

Negotiation of Representations and Warranties in Italy

By Francesco Portolano

During negotiations of a deal in almost all jurisdictions, some of the most extensive work is done by attorneys in drafting and negotiating representations and warranties.

As an attorney, I have been asked many times from sellers: “how much information shall I give to the buyer?” In other words: what representations and warranties to offer.

Italian law does not provide for any specific regulation on this: a seller has no specific obligation to provide minimum representations and warranties or to disclose specific information to a buyer. However, there is a general principle of good faith which may require the seller to disclose all information that a buyer would consider decisive in determining whether to acquire the target. In any case, if the seller provides certain representations, it must disclose any exceptions to such representations; otherwise, the buyer will be entitled to claim indemnity in respect of any breach of the representations.

On the other side, as attorney representing the buyer, I have been asked: “Is it advantageous to ask for and obtain information from seller?”

Italian law requires a buyer to investigate the target company in accordance with the same good-faith principles that apply to the seller. This means that a buyer cannot claim indemnification for breach of representation (or another element of an agreement) if such a breach was recognizable by ordinary diligence – if the buyer should have discovered a breach of the agreement in the course of customary due diligence, it cannot claim indemnification.

In case of a breach of representations and warranties, under Italian the regime is controversial, mainly because of the consequences of the remedies available in the event of breach.

In the event that the value of the target’s assets is substantially lower than what is stated in the representations and warranties, then the sale may be qualified as *aliud pro alio* (i.e., the regime applicable when a seller transfers something that is fundamentally different from that on which the agreement was based). In this case, the buyer has the right to terminate the agreement within the ordinary statutory limitation period of 10 years.

A strict limitation of the protections afforded to the buyer in an acquisition agreement may occur if representations and warranties are qualified as promises in respect of the qualities and characteristics of the target’s assets, based on the interpretation that the acquisition of shares indirectly involves a pro-rata transfer of the target company’s assets. If so, the buyer may seek protection under the provisions of the Civil Code regarding the sale of goods in the event of the seller’s misrepresentation or breach of representations and warranties. The code allows a purchaser to claim compensation, in the form of either a reduction in the purchase price or damages, or to terminate the agreement. In this case the buyer shall first inform the seller of the

claim within eight days (which can be extended by the parties) and than the action is subject to a statutory limitation period of one year from closing.

In addition to the regime applicable by law, appropriate indemnification clauses are usually included in the acquisition agreement in order to give effect to the protections granted by representations and warranties. The choice of an appropriate remedy will depend largely on an evaluation of the interests in each case. The remedies provided by the indemnification clauses may range from a reduction in purchase price to termination of the agreement. However, the nature and definition of such indemnities remains the subject of debate. Under certain circumstances, they have been interpreted as remedies under the sale of goods regime, making them subject to a short statutory limitation period of one year. In other cases, it is deemed to be autonomous remedies that are not be subject to the short statutory limitation period.

Therefore, it is important to draft indemnification clauses strictly related to the representations and warranties so to allow the best protection to the buyer or to limit the seller's liability as far as possible.