

Synthetic Warranties: A New Protection Tool in Extraordinary Transactions

An Italian Perspective

Abstract

This article examines the principal characteristics and legal implications of synthetic warranties, an emerging risk-allocation tool in extraordinary transactions. These policies represent an evolution of warranty and indemnity (W&I) insurance and are negotiated directly between the buyer and the insurer, with little or no involvement on the part of the seller. They are particularly useful where the seller is unable or unwilling to give contractual warranties or to support a conventional underwriting process. Synthetic warranties can therefore provide flexible, transaction-specific protection, while raising distinctive questions under Italian contract and insurance law.

Keywords: synthetic warranties; warranty and indemnity (W&I) insurance; mergers and acquisitions (M&A); Italian law.¹

1. W&I Insurance Policies: Key Features

This article examines the characteristics of synthetic warranties and certain issues arising in their application. Synthetic warranties are a recently developed form of insurance in the field of extraordinary transactions and promise to address needs that cannot readily be met through the conventional tools available to lawyers specialising in such transactions.

Synthetic warranties are a subcategory of the policies commonly known as warranty and indemnity insurance (“*W&I insurance*” or “*W&I policies*”), which have only recently begun to attract sustained scholarly attention. It is therefore appropriate to begin with a preliminary examination of this broader category.

The relevant setting is a significant corporate finance transaction, typically falling within the field of mergers and acquisitions (M&A). On completion of such a transaction, ownership of a company, a business or material assets passes to a new owner. Market practice has developed a well-established sequence of steps for transactions of this kind. Most readers will already be familiar with them, and they are outlined here only to the extent necessary for the analysis that follows.²

Following an initial exchange of non-binding or only partially binding agreements, the prospective buyer is granted access to a due diligence process, during which it may review confidential information concerning the acquisition target. If due diligence reveals no issue sufficiently serious to require more than an adjustment to the broad terms of the transaction, the parties proceed to negotiate the sale and purchase agreement. That agreement is invariably accompanied by an extensive set of warranties³

¹ This paper is an adapted English-language version of an article originally written in Italian and reflects the perspective of a jurist examining the subject through the lens of the Italian legal system

² The pages that follow can provide only a brief account of the much broader contractual issues raised by extraordinary transactions, which have already generated a substantial body of scholarship. For a wide-ranging discussion of the principal issues, see, among others, A. TINA, *Il contratto di acquisizione di partecipazioni societarie* (Milan: Giuffrè, 2007), and G. DE NOVA, *Il sale and purchase agreement: un contratto commentato* (Turin: Giappichelli, 2011).

³ For the purposes of this article, the term “warranties” is used throughout, notwithstanding that it does not capture every aspect of the broader formulation “representations, warranties and indemnities”. These concepts are often, and somewhat mechanically, rendered in Italian as “*rappresentazioni*”, “*garanzie*” and “*indennizzi*”, with insufficient attention to the role of the international lawyer as a cultural interpreter. For a careful analysis of the relevant terminology, see the still highly instructive F. DE FRANCHIS, *Dizionario giuridico* (Milan: Giuffrè, 1984). On the broader transplantation of foreign contractual models into Italian law, see G. DE NOVA, *Il contratto alieno* (Turin: Giappichelli, 2010).

concerning the target and detailed procedures governing any breach. For example, even after conducting customary due diligence, the buyer of a business will normally ask the seller to warrant that, except as disclosed in the documentation made available in the data room, the business has no material tax, employment or similar liabilities. A breach will trigger specific contractual remedies, most often the payment of a sum intended to compensate the buyer for the loss suffered when, after completion, facts emerge that are inconsistent with a warranty given by the seller. Thus, a seller may have warranted that the business has always complied with employment law, only for the buyer, following the acquisition, to face a successful claim by an employee of the transferred business for unpaid salary - a matter that had not emerged during due diligence.

Negotiating and giving such warranties is no minor undertaking for the seller. Even some time after the sale,⁴ it may be held liable for a breach and required to compensate the buyer.

Conversely, precisely because a warranty claim may be brought long after closing, the buyer may take little comfort from having to proceed against a seller that may no longer be able to satisfy its payment obligations. Among the solutions most commonly used, the buyer may require a bank guarantee,⁵ the placement of part of the purchase price in escrow,⁶ or the deferral of part of the consideration. Each is designed to protect the buyer if a dispute arises after completion and the seller is unwilling or unable to honour its obligations.

These arrangements, however, leave the seller exposed, directly or by way of recourse, to potential warranty claims until the expiry of the applicable warranty survival period. The consequences may be significant. The seller must continue to regard itself as potentially liable, at least up to the agreed cap, and may therefore consider it prudent to retain sufficient resources to cover that exposure⁷ or to defer any liquidation process while the warranties remain in force. From the perspective of an investor that acquires control of a company, restructures it and then resells it, any delay in fully realising its return - and thus in achieving a clean exit - carries a financial cost that inevitably reduces that return.

W&I insurance developed as an effective response to these divergent and potentially conflicting interests. Under a W&I policy, the insurer covers the buyer against loss arising from a breach of a

⁴ Warranties ordinarily remain in force for between twelve months and three years, although occasionally for longer. The seller's liability is generally subject to a cap ranging from ten to thirty per cent of the purchase price. These are broad indications only and are subject to many exceptions in contractual practice, which can be addressed here only briefly. Such limitations of liability will not apply where the seller has intentionally misled the buyer or has given its warranties in gross breach of its duty of care - for example, without conducting even a basic inquiry into the matters whose compliance it warranted (Article 1229 of the Italian Civil Code, "ICC"). In the employment-law example given in the text, the seller may therefore invoke the limitations where the irregularity results from ordinary negligence, such as an incorrect calculation of employee contributions caused by the complexity of the applicable rules. The limitations will not apply to plainly intentional conduct, such as deliberately withholding all salary payments in order to meet the business's cash-flow needs. The distinction between negligent and intentional breach of warranty will be important later in this article.

⁵ In this case, a bank or insurer acts as guarantor for the seller. The instrument may take the form of an autonomous or first-demand guarantee, a structure not expressly governed by the ICC but well established in commercial practice. An insurance guarantee of this kind, under which an insurer operating in the surety class acts essentially as guarantor for the seller, should not be confused with W&I insurance. As explained in the text, the latter has a very different legal and regulatory classification.

⁶ Under an escrow arrangement, part of the purchase price is placed in the custody of a third party, to be released to the seller or the buyer only when specified conditions are met. The escrowed amount provides indirect security - here too, the polysemous character of the word "guarantee" should not cause confusion - by ensuring that an asset is available against which the buyer may enforce if it has to pursue a seller unwilling to acknowledge its liability.

⁷ Depending on the circumstances, the accounting standards applicable to the seller may even require a specific provision for liabilities, for example where a dispute with the buyer has arisen and there is a significant risk of an adverse outcome.

warranty given by the seller and waives any right of recourse against the seller except in the event of fraud or wilful misconduct. The insurable risk is therefore defined by reference to the matters covered by the seller's warranties. If a warranty is breached, the buyer claims against the insurer rather than the seller. Once satisfied that the loss falls within the scope of the breach, the insurer indemnifies the buyer subject to the terms and limits of the policy.

Where an acquisition is structured around W&I insurance, the contractual architecture will generally consist of at least three principal components: the sale and purchase agreement, reduced to its essential function of transferring title and stripped of ancillary warranties; the warranty agreement, which sets out the specific warranties given by the seller in respect of the target; and the W&I policy, which uses that warranty agreement to define the risk insured for the buyer's benefit.⁸

It is easy to see how this form of insurance addresses the practical difficulties outlined above. The buyer deals with an insurer that is generally more solvent and less inclined to pursue tactical litigation than the seller,⁹ while the seller is removed from both the claims-handling process and the risk of liability, subject to the important exception of fraud or wilful misconduct. In that exceptional case, the seller may face claims from the buyer, because contractual limitations of liability will not apply,¹⁰ as well as a subrogated claim by the insurer. Consistent market practice is for insurers not to waive recourse against a seller whose misconduct has caused loss to the insured.¹¹

A W&I policy naturally requires payment of a material premium. The parties may agree that all or part of that cost is to be borne by the buyer in exchange for the seller's almost complete release from post-closing exposure. Regardless of which party ultimately bears it, the premium remains a transaction cost and will be taken into account in assessing the overall economics of the deal. From an Italian-law perspective, it also contributes to the legal and economic basis of the W&I structure. One might otherwise ask what legal function - or, more precisely, what "*causa*" - can be attributed to a

⁸ There is, of course, no impediment to including the contractual warranties in the sale and purchase agreement itself, to which they remain connected by their legal and economic basis. A separate warranty agreement is sometimes viewed as a drafting convenience because it "condenses" into a single document the scope of the risk to be covered by the W&I policy by reference.

⁹ Some industry studies suggest that insurers operating in this market take a more efficient and constructive approach to claims, in part to preserve the commercial attractiveness of W&I products. In other words, a buyer with a well-founded warranty claim may have a better prospect of prompt payment, without facing tactical litigation, when it proceeds against an insurer rather than a private seller. To our knowledge, however, no comprehensive scientific and cross-jurisdictional studies have yet confirmed this tendency.

¹⁰ Article 1229 of the ICC renders void any agreement that prospectively excludes or limits the debtor's liability for wilful misconduct or gross negligence. Two important qualifications must be borne in mind when applying this general principle - which appears, not coincidentally, in Title I ("Obligations in General") of Book IV of the ICC - to the matters considered here. First, the principle applies only to matters on which the seller has actually given a warranty; it does not apply to matters wholly excluded from the contract's subject matter. Thus, if the parties agree that an asset is transferred without any warranty, for example as to its compliance with legal requirements, they are not limiting the seller's liability but defining the subject matter of the contract negatively, within the boundaries of freedom of contract. The seller may nevertheless remain liable for fraud inducing the contract or affecting its terms, but under the rules governing avoidance. Secondly, in a sale contract the parties may validly exclude the seller's liability for gross negligence and confine it to wilful misconduct. The applicable special rule is not Article 1229 but Article 1490(2), which implicitly recognises the validity of clauses excluding or limiting the seller's statutory warranty against defects, except in cases of "bad faith". The Italian Supreme Court reached the same conclusion in Judgment No. 9651 of 11 May 2016, holding that Article 1490(2) presupposes deceit by the seller and does not apply in the less serious case in which the seller, albeit negligently, was unaware of the defects in the item sold. The application of the special regime in Articles 1490 *et seq.* to the warranty agreements used in M&A transactions is particularly complex. Without entering into that debate, for which see generally A. TINA, *Il contratto di acquisizione di partecipazioni societarie*, cited above, at 294 *et seq.*, we consider that the Italian Supreme Court's reasoning may be extended by analogy to an indemnity agreement.

¹¹ A prospective waiver of subrogation is permissible. See M. ROSSETTI, *Il diritto delle assicurazioni*, vol. II (Padua: Cedam, 2012), at 105 *et seq.*

warranty agreement entered into by a seller solely to enable the issue of a W&I policy, while imposing no personal liability on that seller other than in the event of fraud or wilful misconduct. Put differently, can a warranty validly be given under Italian law where its breach does not, as a rule, expose the warrantor to liability or a payment risk, because the parties intend to transfer that risk almost exclusively to the insurer? In our view, the answer is clearly affirmative, provided that the warranty agreement is considered within the broader contractual and transactional framework, in which the parties will necessarily have taken the economic cost of the premium into account.¹²

2. The Underwriting Process for W&I Insurance

The underwriting of a W&I policy¹³ by the insurer¹⁴ is a relatively complex process. As with the assumption of any risk, the process begins by identifying and, so far as possible, quantifying that risk. Acting through its advisers, the insurer will first seek to establish that the buyer has conducted independent due diligence to a professional standard and, in light of its findings, has negotiated the warranty agreement with the seller in good faith.¹⁵

At this stage, the insurer's review must be both exacting and alert to the potential alignment of interests between the parties. The buyer will seek the broadest possible set of warranties to protect its investment, while the seller, eager to complete the sale and receive the purchase price, may be willing to give warranties even on matters of which it has little knowledge, in the expectation that - absent fraud or wilful misconduct - it will bear no liability if they prove untrue.¹⁶

Following this review, which may include several rounds of lengthy interviews with the parties and their advisers, the insurer assesses the risk of breach associated with the warranties negotiated by the parties and decides whether, and on what terms, to insure the resulting loss.¹⁷

¹² The agreements should therefore expressly acknowledge and give appropriate weight to this aspect, for example in the recitals to the warranty agreement. By contrast, it seems unnecessary to impose a fictional liability cap of EUR 1, or another nominal amount, as is sometimes seen in practice. Such clauses probably imitate English-law contracts, where they serve a different purpose. Under English law, the doctrine of consideration requires a contract to display a "badge of enforceability" confirming its legal significance. Without entering into the complexities of the doctrine, it is sufficient to note that consideration can make an agreement enforceable without the court having to assess its adequacy. In some cases, an English lawyer can therefore address the issue by assigning an economic value to the bargain, even for a nominal consideration. See *Thomas v Thomas* (1842) 2 QB 851, in which a promise to pay annual rent of GBP 1 was held sufficient consideration for a promise granting the right to live in a house. Transplanting that device into a contract governed by Italian law is not only unnecessary for the reasons set out above, but potentially harmful because it may generate interpretative uncertainty in litigation.

¹³ Underwriting is the process by which an insurer accepts a policy and thereby "underwrites" the risk in exchange for a premium; the insurer may in turn reinsure that risk with third parties.

¹⁴ The insurance market is particularly complex. For ease of exposition, the terms "insurer" and "insurance company" are used in the text without attempting to reflect every nuance. Participants in the W&I market fall into two main categories: company markets and managing general agents ("MGAs"). Company markets are typically well-capitalised insurers that assume risk directly. MGAs are specialist participants that underwrite policies on behalf of third-party capacity providers, which assume the financial risk.

¹⁵ In international contractual practice, "good faith" retains the elusive quality it has in English and North American law, where its scope is in any event narrower than in civil-law systems. A reasonable approximation in this context is the "absence of intent to defraud or to seek unconscionable advantage": *Black's Law Dictionary*, 8th ed. (Dallas: Thomson West, 2004).

¹⁶ The insurer may require the seller to retain a material economic exposure for breach of warranty - commonly described as "skin in the game" - including in response to a request for a reduction in premium. The retained amount may operate as a deductible.

¹⁷ In practice, the outcome of this review is often less binary. There are matters for which an insurer will exclude cover altogether, sometimes described as "excluded indemnities", but such exclusions often result from risk assessments that are independent of the particular transaction and apply across the insurer's book of business.

3. Sell-Side and Buy-Side Policies

W&I policies have been present in the Italian market for several years and have already undergone a number of changes driven principally by commercial considerations. Initially, they were generally proposed as part of a sale process organised by the seller. The seller would inform the market and prospective buyers that it had already negotiated with an insurer, at least in outline, the terms on which the insurer would be prepared to issue a W&I policy to the eventual buyer. These policies were described as sell-side policies because they had been pre-negotiated by the seller. They did not, however, fit comfortably with the dynamics of an M&A process: save in exceptional cases, a buyer will resist the imposition of a pre-determined set of contractual warranties and will instead seek to negotiate and tailor them to its own protection needs, particularly in light of the due diligence findings. It will also often wish to retain broad discretion in selecting its insurer.

Sell-side policies have consequently been displaced, to an increasing extent, by buy-side policies, negotiated directly between the buyer and an insurer of its choice on the basis of the warranty package actually agreed between buyer and seller.

Beyond its commercial implications, the distinction between sell-side and buy-side policies affects their proper classification under Italian private and regulatory law.

The identity of the policyholder changes the nature of the insured risk and, consequently, the class of non-life insurance to which the policy belongs. Under a sell-side policy, the insured risk is the seller's liability arising from breach of a contractual warranty given to the buyer.¹⁸ The insured seller asks the insurer to indemnify it against the loss it would suffer if, because a warranty given to the buyer proved untrue, it were required to compensate the buyer. Such a policy therefore falls squarely within the model of liability insurance established by Article 1917(1) of the ICC¹⁹ and within the corresponding class of insurance.

A buy-side policy is structurally different. As noted above, the buyer negotiates directly with the insurer for cover against loss caused by the breach of a warranty given by the seller - loss that the buyer would not have suffered had the warranty been true and accurate. The seller does not disappear entirely from the process, as it does in the synthetic policies considered below, because the insurer will still require its participation in underwriting.²⁰ Nevertheless, the subject matter of the insurance differs fundamentally from the liability insurance described in Article 1917 of the ICC.

An insurer may, for example, decide never to cover a particular tax risk in a given jurisdiction because the relevant case law is highly fragmented. More often, the insurer will qualify the insured risk in light of its review of the due diligence exercise. Rather than insuring without qualification that no dispute exists, for example, it may cover only disputes threatened "in writing" and exclude oral allegations, which, however seriously made, will ordinarily be very difficult to detect in acquisition due diligence.

¹⁸ This raises the more complex issue of the legal nature of a warranty and whether fault is required in order to attribute liability for its breach. In light of the most recent authorities, we consider the classification proposed in the text to be correct. See F. SARTORIS, "Teorie a confronto sulla natura della garanzia per vizi a seguito delle ultime pronunce delle Sezioni Unite", *Persona e Mercato* 2021/1, 189 *et seq.*; and P. RAINELLI, "Le polizze assicurative 'Warranty and Indemnity' nelle compravendite di partecipazioni societarie", *Assicurazioni* 3/2022, 443, n. 10.

¹⁹ "Under liability insurance, the insurer is required to indemnify the insured for sums that the insured must pay to a third party as a result of an event occurring during the period of insurance and giving rise to the liability specified in the contract. Loss arising from intentional acts is excluded."

²⁰ As a condition to issuing the policy, the insurer will require the seller to deliver a bring-down certificate at closing, confirming the truth and accuracy of the insured contractual warranties or disclosing intervening facts that have rendered them inaccurate, in which case the relevant matters will be excluded from cover.

More specifically, the loss covered by a buy-side policy has rightly been characterised as the failure to obtain, or the reduction in, the economic benefit that the buyer expected from its investment because an event occurs contrary to a warranty given by the seller. On that basis, although a buy-side policy falls fully within the general statutory definition of insurance in Article 1882 of the ICC,²¹ it is not liability insurance of the kind represented by a sell-side policy. It should instead be classified within the residual non-life class of “miscellaneous financial loss”.²²

Irrespective of their classification as insurance contracts and the particular class to which they belong, the introduction of W&I policies into the Italian market initially gave rise to concern because of their apparent conflict with Article 4(2) of Regulation No. 29 of 16 March 2009, issued by IVASS, the Italian Institute for the Supervision of Insurance, concerning the classification of risks within classes of insurance. That provision states that “cover may not be issued to guarantee reimbursement of subsequently arising liabilities or decreases in the value of assets resulting from valuations made in connection with extraordinary corporate transactions”. It was therefore legitimate to ask whether this difficult provision precluded policies intended to neutralise the risk of loss arising from warranties negotiated in the context of “valuations made in connection with extraordinary corporate transactions”.

IVASS addressed the issue expressly on 25 July 2019, when it published a frequently asked question - a somewhat unusual designation in this context, but a sign of the times - asking whether Article 4(2) of Regulation No. 29 of 2009 applied to policies covering risks arising from the inaccuracy or breach of specific representations and warranties given in the context of an extraordinary corporate transaction, namely W&I policies.

The answer, itself not immediately straightforward, considered sell-side and buy-side policies separately and confirmed that both are permissible, subject to certain qualifications.

Policies taken out by the seller are permissible where they are “intended to insure the risk arising from the seller’s own indemnification obligations in the event of a breach of specific representations and warranties given by the seller to the buyer in the context of an extraordinary corporate transaction”. As discussed above, that is the paradigm case for a sell-side policy.

Policies taken out by the buyer were likewise regarded as permissible, but only where they are based on “specific and identified commitments that do not derive from valuations, are capable of an adequate actuarial assessment of the risk, and may give rise to indemnities that do not coincide with the consideration paid in the extraordinary corporate transaction”. The Authority’s reasoning is more elaborate here. On closer examination, however, and as has been persuasively observed,²³ it largely restates general principles of insurance law. First, the requirements of sound and prudent management applicable to insurers necessarily demand that the insurer’s commitments be supported by an adequate actuarial assessment of risk rather than by mere valuations, which inevitably retain an element of

²¹ “Insurance is a contract under which, in exchange for payment of a premium, the insurer undertakes, within the agreed limits, to indemnify the insured against loss caused by an insured event, or to pay a capital sum or an annuity upon the occurrence of an event relating to human life” (Article 1882 of the ICC). In this case, the insured event is the economic loss described in the text, which is necessarily uncertain when the policy is entered into.

²² See P. RAINELLI, “Le polizze assicurative ‘Warranty and Indemnity’”, cited above n. 17, at 443. Under Article 2(3), class 16, of Legislative Decree No. 209 of 7 September 2005 (the Italian Private Insurance Code), miscellaneous financial loss comprises: “employment risks; insufficiency of income (general); bad weather; loss of profits; continuing general expenses; unforeseen trading expenses; loss of market value; loss of rent or revenue; indirect trading losses other than those mentioned above; non-trading financial loss; other financial loss”.

²³ A. TINA, *Le polizze W&I* (Milan: Giuffrè, 2023), at 97 *et seq.*

discretion even when properly performed. Secondly, the requirement that the indemnity not coincide with the transaction consideration appears to reaffirm the indemnity principle governing non-life insurance. It excludes a speculative purpose, which would arise if the amount payable equalled the consideration regardless of the loss actually suffered.²⁴

4. Synthetic Warranties as an Evolution of Buy-Side W&I Insurance

As we have seen, conventional W&I insurance, notwithstanding the variations described above, presupposes - and indeed requires - a preliminary exchange between buyer and seller concerning the warranties that will form the core of the policy.

During underwriting, the insurer will ask to review the due diligence reports prepared by the buyer's advisers and to receive confirmation that those advisers had access to a properly organised data room and an opportunity to engage with the seller and its advisers, so as to identify and understand any issues emerging from due diligence.

The insurer will also want to establish that both parties negotiated the seller's warranties with an adequate understanding of the due diligence findings. In particular, it will generally decline to cover warranties concerning matters on which the buyer appears not to have conducted an adequate investigation. Suppose, for example, that a due diligence report concerning real estate owned by the target company records that the data room contained no documentation confirming the absence of encumbrances. The insurer would reasonably refuse to cover the risk arising from a seller's warranty that "the property is free from registrations or filings having an adverse effect, liens, charges, encumbrances or third-party rights of any kind". The reason is clear and consistent with the principles reiterated in the IVASS guidance: insurance is not a wager. The insurer must satisfy itself that the risk is sufficiently capable of definition and has been properly assessed by the parties during negotiations.

That is the conventional W&I market. In some circumstances, however, the seller may be unwilling or unable either to provide adequate support during due diligence or to give any warranties.

There may be several reasons. The seller may lack the organisation and professional support required for a demanding contractual process. Alternatively, there may be no seller in the conventional sense with whom warranties can be negotiated, as where real estate is transferred following enforcement proceedings. The seller may also be subject to judicial liquidation, in which case it may be unrealistic to expect warranties or due diligence assistance extending beyond the production of a small number of essential documents.

Finally, and not infrequently, the prospective buyer itself may decide not to request substantial warranties from the seller, so as to make its bid more attractive in a competitive process²⁵ and thereby outperform other bidders.

To ensure that a buyer can nevertheless obtain protection in these circumstances, insurers in certain markets have begun to offer so-called synthetic policies. These policies operate by reference to

²⁴ It remains open to question whether the Authority might have expressed its reasoning more clearly, especially since, as a matter of commercial practice, damages for breach of warranty are invariably capped at a percentage of the purchase price, save in exceptionally serious cases that will almost always undermine the very basis (*causa*) of the contract.

²⁵ A. BORSELLI, "Insurance in M&A Transactions", in *The Governance of Insurance Undertakings*, AIDA Europe Research Series on Insurance Law and Regulation, vol. 6 (2022), at 207.

“warranties” negotiated directly between buyer and insurer and therefore do not depend on the existence of an indemnity agreement with the seller.²⁶

This contractual route differs materially from the structures considered thus far. The first question is whether these new policies genuinely qualify as contracts of insurance. In our view they do. It is important, however, not to be misled by the colourful market term “synthetic warranties”.

The policies are described as synthetic because they combine, or synthesise, otherwise separate contractual instruments: a set of warranties, ordinarily negotiated between seller and buyer, and the insurance policy are brought together in a single contract. The insurer plainly gives no warranty in the true sense in which a seller would do so. Rather, the set of “warranties” negotiated between the insured buyer and the insurer identifies risk events that may cause loss to the buyer after completion of the acquisition. Those events may correspond to circumstances ordinarily addressed by contractual warranties given by a seller.

An example may assist. Assume that a buyer wishes to acquire development land from a company in judicial liquidation. The insolvency office-holder permits access to documents, most of which have been obtained from public registers, and the transfer is made subject only to the statutory warranties attaching to the transfer of title. The office-holder will not give any additional warranties, including as to the absence of contamination, although the buyer is allowed to undertake specific environmental investigations at its own expense. Protection on this issue is fundamental to the buyer, which instructs its technical advisers to conduct surveys and take soil samples. The results give the buyer reasonable confidence that no material risk threatens its development project. Given the importance of the issue, however, it still seeks contractual protection, which would also improve its prospects of obtaining real estate financing.

A synthetic policy may be particularly useful in this situation. The insured buyer and the insurer can isolate the risk that would arise from the notional breach of a warranty ordinarily given by a seller in a comparable real estate transaction - for example, “the seller represents and warrants that no contaminating substances are present on or beneath the land”. That notional breach may consist in the discovery, during preparatory excavations and despite the investigations already undertaken, of contamination requiring remediation. The synthetic policy can then cover the resulting loss: the additional cost, and thus the reduction in profit, borne by the buyer because it must fund remediation that was not included in its original business plan.

A synthetic policy is therefore a particular form of buy-side insurance in which the scope of the insured risk does not derive from a warranty negotiated with the seller, because the seller gives none, but is defined directly by the buyer and the insurer. Consistently with the analysis of buy-side policies above, we consider that a synthetic policy falls within the statutory model of an insurance contract under Italian private law and, for regulatory purposes, within the residual class of miscellaneous financial loss.²⁷ The sole difference from a conventional buy-side policy lies in the method used to identify the insured risk. A conventional buy-side policy does so *per relationem*, by reference to the indemnity

²⁶ Cover for “synthetic” risks, initially offered only for tax matters, has gradually extended to the other subjects ordinarily addressed by traditional representations and warranties. Synthetic policies have been available in the United Kingdom for some time and, to our knowledge, have been proposed in a number of extraordinary transactions carried out in Italy over the past two years. Their use has not yet developed into established market practice in Italy.

²⁷ Synthetic policies are also briefly classified as a subtype of buy-side insurance by P. RAINELLI, “Le polizze assicurative ‘Warranty and Indemnity’”, cited above n. 17, at 460-461; and A. TINA, *Le polizze W&I*, cited above n. 22, at 118.

agreement; a synthetic policy, in the absence of a warranty agreement with the seller, defines that risk through direct negotiation between buyer and insurer.

Underwriting is more complicated in this context. The seller's lack of active involvement does not dispense with due diligence by the buyer. If anything, that investigation becomes still more important, although it must rely on sources other than the professionally prepared data room ordinarily provided by the seller's advisers. Correspondingly, the insurer will have no meaningful opportunity to engage with the seller. Insurers may still seek some contact, but cannot place legally relevant reliance on it and must ultimately rely on the work undertaken by the buyer and its advisers.

These features materially affect the negotiation of the policy and will generally result in a higher premium. First, the scope of cover is likely to be narrower than under a conventional W&I policy because due diligence will usually have been less extensive and less searching.

Secondly, the absence of contractual warranties given by the seller will, as a matter of principle, prevent the insurer from exercising recourse against it,²⁸ subject to two important exceptions. The sale and purchase agreement, even if reduced to a contractual minimum, may preserve certain statutory warranties of the seller, some of which may be reflected in the insured statements. In that event, the insurer may pursue the seller by subrogating to the insured buyer's rights arising from breach of the statutory warranty.

The second exception arises where the seller has fraudulently concealed material circumstances that, if known to the buyer, would have caused it either not to enter into the agreement or to do so on different terms. Irrespective of any express warranty, such conduct may constitute fraud that either induced the contract or affected its terms ("*dolo determinante*" or "*dolo incidente*"), entitling the buyer to claim damages from the seller. To the extent that the seller's fraud concerns a matter covered by the synthetic policy, there is a sound basis for concluding that the insurer may exercise recourse against the seller. The insurer will, however, face a demanding evidential burden: it must prove subjective states of mind and aspects of the buyer's decision-making in negotiations to which it was not a party, or in which it was involved only indirectly. From a drafting perspective, an insurer issuing a synthetic policy would therefore be well advised to strengthen the cooperation clauses ordinarily found in W&I policies and to require more extensive assistance from an insured in support of any such subrogated claim.

In conclusion, despite the significant issues that may arise in their application, synthetic warranties - once stripped of their exotic commercial label - could become a valuable instrument in the Italian market. Their flexibility allows them to respond to changing market requirements and to provide bespoke solutions to the challenges posed by extraordinary transactions. Their development and application deserve close attention, as they may materially reshape risk allocation in M&A transactions.

²⁸ P. RAINELLI, "Le polizze assicurative 'Warranty and Indemnity'", cited above n. 17, at 461.