Warranties and Indemnities: Acquisitions (France)

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A Practice Note providing an overview of the legal and practical considerations regarding the use of contractual warranties and indemnities when acquiring shares of a company through a private acquisition in France

While the French Civil Code (*Code civil*) provides statutory protections to the buyer in an acquisition, contractual warranties and indemnities are widely used in acquisition transactions in France.

A buyer that aims to acquire control of a company should ensure that the net asset value and liabilities of the company or business are accurate.

To mitigate risks, buyers and sellers usually organise a financial and legal due diligence process before the acquisition. The due diligence process assists the buyer in identifying and assessing potential liabilities and risks related to the target. However, the effectiveness and relevance of a due diligence exercise depend on the:

- Time allocated to carry out due diligence.
- Quality of documentation provided.
- Seller's co-operation.

In addition, the due diligence process does not protect a buyer from the seller's omissions or future operating risks.

In this context, French market practice relating to warranties and indemnities has been influenced by Anglo-Saxon transactions, which tend to cover as many risks as possible.

Statutory Protections in Acquisition Transactions

The Civil Code provides several statutory protections for buyers in share purchases.

In the context of a sale (*vente*), the buyer benefits from the following protections:

- **Guarantee against hidden defects (*garantie des vices cachés*) (*Article 1641, Civil Code*).** This protects the buyer against hidden defects that render the company/asset unfit for the use for which it was intended, or which so diminish this use that the buyer would not have acquired it. In practice, to benefit from this guarantee, the buyer must show that they are not able to run their business due to the hidden defects. Therefore, this protection is quite limited.
- **Guarantee against dispossession (*garantie d'éviction*) (*Article 1626, Civil Code*).** The seller must warrant the buyer against dispossession of the thing sold (that is, the shares of the target company). However, this guarantee applies to shares but not to the underlying assets (that is, the company and its business), so that its use is rather limited in practice.

The buyer may also benefit from statutory protections under the general principles and rules of the Civil Code, including:

- **Rescission for substantive inequality of bargain (*rescission pour lésion*) (*Article 1674, Civil Code*).** If a seller has been harmed by more than seven twelfths in the price of an asset, they have the right to request the rescission of the sale. However, case law clearly states that this only applies to movable property (that is, not company shares).
- **Duty of disclosure (*Article 1112-1, Civil Code*).** This requires the seller to inform the buyer of any information that has a decisive influence on the buyer's decision to conclude the contract. However, this duty only applies if the buyer is legitimately unaware of the information or relies on the seller's knowledge. This obligation is more generally related to the parties' duty to negotiate, conclude, and perform contracts in good faith (*Article 1104, Civil Code*). For more information on this duty see *Practice Note, Key documents for acquiring a private company (France): General Duty to Negotiate in Good Faith under the French Civil Code*.
- **Misrepresentation (*Article 1132, Civil Code*).** The buyer can request cancellation of a sale if they show that the seller made a misrepresentation on the substantive quality of the shares or assets sold. For instance, courts have ordered cancellation when the buyer showed that the acquired business could not be operated and achieve its corporate purpose and to carry out a profitable economic activity (*Cass. Com., 7 February 1995, n°93-14.257*).
- **Wilful misrepresentation (*Article 1137, Civil Code*).** To obtain cancellation of a contract for wilful representation, the buyer must show that they would not have entered into the contract had they known of the true position.

In practice, statutory warranties under the Civil Code are insufficient as they only apply in specific circumstances and do not cover all risks that may arise following an acquisition.

Contractual Warranties and Indemnities in Acquisition Transactions

Contractual warranties and indemnities are complementary to the due diligence process and statutory guarantees (see *Statutory Protections in Acquisition Transactions*). The due diligence process helps the buyer gaining significant knowledge of the target company (or assets), while statutory guarantees protect the buyer in the event of significant defects or misrepresentation..

The inclusion of warranties and indemnities in share purchase agreements has become essential for securing transactions. Warranties and indemnities protect the buyer from events, the cause of which precedes the acquisition, that could lead to an increase of liabilities or a reduction of the target's net asset.

French law does not specifically define or regulate contractual warranties and indemnities, which are therefore subject to the general rules of contract law contained in the Civil Code. Accordingly, warranties and indemnities are subject to contractual conditions of validity (consent and capacity of the parties and lawful content (*Article 1128, Civil Code*)) and must be ancillary to the purchase agreement. Failure to comply with these requirements renders warranties and indemnities void.

What are Warranties?

Warranties are contractual statements as to the characteristics, condition, and state of affairs of the sold company or business as of a certain date. Their aim is to provide a remedy to the buyer if the statements made by the seller are incorrect, thereby reducing the value of the target company or business. Therefore, warranties also encourage the seller to disclose any matter or issue concerning the target, to limit their liability after the acquisition.

A breach of warranty entitles the buyer to claim contractual damages under Articles 1217 and 1231-1 of the Civil Code, unless the agreement includes contractual indemnification clauses.

What are Indemnities?

Indemnities differ from warranties as they aim to compensate the buyer for any liability or loss arising after the acquisition due to specific risks disclosed or identified during the due diligence and negotiation process. Usually, the seller commits to indemnify the buyer on a euro-for-euro basis for any loss or damage suffered after the transaction due to events that occurred before the acquisition, even if the buyer is aware of these risks. When negotiating indemnities, it is important to agree on a contractual process to ensure that the indemnification mechanism is properly managed if damage, loss, or liability arises.

The following sections focus on share acquisitions rather than asset acquisitions. However, most of them also apply to asset purchases.

Market Practice

Based on the freedom of contract principle (*Article 1102, Civil Code*), French practice relating to warranties and indemnities is varied and has evolved over time.

Historically, French market practice referred to net asset guarantee (*garantie d'actif net*) to protect the buyer from any risks of loss or damage due to events preceding the transaction. The seller used to guarantee the net asset value of the company by compensating the buyer from any decrease in net asset value arising after a specific date (usually the date chosen for the preparation of the target company's reference financial accounts). However, under the influence of Anglo-Saxon practice, net asset value guarantees have been replaced by detailed seller warranties (*garanties déclaratives*).

Warranties usually list all the risks attached to the target company and oblige the seller to compensate the buyer for any loss resulting from any breach or inaccuracy of any such warranties.

To compensate losses suffered by the buyer or the target company, the following indemnification mechanisms are commonly used in practice:

- **Price revision clause (*clause de révision de prix*).** This requires the seller to indemnify the buyer for any decrease in the value of the target's shares. In this case, the amount of indemnification is deducted from the purchase price. Under this mechanism, the seller's liability is capped at the purchase price.
- **Restoration clause (*garantie de reconstitution*).** This aims to fully restore the assets of the target company. The beneficiary of the warranty is the target company and, therefore, the indemnified amount can be higher than the purchase price.

Common Areas of Warranty Protection

Before drafting warranties, it is necessary to consider the following information:

- **Characteristics of the transaction.** In particular, it is important to determine whether the acquisition relates to all or a portion of the target company's share capital. It is also important to know whether the transaction involves one or more sellers and if so whether co-sellers will act on a joint and several basis (*solidairement et non conjointement*).
- **Structure of the target company.** If the target company owns subsidiaries, warranties should also cover these subsidiaries. The warranties should also be adapted if the target company holds minority stakes in other entities.
- **Activity of the target company and related risks.** Warranties should be drafted in light of the target company's business (for example, risks related to an industrial company differ from those related to a tech company). Therefore, a good knowledge of the target's activity is required to draft adequate warranties. In this respect, a thorough due diligence should help assessing potential areas if risks.

Warranties included in share purchase agreements tend to cover all key operational areas, including accounts, company's documents, business assets, material contracts, litigation, regulatory compliance, employment, real estate, tax, intellectual property, and environment.

Specific indemnities usually cover matters such as tax, litigation, compliance, employment, and environment.

Fundamental Warranties

Warranties Related to the Seller

The seller always warrants that it has the capacity and power, and has obtained all necessary authorisations (whether corporate, governmental, statutory, regulatory, or administrative), to enter into the share purchase agreement.

Warranties Related to the Target Company

The seller usually warrants that the target company is:

- Validly incorporated.
- Lawfully registered.

- Not insolvent.

Depending on the transaction, the seller usually warrants that the shares sold correspond to the whole of the issued share capital of the target company (or to part of the share capital, as agreed), and that they are validly issued, subscribed, and fully paid up. Further, the parties can agree on warranties as to the absence of third-party rights over the shares.

Accounts

In practice, purchase price mechanism is either based on a locked-box mechanism or completion accounts. In both cases, it is important to include warranties on a set of accounts. This is fundamental when a locked-box mechanism is used, since the price is based on these accounts. It is also very important in other cases, as these accounts will be the basis of the due diligence exercise. Accounts are usually referred to as "reference accounts" or "warranted accounts."

As a minimum, the seller usually warrants that the warranted accounts:

- Are true, accurate, and present a fair view of the state of affairs of the target company and of its assets and liabilities.
- Have been prepared on a consistent basis and in accordance with the applicable accounting principles.

The seller generally also warrants that:

- No material adverse change has occurred since the date of the warranted accounts.
- The target company has not changed any of its characteristics, shares, activities, assets, and liabilities since that date (except for items specifically disclosed).

The buyer may also require the seller to provide warranties in relation to:

- The level of provisions accounted for in the warranted accounts.
- Any off-balance sheet commitments.

Financing and Banking

The main purpose of financing and banking warranties is for the buyer to obtain full disclosure of any banking facilities (such as bank accounts and securities), the financial exposure of the target company, and any possible impact of the acquisition on that exposure. The buyer should pay specific attention to any change of control provisions in financing documents that would be triggered by the transaction and result in a reimbursement obligation.

The seller usually warrants that:

- No event has occurred that would entitle any person to call for early repayment of any financial indebtedness or to enforce any security given by the target company.

- No party to a financing agreement has threatened to request early repayment or termination due to the transaction or the change of control.

The buyer sometimes requires the target company to be debt-free, obliging the seller to organise early repayment of any debt of the target company. However, this is rare in practice.

Contractual Matters

The seller usually warrants that material contracts (for example, in terms of value or duration) are in full force and effect, valid, binding and, enforceable, and that neither the target company nor the counterparty is in breach of such contracts. The seller may also warrant that no party to material contracts has notified its decision or indicated its intention (although sellers will generally not accept to warrant this), to terminate a contract.

Litigation

The seller usually warrants that, except for litigation or disputes listed and identified in the share purchase agreement (or the data room), the target company is not involved in any investigation, audit, proceeding, or claim before any court, regulatory authority, or arbitrator.

The seller sometimes warrants that there is no event or fact that could result in any litigation or loss for the target company.

Product Liability

The seller may warrant that the target company:

- Has not manufactured, sold, or supplied defective products.
- Has put in place appropriate procedure to avoid such situation.
- Is not involved in any related disputes.

Real Estate

Details of real estate owned and leased by the target are usually audited by the buyer and listed in a schedule attached to the share purchase agreement. The seller usually warrants that these details:

- Cover all real estate matters involving the target company.
- Are true, complete, accurate, and not misleading.

The seller also confirms that the rights of the target company over its real estate are not contested and that no event may affect these rights.

These warranties may be more or less extensive depending on the target company's activity and real estate portfolio.

Intellectual Property

Warranties covering intellectual property (IP) rights depend on the target company's activity and business. The share purchase agreement usually includes a list of all IP rights owned or used (under a licence, franchise, or similar contract) by the target company. The seller normally warrants that it has valid rights over the listed IP rights, that such IP is valid, and is not subject to challenge or removal.

Environment

Environmental laws now play a significant role in the activity and business of companies. Environmental warranties may vary depending on the target company's business. Usually, the seller warrants that:

- The target company complied with all environmental laws and regulations, including the Environmental Code (*Code de l'environnement*).
- No event or circumstance has occurred that is in breach of environmental rules.

Compliance

The buyer may seek to obtain a warranty from the seller that the target company is compliant with all applicable laws and regulations (although the seller will generally resist this). The buyer will also generally require the seller to warrant that the target company has obtained all licences, permits, permissions, authorisations, and consents necessary to conduct its business. Generally, the seller seeks to qualify this type of blanket warranties to the seller's knowledge and with a materiality threshold.

Employment

The share purchase agreement usually contains a list of the target company's employees (without their names), including their age, seniority, remuneration and other benefits, and whether they are working part time or full time.

The seller also usually discloses a list of all applicable collective bargaining agreements, company agreements, and other agreements entered into by the target company and trade unions.

The seller may warrant that:

- All employment agreements have been disclosed and are valid.
- The target company is not bound by any individual or collective undertaking involving the payment of indemnities or the granting of benefits (such as termination indemnities or golden parachutes).
- There have been no strikes in the preceding years.
- The target company has complied with all applicable laws relating to employment and social security, and with all its obligations resulting from collective bargaining agreements.
- There is no pending dispute, claim, action, proceeding, demand, or complaint in respect of any of the employees.
- The target company has paid all amounts required for any funded employee benefit plan.

Tax

Non-compliance with tax laws and regulations may have significant detrimental consequences for the buyer. To ensure compensation of the buyer or target company, the share purchase agreement usually includes extensive tax warranties covering as many potential issues as possible. Tax warranties generally focus on corporate taxation and value added tax (VAT), as these are more likely to involve litigation.

The seller may also warrant that:

- The target company has complied with all applicable tax laws.
- Since the date of the reference account, the target company has not been involved in any operation or transaction that could trigger any potential taxation.
- The target company has duly paid all tax due within the applicable time limits, or the reference accounts make proper provision or reserve for all tax liabilities due.
- The target company duly completed, filed, and submitted all declarations, formalities, and documents imposed under tax laws.
- All information concerning tax losses is true, complete, accurate, and not misleading.
- The target company did not enter into agreements likely to be assessed, rejected, or reclassified for tax purposes on the ground that the underlying transaction aimed to evade, circumvent, or reduce its obligations under any tax laws.
- The target company has not been or is not subject to any tax investigation, inquiry, or audit.
- The target company has always been resident for tax purposes in its place of incorporation and has never been treated as resident in any other jurisdiction for tax purposes.

Data Protection

The seller usually warrants that the target company has fulfilled its obligations under all applicable data protection laws, guidelines, and industry standards. Given the complexity of data protection regulations, the seller may seek to limit these warranties through a materiality or knowledge qualification.

Insurance

Some companies must subscribe to insurance policies to conduct their activity and protect their business from harmful events. In this case, the share purchase agreement usually lists the target's insurance policies, and the seller warrants that:

- These policies are adequate and sufficient for the target company's activities.
- All premiums have been duly paid.
- There is no breach of, or pending claim under, these policies.

Listed Target Companies

When the buyer is purchasing an interest in a listed entity, contractual warranties must be tailored to the nature of the target.

It is common practice to limit warranties to fundamental matters (that is, authorisation, capacity, and title to shares). In addition, the buyer generally requests the seller to warrant that all information that has been made public (either in regular communications to the market or in financial reports) is correct and exhaustive, and that the seller has not omitted to disclose any material information that has not been made public.

Other Warranties

Share purchase agreements may also contain other types of warranties, for example:

- Completeness of information provided to the buyer.
- Termination of all contractual relations between the target and seller from completion.
- Absence of impact of the COVID-19 pandemic on the target's business.

Judicial Interpretation of Warranties

Generally, warranties must be interpreted in accordance with the general principles set out in the Civil Code. Therefore, the French courts apply the following rules:

- A contract must be interpreted in light of the common intention of the parties (*Article 1188, Civil Code*), which means that it is not sufficient to apply the literal meaning of contract terms. For example, French courts have held that, when a seller undertakes to guarantee a buyer "against the consequences of any reduction in assets or increase in liabilities" on a specific date and the accounts show a reduction/increase that may have originated before that date, the guarantee will only be triggered if the judge considers that this was the intention of the parties (*Cass. Com., 19 June 2019, n°17-26635*).
- A contract must be interpreted as a whole (*Article 1189, Civil Code*), and clauses must be interpreted in relation to each other. Clear special contractual clauses should prevail over a general clause. Therefore, when a court is faced with a general clause requiring the buyer to "without delay and without sanction [...] inform the seller of any event likely to lead to the application of the warranty", while a special clause provides that "under penalty of forfeiture and within a period of 15 days, the buyer must inform the seller of any event likely to reveal a liability," the judge must apply the special clause.
- The judge can interpret clauses to the advantage of one of the parties (*Article 1190, Civil Code*). Current case law indicates that contractual warranties against liability are usually interpreted in favour of the warrantor (CA Aix en Provence, 6 June 2017).
- When a clause has more than one possible meaning, the meaning that gives effect to the clause will prevail (*Article 1191, Civil Code*). Therefore, when a guarantee against liability provides that it can only be implemented by a named manager, and the manager is replaced, a judge cannot refuse to enforce the

guarantee on the ground that a new manager is not the one named in the underlying contract, as this would deprive the guarantee of any effect.

- The judge cannot interpret clear and precise clauses (*Article 1192, French Civil Code*).

When a contract is silent on a specific matter, the courts have two options:

- Conform to the parties' silence and refuse to imply any term in the contract.
- Fill in the gap by drawing on equity or usage (this is referred to as a creative interpretation).

In relation to warranties, the courts systematically refuse to fill in gaps, except when interpretation is aimed at identifying the beneficiary of a warranty.

Beneficiaries of Warranties

There are three potential beneficiaries of warranties and indemnities:

- The buyer.
- The target company.
- Creditors of the target company.

The usual beneficiary of warranties and indemnities is the buyer (this is automatically the case for price revision clauses). Case law indicates that, in absence of specific provisions designating the beneficiary of warranties, the beneficiary is the buyer (CA Paris, 28 June 2002). Therefore, it is important to expressly designate the beneficiary of warranties and indemnities.

When the target company is designated as the beneficiary, the warranties and indemnities are considered as provisions in favour of third parties (*Article 1206, Civil Code*). This means that the target company has a direct right of action against the seller to enforce the warranties and indemnities.

In practice, creditors are very rarely beneficiaries of warranties and indemnities. This may occur when third party creditors are involved in financing the purchase (for example, banks). In this case, third party creditors are subrogated in the buyer's rights under the warranties and indemnities.

Case law is unclear on whether sub-buyers may benefit from warranties and indemnities provided in the initial share purchase agreement. When the agreement is silent, sub-buyers are unlikely to be entitled to rights under warranties that were stated for the benefit of the initial buyer. Consequently, it is highly recommended to regulate this issue in the share purchase agreement, by expressly authorising (or not) the transfer of warranties and indemnities from buyers to sub-buyers.

Who Gives Warranties?

Warranties and indemnities must also designate the warrantor. When there are multiple sellers, those with a small shareholding may be unwilling to give warranties or may seek to limit their liability to their share of the sale proceeds or a proportionate part of each claim.

Share purchase agreements can distinguish between different categories of sellers, taking into consideration either their:

- Equity participation.
- Role in the daily management of the target company.

When equity participation is used as a criterion to distinguish sellers, this usually leads to two categories, principal sellers and sellers, where each category is responsible for specific warranties and indemnities. Similarly, sellers may be referred to as reporting guarantors (*garants déclarants*) based on their in-depth knowledge of the company, or non-reporting guarantors (*garants non-déclarants*). Reporting guarantors can be held liable for breach of warranties and liable to compensation, while non-reporting guarantors are only required to contribute to compensation.

Under French law, a share purchase agreement relating to a commercial company is considered a commercial act. This means that the sellers are jointly and severally liable, unless otherwise provided in the agreement. Therefore, the buyer is entitled to claim full compensation from any one or more of the sellers (and a seller liable for full compensation can then seek a contribution from the other sellers). A share purchase agreement can exclude the seller's joint and several liability.

The buyer also generally gives warranties in the share purchase agreement. These warranties are usually limited to valid incorporation, capacity, authorisation, and absence of violation of laws, regulations, or contractual obligations. In some cases, the buyer may be required to warrant that it:

- Benefits from binding financing commitments.
- Has sufficient financial resources to pay the purchase price and, more generally, to meet its financial obligations under the share purchase agreement.

Limitation of Seller's Liability under Warranties and Indemnities

Buyers and sellers usually negotiate limitations and qualifications to warranties and indemnities. These limitations fall into various categories, as outlined below.

Knowledge

The seller generally seeks to qualify certain warranties, especially those relating to a likelihood or potential risk, to their knowledge of related facts, events, and matters. The parties negotiate the definition of "seller's knowledge" by reference to the knowledge of certain individuals in the company (key persons or management).

The seller usually seeks to limit the "seller's knowledge" to the actual knowledge of management, while the buyer may want to extend it to the actual knowledge of any individual within the seller. The buyer may want the definition to refer to the "seller's best knowledge" (that is, what the seller should have known if it had acted diligently).

Repeat Warranties

In French transactions, warranties and indemnities are generally repeated on closing. However, some warranties may only cover the period between signing and closing. In these cases, it is customary for the buyer to be entitled to walk away from the transaction and terminate the share purchase agreement if there is a material breach of a fundamental warranty before closing.

Disclosure

Buyers and sellers may agree to exclude from the scope of warranties information that has been disclosed before the transaction or in the share purchase agreement. Data room exclusion clauses, which are becoming common practice in France, exclude from the seller's indemnification obligation any fact or matter that has been fairly disclosed to the buyer in the data room during the due diligence process. The share purchase agreement usually specifies that exclusions are valid if the relevant matters or facts are disclosed in a manner that enables a competent professional buyer and its advisers to make a fair assessment of the situation.

In Anglo-Saxon practice, the seller tends to only make specific disclosures, while French transactions generally involve general disclosures based on information revealed during the due diligence process.

Exclusion of Indirect Loss

Under French law, the general rule is that only direct damages are compensated, unless the parties expressly agree otherwise. Indirect losses are those that are not an immediate and direct consequence of the breach of warranties and indemnities. Direct loss is referred to as actual and direct damage (*prejudice direct et certain*) and excludes any loss of opportunity (*gain manqué* or *perte d'une chance*), any diminution in value determined using a "multiple of profits" or "multiple of cash flows," and any loss that is contingent (uncertain) or indirect.

However, under the freedom of contract principle, the parties may agree that the seller will be liable for indirect losses caused by breach of warranties, although this is rare in practice.

Financial Limits on Warranty Claims

Minimum Limit for Individual Claims (*De Minimis*)

To avoid excessive use of the warranty claim process, buyers and sellers usually agree that the buyer is only entitled to make a warranty claim if that claim is equal to, or higher than, a *de minimis* threshold. The *de minimis* limit is usually 0.1% of the purchase price. This aims to reduce the cost of managing warranties and indemnities for claims that are not of great importance.

Minimum Limit for Aggregate Claims (Basket or Deductible)

The seller may also seek to include a financial limit for aggregate claims before the buyer can claim indemnification. This limit may take one of the following forms:

- A deductible (*franchise*), under which the seller must only indemnify the amount exceeding the relevant threshold.
- A basket (*seuil de déclenchement*), under which the seller must pay the full amount of claims if the threshold is exceeded.

In practice, the threshold is often in the range of 1% of the purchase price.

Overall Limit

The seller usually seeks to limit its overall liability to a maximum amount. A maximum cap (*plafond de la garantie*) aims to limit payment for aggregate claims that exceed a certain amount. The buyer must bear the amount exceeding the maximum cap. In practice, the maximum cap is usually in the range of 10% to 15% of the purchase price. It is also possible to provide for separate caps for different matters and issues.

Financial limits do not usually apply to indemnities covering specific risks, unless the parties agree on specific limits.

Time Limits on Warranty Claims

The agreement can derogate from the statutory limitation period and specify time limits for making warranty claims.

Time limits usually depend on the nature of the warranties. In practice, specific time limits are usually provided for:

- Tax, labour, and social security warranties and indemnities: these are usually subject to the statutory limitation period (that is, three years plus the ongoing year in most cases).
- Other representations and warranties: these are usually subject to a 12 to 24-month limitation period following the completion date.

In addition, French practitioners tend to include specific time limits for environmental warranties and specific indemnities.

Time limits should be clearly drafted to determine whether they apply to the warranties coverage period or the period within which to make warranty claims.

Enforcement of Warranties and Indemnities

Obligation to Notify the Seller

There is no legal obligation to notify the seller of any event that may result in a breach of warranties and indemnities.

Therefore, the share purchase agreement usually requires the buyer to inform the seller of any event or third-party claim that may result in a breach of warranty.

Failure to comply with this obligation may mean that the buyer loses its right to indemnification. When the agreement does not specify the consequences of failure to notify, French case law usually considers that it is up to the courts to decide whether failure to notify may deprive the beneficiary from its right to indemnification (*Cass. Com., 9 June 2009, n°08-17843*). More recently, the French Supreme Court refused to deprive a beneficiary from its right due to its failure to notify but decided to reduce the indemnification amount (*Cass. Com., 18 May 2016, n°14-22.354*).

Third-Party Claims

The management of third-party claims is often a key point of discussion. It is usual for the buyer to undertake to

- Give the seller reasonable access to information relating to third-party claims.
- Consult with the seller before admitting any liability or accepting any settlement or compromise with a third party.

The share purchase agreement may also require the parties to co-operate in the event of any litigation arising following completion.

Security for Breach of Warranty

To guarantee the seller's ability to indemnify the buyer for breach of warranty, the buyer usually seeks some form of security from the seller. The most common types of security used in France are as follows.

Escrow

Contractual escrow (*séquestre conventionnel*) is regulated by Article 1956 of the Civil Code. It consists of depositing part of the purchase price (usually about 10%) in an escrow account held by a third party (usually a bank or notary (if the underlying asset is real property)). The escrow amount is then released at the specified date, after deducting any amount due under warranties and indemnities.

Escrow mechanisms are commonly used in France. The usual escrow period depends on the warranty limitation period, but frequently ranges between 18 and 24 months. One of the key point of negotiations is the release mechanism, in particular when the parties do not agree on the existence or amount of an indemnification obligation.

Real and Personal Guarantees

The seller may grant a:

- Real guarantee (such as a lien or a pledge over some of its assets).
- Personal guarantee, which may be joint and several (*cautionnement solidaire*).

The buyer generally only accepts a personal guarantee if it is confident of the creditworthiness of the seller.

Bank Guarantee

The buyer may seek a first demand bank guarantee (*garantie bancaire à première demande*) to ensure compensation due for warranty claims. This is really advantageous for the buyer, and sellers usually resist these requests.

Warranty and Indemnity (W&I) Insurance

There has been a significant increase in the use of W&I insurance in French M&A deals in recent years, mainly due to the influence of the private equity market. W&I insurance can be subscribed by either the seller or the buyer (but is typically subscribed by the buyer and the premium is often deducted from the purchase price). The premium usually ranges from 1% to 1.5% of the maximum liability covered by the insurance policy. While W&I insurance may fully

cover the seller's liability, W&I policies often exclude the insurer's obligation to indemnify the buyer in the following cases:

- Known or disclosed facts (for example, contingencies identified during the due diligence process or disclosed in the share purchase agreement, such as specific indemnities or exceptions to warranties).
- Losses arising from the insured's fraud or misrepresentation.
- Certain specific liabilities of the seller (for example, environmental liability).

W&I insurance allows the seller to fully escape liability after closing (to the extent agreed in the share purchase agreement) and receive the purchase price in full (minus the W&I insurance premium) without associated financial costs (such as a first demand bank guarantee or an escrow).

The main advantage for the buyer is that it can claim directly against the insurer, without having to rely on the seller's solvency after closing.

Therefore, W&I insurance can be especially useful for:

- Sellers that are unwilling to provide warranties (typically private equity funds) or that remain in the business (such as founders or managers).
- Buyers that have concerns about the seller's solvency.
- Sellers and buyers that will maintain a commercial relationship after completion.

The main disadvantages of W&I insurance are:

- The need to involve a third party (the insurer) in the due diligence process and align the W&I insurance policy with the terms of the share purchase agreement.
- In some cases, insufficient warranty coverage for the buyer, due to exclusions in the W&I insurance policy.

For more information on warranty and indemnity insurance, see *Practice Note, Warranty and Indemnity Insurance (France)*

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