Ageas v Kwikfit - Warranty & Indemnity Insurance in action

Warranty and Indemnity Insurance ("**W&I**") has become increasingly popular over the last decade and is now a common feature of corporate acquisitions. As a result of W&I's only recent popularity, very little case law exists concerning W&I policies that indicate how the Courts will interpret them.

The recent case of *Ageas v Kwikfit and AIG* (2014) involved a buy-side W&I policy. Reassuringly for insureds, coverage under the policy was not in dispute and it operated in tandem with the SPA warranty provisions and liability cap as intended.

Background

Kwikfit agreed to sell to Ageas for £214.75m a wholly owned subsidiary (the "**Target**"), which sold motor insurance products. The terms of the acquisition were set out in a share purchase agreement ("**SPA**") that included various warranties and indemnities from Kwikfit concerning, among other things, the accuracy of the Target's accounts, which Ageas had relied on when valuing the Target.

As is commonly the case, the SPA included a cap on the total amount that Ageas could claim from Kwikfit for breach of warranty and/or indemnity, in this case £5m. For added protection against breach of warranty by Kwikfit, Ageas also took out a buy-side W&I policy with AIG that provided cover for breaches of warranty by Kwikfit in excess of the £5m cap in the SPA.

Following completion of the sale, Ageas discovered that the Target's accounts contained a number of errors relating to the treatment of bad debts. The combined effect of the errors was an overstatement of the Target's net profit and assets. Ageas therefore brought claims against Kwikfit under the SPA and AIG under the W&I insurance.

By the time the case reached trial the fact of the accounting error and that Kwikfit was in breach of warranty was admitted and the only issue left to be decided was the amount of damages Ageas should receive – Ageas contended it was £17.5m, Kwikfit and AIG contended it was £8.7m. On either case Kwikfit's £5m liability cap would be breached so the dispute was essentially between Ageas and AIG, who was liable for damages in excess of £5m.

The benefit of hindsight?

The measure of loss for breach of warranty in a share sale is the difference between the value of the Target's shares as warranted and the true value of the shares. It was accepted that the 'as warranted' value of the shares was £214.75m but the true value of the Target's shares was disputed as between Ageas and AIG. At the heart of that dispute was the question: should post completion events be taken into account when calculating the true value of the shares as at the date of completion or should this be ignored? In other words, should the Target be valued with the benefit of hindsight.

A valuation of the Target based only on the facts known at the time of completion (which was essentially the exercise Ageas had carried out to calculate the purchase price) required assumptions to be made about the Target's future business performance. In the event, those assumptions had proved incorrect and the Target had actually performed below expectation.

AIG contended that the Target's actual performance should be taken into account in place of the assumptions, the net result of which was to lead to a lower award of damages. Ageas disagreed, contending that there was no reason to depart from the normal position that damages for breach of contract should be calculated at the date of breach (here the date of completion) and, therefore, the subsequent events should be ignored.

Calculating damages for breach of warranty

The Court held that the starting position must be that damages are assessed as at the date of breach of contract (i.e. subsequent events are ignored). The Court should only depart from that position where there is justification for doing so.

The Court highlighted two factors to consider whether it was just to depart from the normal rule:

(a) **The Compensatory Principle** – damages for breach of contract are intended to place a claimant in the position it would have been in had the breach not occurred. Where that is not possible on the normal position, it may be just to depart from the normal rule.

(b) **Allocation of Risk** – the Court should have regard for how the parties have allocated risk under the contract in question. If a contract places a particular risk to one party, which happens to result in them suffering a detriment, the Court should not interfere with the contractual risk allocation by reducing its award for damages.

In the present case, under the terms of the share purchase agreement Ageas had taken on the entire risk of the Target's future business performance, for better or worse. The Court noted in particular the absence of a price adjustment mechanism in the SPA to shift any of the consequences of that risk back to Kwikfit.

On that basis alone the Court held that it would be unjust to depart from the normal position of calculating damages as at the date of breach. Therefore, the Target's post-completion performance was ignored and Ageas was awarded the higher damages of £17.5m.

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