IN THIS ISSUE

The popularity of representations and warranties insurance policies (R&WI Policies)—designed to protect parties from loss arising from breaches of representations and warranties in corporate deals—has expanded dramatically in recent years and, with it, the frequency of claims submitted under such policies. We address key lessons that, based on our experience, companies shopping for or asserting claims under R&WI Policies should bear in mind throughout the process.

1 REPRESENTATIONS AND WARRANTIES INSURANCE POLICIES – LESSONS FROM THE CLAIMS PROCESS

Representations and warranties insurance policies (R&WI Policies)—designed to protect parties from loss arising from breaches of representations and warranties in corporate deals—are not a new phenomenon; they were introduced in the marketplace over 15 years ago. But the popularity of R&WI Policies has expanded dramatically in recent years and, with it, the frequency of claims submitted under such policies. The growing volume of claims experience under R&WI Policies has confirmed their significant value to acquiring and selling businesses alike. That experience also has revealed, however, certain key lessons that companies shopping for or making claims under R&WI Policies should keep in mind throughout the process.

Background

First offered in 1999, R&WI Policies are generally intended to provide coverage for breaches of representations and warranties made by the seller (or acquired entity) in a purchase agreement. These policies serve as either a supplement to, or in some instances a substitute for, the sellers' obligations to maintain a portion of the transaction price in escrow to ensure that funds are available to indemnify the buyers in the event of a breach. Although coverage is available for both buyers and sellers, the vast majority of R&WI Policies underwritten are buyer-side policies

in which the acquiring company or its affiliate is the named insured.

There are now at least 17 insurance carriers that offer R&WI Policies, and as the number of policies placed each year continues to grow, new carriers continue to enter the marketplace. The volume of claims submitted has, not surprisingly, expanded along with the number of R&WI Policies placed. The adjustment of claims under R&WI Policies raises complex issues, and a specialized claims practice is quickly developing.

Types of Claims

Claims under buyer-side R&WI Policies are generally first-party claims made by the insured buyer against the insurance carrier that placed the policy. Although specific policy terms may vary, the claims process typically includes the insured buyer's submission of a notice of claim, followed by a more detailed proof of loss specifying the nature of the breach, the specific facts and circumstances establishing the breach, and a calculation of the damages resulting from the breach. The insurance carrier will then provide the insured buyer a written evaluation of the proof of loss, to which the buyer may provide a rebuttal. At that point, the parties will typically negotiate over the claim in an effort to resolve it.

If those negotiations fail, the insured buyer may elect to proceed with the claim under the dispute resolution process set forth in the policy, which is most frequently submission of the claim to binding, confidential arbitration. Many R&WI Policies provide for a "closed" arbitration, which, generally speaking and subject to certain exceptions, is limited to the parties' submissions and other materials exchanged during the claims process, such as the notice of claim, proof of loss, evaluation, any mediation materials, and so on. This may reduce the overall cost of the arbitration, and it helps to promote the full development of the parties' positions and evidence as part of the claims process. Because most claims are arbitrated and the arbitrations are confidential, there is little to no public legal precedent concerning R&WI Policy terms, and such precedent may be slow to develop. Experienced claims counsel with an understanding of how policy terms are interpreted in practice is therefore critically important.

Challenges for All Parties

The claims process poses challenges for both insurance carriers and insureds. The underlying legal claims often relate to alleged breaches by the sellers, but the sellers are not generally parties to the R&WI Policies or active participants in the claims process. Carriers are therefore tasked with adjusting a claim that a representation or warranty has been breached without the benefit of arguments, much less supporting evidence, from the party accused of the breach. The adjustment of claims thus requires significant diligence by carriers. Carriers have an obligation to adjust claims in good faith, and they take that obligation seriously.

For insureds, a thorough and well-supported proof of loss in support of a claim is therefore necessary, but not sufficient, to establish entitlement to payment. Even after providing such materials, insureds must be prepared for and cooperate with requests from insurance carriers for additional documents and information as the carriers evaluate the claim. Often, the nature of the alleged breaches will require both the insureds and the carriers to obtain assistance from experts. All of these steps take time, and insureds should not expect an immediate decision on or resolution of their claim. Even so, the claims process may generally be faster and less expensive for insureds than litigating post-closing indemnification disputes against sellers to recoup escrow funds.

To the extent that R&WI Policies supplement, rather than wholly replace, escrow and seller-indemnification obligations, insured buyers should also expect that insurance carriers will pay close attention to how the buyers resolve their separate indemnity claims against the sellers. Under a typical (though by no means universal) policy structure, the seller is effectively responsible for a portion of the policy retention through the indemnification escrow, with the insured buyer responsible for the remainder of the retention. This structure is popular for the insured buyer because it reduces the buyer's exposure for the retention, and is of benefit to the carrier because it provides an incentive to the buyer to thoroughly vet the entity it is acquiring before closing. This also serves as an incentive to the seller to pay close attention to the representations and warranties it is making in the deal.

On the other hand, when a policy is structured in this way, carriers may view skeptically claims by insured buyers who seek to settle their indemnity claims with sellers for substantially less than the full escrow amount and then seek to recover the full quantum of damages from the carriers. Insured buyers should therefore consider their indemnity claims and their insurance claims as part of a single coherent strategy and avoid undermining their insurance claims through the manner in which they settle their indemnity claims with sellers (which the carriers must typically approve in advance under the R&WI Policies). Most R&WI Policies also provide for subrogation rights by carriers against the sellers in circumstances of fraud, which will further necessitate the coordination of such indemnity and insurance claims.

Next Steps

Companies seeking R&WI Policy coverage should shop with the claims process in mind. Choosing a policy based on cost alone may be a false economy if the insurance carrier is inexperienced or lacks a track record of paying meritorious claims. While claim settlements and arbitrations

are often confidential, an insurance broker with experience in the marketplace can advise on carriers with whom past clients have had positive claim experiences, and purchasers should carefully consider such advice. The policy forms themselves are also highly negotiable and customizable, and small changes in phrasing can have immense consequences in the claims process. Companies purchasing such policies should always consult with experienced counsel.

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2 REGIONAL CASE SUMMARIES

CALIFORNIA

Class Action Need Not Show Feasible Way to Identify Absent Class Members: In *Briseno v. ConAgra Foods, Inc.*, No. 2:11-cv-05379 (9th Cir. Jan. 3, 2017), the Ninth Circuit joined the Sixth, Seventh and Eighth Circuits in holding, contrary to the Third Circuit, that Federal Rule of Civil Procedure 23 does not require class representatives to demonstrate an administratively feasible means of identifying class members. The defendant had challenged certification of a class of persons who purchased cooking oil, arguing that there was no administratively feasible way to identify the class members. The Ninth Circuit held that the superiority requirement of Rule 23 already includes a general manageability criterion, that Rule 23 does not require actual notice to each individual class member, that the risk of fraudulent or illegitimate claims is low, and the defendant will have the right to challenge claims submitted by absent class members.

Court Finds Potential Consumer Reliance and Injury Even Where Allegedly False Advertisement is Corrected Prior to Purchase: In *Veera v. Banana Republic, LLC*, 6 Cal. App. 5th 907 (2d Dist. 2016), the plaintiffs filed a putative class action alleging they were lured into the defendant's stores by advertisements for a "40 percent off" discount and, after being told that their desired items were not on sale, proceeded to purchase the items at full price based on "embarrassment" and having otherwise wasted time and energy shopping. The court held that these supposed facts, if proven, could establish that the plaintiffs had relied on the allegedly false advertisements and had been injured when they purchased at full price rather than the allegedly advertised discounted price.

U.S. Supreme Court Grants Review of Sweeping California Supreme Court Personal Jurisdiction Ruling: As described in our last issue, the California Supreme Court held in *Bristol Myers Squibb Co. v. Superior Court of San Francisco County*, S221038 (Cal. Aug. 29, 2016), that 592 non-resident plaintiffs could join a California court lawsuit filed by California residents against an out-of-state defendant because all the plaintiffs alleged the same kind of tort claim, even though the non-residents did not allege any product exposure in California. On January 19, 2017, the United States Supreme Court granted the defendant's petition to review that decision, which could result in a vast expansion of personal jurisdiction if left uncorrected.

DELAWARE

Directors' Outside Relationships May Excuse Shareholder's Failure to Make Demand. In *Sandys v. Pincus*, 2016 WL 7094027 (Del. Dec. 5, 2016), the Supreme Court of Delaware held that certain directors' alleged outside relationships with interested persons were sufficient to

establish that a majority of directors lacked independence and thus to permit a shareholder derivative action to be filed without making a demand on the board. One director co-owned an airplane with the company's former CEO and controlling shareholder, while two other directors were partners at a venture capital firm that controlled almost 10% of the company's stock. The court held that, at the pleading stage, these facts created a reasonable doubt as to the directors' independence, and thus excused the need for the plaintiff to have made a demand on the board. *Sandys* continues the Delaware Supreme Court's trend toward closely scrutinizing the personal relationships between directors and interested persons in assessing director independence.

Chancery Court Warns Against Generic Discovery Objections. In *In re Oxbow Carbon LLC Unitholder Litigation*, C.A. No. 12447-VCL (Ct. Ch. Mar. 13, 2016), Vice Chancellor Laster issued a strong reminder that parties may not assert generic, boilerplate objections when responding to discovery. He explained that a formulaic objection is "no objection at all." Instead, "the objection must be specific" and "the party making it must explain why it applies on the facts of the case to the request being made." He added that where documents are withheld on the basis of privilege, the withholding party must provide "facts" showing the basis for the privilege, work product objections must "identify the litigation that was being contemplated," and privilege logs likewise may not use brief, generic descriptions.

MASSACHUSETTS

Chapter 93A Claim Not Barred by Contractual Liability Limitation Clause: In *ABCD Holdings, LLC v. Hannon*, No. 15-1367-BLS2 (Mass. Super. Ct. Jan. 17, 2017), the defendant, guarantor of a $219,759 loan to two companies, argued that a provision in the guaranty limiting his liability to "no more than $109,879" barred the plaintiff's chapter 93A claim. The Business Litigation Session denied the defendant's motion to, holding that a contractual limit on liability does not bar recovery under chapter 93A where the claim "is more tortious in nature" and does not depend wholly on a breach of contract claim. The court further held that the allegations that the defendant had made it impossible for the debtor companies to repay the loan sounded in tort, meaning that the chapter 93A claim was not subject to the contractual limitation of liability.

Employer Owed Duty of Care to Third Party Whose Personal Information was Misused by Employee: In *Adams v. Congress Auto Ins. Agency, Inc.*, 90 Mass. App. Ct. 761, 65 N.E.3d 1229 (2016), the plaintiff's car was struck by a vehicle owned by one of the defendant's employees. The employee subsequently accessed confidential data that the plaintiff had provided to the employer and passed that information to her boyfriend, who made a threatening call to the plaintiff. The plaintiff then sued the employer for its alleged negligent failure to protect his personal information. The court observed that, under Massachusetts law, an employer may owe a duty of care where an employee's job enables the employee to harm third parties. In this case, the court held that the employer owed the plaintiff a duty to prevent the employee's foreseeable misuse of the confidential information that he had provided in connection with his insurance claim and that a jury could find that the employer had breached that duty.

Employer's Alleged Contract Breach Not a Defense to Enforcing Non-Competition and Non-Solicitation Covenants Against Former Employee: In *United Salvage Corp. of America v. Kradin*, No.16-03131-BLS2, 2016 WL 7735765 (Mass. Super. Ct. Nov. 8, 2016), an employer sought a preliminary injunction enforcing non-competition and non-solicitation covenants against a former employee whom it had fired. The employee argued that the employer had fired him without cause and otherwise breached its obligations to him. But the Business Litigation Section enforced the covenants against the employee, holding that the covenants were independent obligations and that any claim against the employer was not a defense to their enforcement.

NEW YORK

Court Expands Factors Used to Analyze Non-Monetary Settlements. In *Gordon v. Verizon Commc'n, Inc.* , 2017 WL 442871, 2017 N.Y. slip op. 00742 (1st Dep't, Feb. 2, 2017), holders of Verizon stock alleged that the board had breached its fiduciary duties by overpaying to acquire another entity and by failing to disclose material information. Following negotiations, the parties proposed a non-monetary settlement under which Verizon would (1) make additional disclosures, (2) obtain an independent fairness opinion for certain transactions, and (3) agree not to oppose a fee and expense application from plaintiffs' counsel up to exceeding $2 million. On appeal from an order rejecting the settlement, the First Department revised the long-standing five-factor test for analyzing non-monetary settlements by adding two new factors: whether the relief is in the best interest of the members of the putative class, and whether the settlement is in the best interest of the corporation. Based on the totality of the now-seven factors, the court held that the settlement should be approved.

Use of New York Correspondent Bank Accounts Held to Create Personal Jurisdiction. In *Rushaid v. Pictet & Cie*, 28 N.Y.3d 316, 2016 N.Y. slip op. 07834 (2016), a Saudi company sued a Swiss bank and its partners in New York for allegedly laundering kickbacks obtained by certain of the plaintiff's employees, and the defendants moved to dismiss for lack of personal jurisdiction. The Court of Appeals noted that

personal jurisdiction exists if the plaintiff's claim arises from the defendant's "purposeful activities" in New York. Applying that test, the court held that the defendants' use of a New York correspondent bank account was purposeful rather than passive, since the defendants had repeatedly approved deposits and the movement of funds through the account, even though a third party had made the deposits themselves and given the bank instructions to transfer the funds.

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3 MAKING AN IMPACT: PARTNERS IN THE NEWS

Privacy Shield Seems Safe, But Have a Backup Plan
Wall Street Journal

March 22, 2017
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Home Depot Deal May Spur Banks to Sue Data Breach Targets
Law360, Brenda Sharton

March 14, 2017
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Goodwin Shortlisted as "US Law Firm of the Year" at 20th Legal Business Awards
Legal Business UK

March 02, 2017
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Marketing Partner Forum Video: Goodwin's Caplan on How Law Firms Should Partner with Clients
Technology Media, Michael Caplan

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Goodwin Returns to Freshfields for New York Litigation Hires
Legal Business

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Orrick Losing Star IP Litigator to Goodwin
*Wall Street Journa*l, Neel Chatterjee

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Trump Travel Ban Brings Offers of Help From Lawyers of all Stripes

Massachusetts Lawyers Weekly

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Life Sciences Group of the Year: Goodwin
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FTC's Smart-TV Privacy Settlement Unlikely to See an Encore
Law360, Karen Neuman

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DC Ethiopian Woman Alleges Housing Discrimination at Building Near U Street Corridor
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Snapchat Maker Files Long-Awaited $3B IPO
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Saugus to Sift Through Ash Landfill Proposals
Itemlive.com, John Daukas

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The American Lawyer, Blake Liggio

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John Kelly's Homeland Security Hearing: 3 Questions Congress Must Ask
Wired, Karen Neuman

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Marketing Co. Wants $1.4M Award to Asset Manager Nixed
Law360, Brenda R. Sharton and Joseph P. Rockers

December 08, 2016

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