally or by engaging a third party, to reload the Client Data and/or replace any Intellectual Property, Equipment, Software and Material which are lost or damaged due to a breach or any act or omission of or by the Supplier; or

(F) any costs whether incurred internally or by engaging a third party, to implement a temporary workaround to correct a breach or failure to perform by the Supplier.
Negotiation Workshop on Indemnities

Stuart Borrie and Jeremy Davis, Partners
The Supplier / Seller shall indemnify the Buyer against losses suffered or incurred by the Buyer arising out of:
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses...
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, loss of reputation and all interest, penalties and legal costs (calculated on a full indemnity basis) and all other professional costs and expenses) arising out of:
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, loss of reputation and all interest, penalties and legal costs (calculated on a full indemnity basis) and all other professional costs and expenses) suffered or incurred by the Buyer arising out of or in connection with:
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, loss of reputation and all interest, penalties and legal costs (calculated on a full indemnity basis) and all other professional costs and expenses) suffered or incurred by the Buyer arising out of or in connection with:

(a) the Supplier’s / Seller’s breach, including any breach of warranty, or negligent performance or non-performance of this agreement;
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, [loss of reputation] and all interest, penalties and reasonable legal costs (calculated on a full indemnity basis) and all other reasonable professional costs and expenses) suffered or incurred by the Buyer arising [out of or in connection with] [as a result of]:
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, [loss of reputation] and all interest, penalties and reasonable legal costs (calculated on a full indemnity basis) and all other reasonable professional costs and expenses) suffered or incurred by the Buyer arising as a result of:

(a) any breach of clause [ ];
SUPPLIER’s / SELLER's REPLY – DRAFT 3

The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, [loss of reputation] and all interest, penalties and reasonable legal costs (calculated on a full indemnity basis) and all other reasonable professional costs and expenses) suffered or incurred by the Buyer arising as a result of:

(a) any breach of clause [ ];

This indemnity shall not cover the Buyer to the extent that a claim under it results from the Buyer’s negligence or wilful misconduct.
The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, [loss of reputation] and all interest, penalties and reasonable legal costs (calculated on a full indemnity basis) and all other reasonable professional costs and expenses) suffered or incurred by the Buyer arising as a result of:

(a) any breach of clause [ ];
This indemnity shall not cover the Buyer to the extent that a claim under it results from the Buyer’s negligence or wilful misconduct.

If any third party makes a claim, or notifies an intention to make a claim, against the Buyer which may reasonably be considered likely to give rise to a liability under this indemnity (a Claim), the Buyer shall:

(a) as soon as reasonably practicable, give written notice of the Claim to the Supplier / Seller, specifying the nature of the Claim in reasonable detail;
(b) not make any admission of liability, agreement or compromise in relation to the Claim without the prior written consent of the Supplier / Seller;
(c) give the Supplier / Seller and its professional advisers access at reasonable times (on reasonable prior notice) to its premises and its officers, directors, employees, agents, representatives or advisers, and to any relevant assets, accounts, documents and records within the power or control of Party B, so as to enable the Supplier / Seller and its professional advisers to examine them and to take copies (at the Supplier’s / Seller’s expense) for the purpose of assessing the Claim; and

(d) take such action as the Supplier / Seller may reasonably request to avoid, dispute, compromise or defend the Claim.
THE BUYER's FINAL REPLY

The Supplier / Seller shall indemnify the Buyer against all costs, damages, expenses, liabilities, and losses (including but not limited to any direct, indirect or consequential losses, loss of profit, [loss of reputation] and all interest, penalties and reasonable legal costs (calculated on a full indemnity basis) and all other reasonable professional costs and expenses) suffered or incurred by the Buyer arising as a result of:

(a) any breach of clause [ ];
This indemnity shall not cover the Buyer to the extent that a claim under it results from the Buyer’s negligence or wilful misconduct.

If any third party makes a claim, or notifies an intention to make a claim, against the Buyer which may reasonably be considered likely to give rise to a liability under this indemnity (a Claim), the Buyer shall:

(a) as soon as reasonably practicable, give written notice of the Claim to the Supplier / Seller, specifying the nature of the Claim in reasonable detail;

(b) not make any admission of liability, agreement or compromise in relation to the Claim without the prior written consent of the Supplier / Seller; (such consent not to be unreasonably conditioned, withheld or delayed) and provided that the Buyer may settle the Claim (after giving prior written notice of the terms of settlement (to the extent legally possible) to the Supplier / Seller, but without obtaining the Supplier’s / Seller’s consent) if the Buyer reasonably believes that failure to settle the Claim would be prejudicial to it in any material respect;

(c) give the Supplier / Seller and its professional advisers access at reasonable times (on reasonable prior notice) to its premises and its officers, directors, employees, agents, representatives or advisers, and to any relevant assets, accounts, documents and records within the power or control of the Buyer, so as to enable the Supplier / Seller and its professional advisers to examine them and to take copies (at the Supplier’s / Seller’s expense) for the purpose of assessing the Claim; and

(d) subject to the Supplier / Seller providing security to the Buyer to the Buyer’s reasonable satisfaction against any claim, liability, costs, expenses, damages or losses which may be incurred, take such action as the Supplier / Seller may reasonably request to avoid, dispute, compromise or defend the Claim.
Concluding Remarks