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Mergers and Acquisitions ALERT
JUNE 2018

# Getting to Yes: Utilizing Reps and Warranties Insurance to Facilitate M&A Transactions

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Record numbers of M&A transactions were announced in 2017, and that number is expected to increase in 2018. That doesn't mean, however, that every announced deal is completed, that the process is always smooth, or that buyers' expectations were always met. The uncertainty that often abounds in the M&A context, concerning everything from the seller's corporate governance to its cyber security posture, can create obstacles that can impede and even derail a transaction.

To facilitate the process of getting to "yes," more and more companies are turning to Representations and Warranties (R&W) insurance. R&W insurance can be a key transaction facilitator, which protects a party in the event of post-sale discovery of incorrect representations and warranties in a sales contract.

**Overview of R&W Insurance**

Once a relatively obscure form of coverage, R&W insurance uptake is on the rise, particularly in middle market deals in the range of $100 million to $500 million. A seller-side policy protects the seller from claims that it breached a representation or warranty. Under a buyer-side policy, the risks associated with those seller breaches are transferred to the insurer, thereby eliminating or reducing the seller's liability. As more insurers, managing general agents and managing general underwriters have entered into the market, policy terms have improved, and data shows that valid claims under the policies are paid.

**R&W Coverage Considerations**

Here are some key issues to consider when contemplating the use of R&W insurance:

1. Costs

Calculating the true cost of R&W insurance to each party requires consideration of several issues. The first is the policy's retention (or deductible), which is generally expressed as a percentage of the value of the transaction. Minimum retentions usually are 1%. Parties should anticipate the possibility of an R&W claim in advance, and by agreement allocate between themselves responsibility for any retention.

The actual policy premium is another cost issue. Premium amounts are generally based on the amount of coverage desired, not on the size of the transaction, and usually range between 2.5% to 4% of the coverage limit. As with the retention, responsibility for payment of the premium is an issue for negotiation between the parties.

2. Scope of Coverage

Virtually any representation can be insured. The facts and circumstances claimed to exist will be specific to each individual transaction, but representations and warranties concerning corporate authority and organization, financial statements, regulatory compliance, full disclosure of liabilities, title to assets, important contracts, and intellectual property usually are insurable.

3. Policy Exclusions

R&W policies are likely to have deal-specific exclusions. Insurers will often consider industry-specific exclusions at the quote stage, and they may have some standard market exclusions such as asbestos. In addition, R&W policies sometimes incorporate exclusions for known issues, including those discovered during due diligence.

**R&W Insurance as a Deal Facilitator**

R&W insurance can be thought of as a transaction facilitator, which provides coverage in the event of post-sale discovery of incorrect representations and warranties in a sales contract. It should be considered in the context of other available options, such as price adjustments and escrow holdbacks, to mitigate the risks of the deal. Notably, however, some alternatives can be more expensive than R&W coverage and may not alleviate certain important obstacles to the deal.

For example, a simple purchase price adjustment can stoke resentment between the parties at a critical moment, and can also miss the mark if events do not unfold as expected. Escrow holdbacks can tie up significant funds for months or years, and determining how to draw down from them is problematic. Offsets against compensation or revenues can entail ongoing relationships that neither party wants.

Savvy advisors can use R&W insurance as a negotiation tool, a straw man, or simply for strategic breathing room. The buyer can offer to pay for all the costs as a sweetener in a seller's market. Or the parties can split or otherwise redistribute the costs, to help solve negotiation issues. Insurers can also be used as a sounding board in the final stages of a deal by either party.

R&W insurance can also benefit the buyer by removing time-consuming issues from the negotiation process and by making its bid more attractive to the seller. The coverage also can help in situations where pursuing post-deal claims against the seller is difficult, such as when there are multiple seller-side parties in diverse jurisdictions.

**Takeaway**

While there are several forms of purchase price protection available to M&A advisors, R&W insurance is particularly well-suited to helping deals close. By relieving the parties of major forms of post-closing liability, or by taking the seller out of the ongoing business entirely, it clears a path to accord. In addition, it can provide several opportunities to distribute costs and liabilities in a bespoke fashion. By learning and understanding the nuances of R&W insurance, M&A practitioners can take advantage of a valuable instrument for finalizing deals.

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