

# Representations and warranties insurance in M&A deals

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## Introduction

### Representations and warranties insurance

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Setting aside commercial issues and discussions surrounding considerations for target shares, negotiations concerning contractual representations and warranties and indemnification structures are often the most challenging and time-consuming stages of an M&A deal. These negotiations typically result in escrow or holdback structures, wherein the buyer seeks to secure any potential risks identified during its due diligence review. Frequently the seller is ultimately left with an escrow or holdback request, despite an intention to avoid any retention or delay of the consideration due.

Escrow generally requires involvement of a third party (the escrow agent). Thus, negotiations on escrow agreements further delay signing and parties may experience deal fatigue as their interest in proceeding with the transaction fades with each hurdle encountered. Further, an escrow occasionally provides insufficient protection to its beneficiaries, because the funds in escrow are insufficient or because litigation may be required to obtain them. As a result, M&A practitioners often seek alternative solutions.

Recently, an insurance product – namely M&A insurance (or representations and warranties insurance) – has emerged as an alternative option for both sellers and buyers. This product provides coverage against the risks associated with breaches of contractual representations and warranties by the seller.

In practice, there are two types of representations and warranties policy: seller side and buyer side. Seller-side policies provide direct protection to a seller against a buyer's representations and warranties claims, similar to a third-party liability insurance policy. Buyer-side policies directly compensate the buyer for losses incurred due to a breach of representations and warranties by the seller, similar to a first-party liability insurance policy.

Although the policies have many identical aspects, they differ in certain key features. Seller-side policies generally mirror the liability caps and statute of limitations provisions under the share purchase agreement, while buyer-side policies are used for losses above these contractual caps and beyond the enumerated limitations of liability.

#### Representations and warranties insurance

The Insurance Law is the main piece of legislation that applies to insurance activities in Turkey. This law regulates insurance products, as well as the establishment, management, operation, supervision and audit of insurance and reinsurance companies, agencies and brokers. The Insurance Law also sets out the framework applicable to Turkey's insurance sector; its principles are further detailed in secondary legislation. The Communiqué on Insurance Branches lists the branches of insurance in which an insurance company can operate and establishes a licensing requirement for each branch. Turkish insurers cannot offer policies for insurance products which are not specifically listed in the communiqué.

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Representations and warranties insurance is a new product for Turkey and is not yet regulated under the communiqué as a branch of insurance. Therefore, Turkish insurers cannot directly issue this type of policy. Although some scholars and insurance practitioners believe that representations and warranties insurance falls within the scope of general liability insurance, Turkish insurers opt not to issue policies for coverage of sellers' representations and warranties, given the lack of legal grounds and the Treasury's silence regarding the product's legality.

M&A practitioners and insurance companies believe that local market expectations will lead the Treasury to focus on this insurance product and develop legislative grounds that allow Turkish insurers to issue policies for it. For now, representations and warranties insurance can be issued through foreign insurance companies in Turkey, but it is generally not cost effective. It simplifies indemnification procedures for both parties, but the gap between cost and risk should be balanced. Only then can escrow agents be replaced with insurers.

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