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REPRESENTATIONS AND WARRANTIES INSURANCE (RWI) SOLUTIONS FOR STRATEGIC ACQUIRERS

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With some notable exceptions, strategic acquirers have been slower than other M&A market participants to adopt RWI. However, as RWI has developed into a more robust and flexible product, and sellers have been less willing to provide broad indemnity packages, strategic acquirers have started using RWI more frequently, particularly during auction processes, or when acquiring targets bilaterally from private equity sellers. This note examines the benefits of using RWI for strategic acquirers.

1. Eases Negotiations and Enhances Protection:

Sellers are far more likely to give a broad suite of representations and warranties, including broadly drafted representations for higher risk matters such as condition of assets, product liability, cybersecurity, data protection and intellectual property, if there is nil/limited liability under the purchase agreement.

Further, RWI insurers can offer enhancements under the policy, providing an insured with positions that would otherwise likely not be agreed to by the seller under the purchase agreement, including (i) scraping away materiality qualifiers (including MAEs); (ii) broader loss definitions, including cover for indirect and consequential losses and silence with respect to multiplied losses; (iii) extending survival periods to seven years for key representations (e.g., intellectual property representations on software company acquisitions); and (iv) providing larger caps, with strategic acquirers often buying up to 30% of enterprise value as a policy limit, far more than most sellers are willing to offer under purchase agreements. If sellers are unwilling to provide certain more standard positions such as repeating the representations at closing or providing a tax indemnity, RWI insurers are also willing to do this "synthetically" (i.e., directly under the policy).

2. Internal Diligence:

Strategic acquirers commonly utilize their internal experts to lead key due diligence workstreams (e.g., finance, technical, insurance) as opposed to engaging third-party advisors. Insurers are now much more comfortable underwriting policies based on internal due diligence provided the due diligence scopes are commensurate with the risks being covered by the insurer. Certain insurers are even comfortable underwriting policies based on no or very limited written due diligence, so long as they can get comfortable during the underwriting call with the work that has been undertaken.

Atlantic's legal, financial, tax and insurance specialists assist in scoping the due diligence exercise at the outset of a transaction. We do this to ensure we select an insurer whose diligence expectations align with the buyer's due diligence process, as opposed to amending the due diligence process to meet the expectations of an insurer. This approach is particularly useful on transactions where the target operates across numerous geographies, and ensures broad RWI cover with no last minute surprises.

3. Competitive Premiums and Retentions:

Atlantic approaches the entire market of ~30 RWI insurers to secure the best possible pricing, retention and cover. For deals with enterprise values of $51m – $1b, strategic acquirers typically purchase policy limits of 10 – 30% of the enterprise value, with current premium rates for a 10% limit being ~2 – 2.5% of the limit purchased (the "rate on line" or "ROL"), significantly less than historic averages of ~3 – 4% ROL. Rates for larger deals or with limits of 20 – 30% of enterprise value are even lower, often less than 2% ROL. Similarly, initial retentions are now typically ~0.5% of the enterprise value and drop to 0.3% of the enterprise value 12 months after closing. For large or particularly desirable transactions, the retention can be even lower.

4. Strength of Indemnity:

Strategic acquirers often prefer having an A-rated institutional counterparty when negotiating a claim for a breach of representation, warranty or indemnity. This is particularly the case when the sellers are individuals, a closed-end fund or not based in the US/Canada and has proven to be extremely helpful for seller fraud claims, which constitute a significant portion of large claims under RWI policies.

5. Preserves Commercial Relationships:

Strategic acquirers are frequently able to exert significant influence over sellers in order to obtain their desired suite of representations. This leverage during contractual negotiations often does not translate to a claim scenario due to the strategic acquirer's competing incentives, e.g., not wishing to claim against sellers who are now key employees. Claiming against an insurer instead of an employee solves this issue.

On an uninsured deal, when the breach of a representation arises from a supplier's conduct, the seller may assert that the strategic acquirer's primary recourse is against the supplier to the extent that supplier's action caused the breach. Pursuing such claims would likely damage the target and strategic acquirer's ongoing commercial relationships. RWI can help avoid these issues and preserve commercial relationships: Atlantic will negotiate with insurers so that (i) the strategic acquirer is not required to seek direct recourse with key suppliers that would disproportionately impact these commercial relationships, and (ii) the insurers ability to assert subrogation rights against key suppliers under the RWI policy is minimized.

6. Claims Processes:

Atlantic's market-leading claims team, led by a US insurance litigator with more than 15 years of experience (i) understands how RWI insurers think and behave during claims processes, and (ii) uses this knowledge to work closely with counsel and guide strategic acquirers with their claims process in an efficient manner. A particular focus is placed on collating the information required to assess the quantum of loss (particularly the application of a multiple).

In one recent example, Atlantic leveraged its claims experience for a strategic acquirer to anticipate key questions and identify the necessary documentation to substantiate the quantum of loss based on a purchase price multiple, all before the insurer asked for the information. This resulted in an expedited, positive outcome for the strategic acquirer.

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Strategic acquirers are also looking towards RWI and ancillary transactional insurance products to assist with public transactions and other potential exposures arising during deal processes:

1. **Take-privates:**

   RWI is widely available for take-privates, with cost, cover and an underwriting process broadly comparable to what is available on private transactions. However, some policy adjustments are required to reflect take-private transaction structures. – see here for more details.

2. **Known Issues:**

   The RWI market has evolved to cover identified issues that historically would have been subject to a specific indemnity (e.g., a known tax liability or an identified issue that could result in future litigation). Atlantic's specialist tax and contingent risk practices are able to quickly assess and develop bespoke solutions for such known issues, facilitating the closing of transactions without the need for specific indemnities/escrows.

3. **Reverse Termination Fees (RTF):**

   Strategic acquirers are often requested to enter into RTF agreements in order to engage in a transaction. Atlantic can help strategic acquirers "level the playing field" by proactively offering sellers a RTF that is backed by insurance in return for a fixed, one-time premium that is far less than the RTF amount. – see here for more details.

CONTACTS


Richard French
Founding Partner
(917) 789-3566
richard.french@atlanticgrp.com


Hannah Ellithorpe
Executive Director
(917) 819-0028
hannah.ellithorpe@atlanticgrp.com


Carolyn Stroz
Managing Director
(416) 639-9971
carolyn.stroz@atlanticgrp.com


David Haigh
Founding Partner
(917) 617-7951
david.haigh@atlanticgrp.com


Ido Mor-Chaim
Managing Director
(929) 699-3515
ido.mor-chaim@atlanticgrp.com


Alexandra Fischbein
Senior Vice President
(617) 663-8174
alexandra.fischbein@atlanticgrp.com


Alvin Reynolds
Managing Director
(781) 819-4837
alvin.reynolds@atlanticgrp.com


Ben Prebble
Managing Director
(310) 954-0895
ben.prebble@atlanticgrp.com


Ivan Biros
Senior Vice President
(415) 599-5556
ivan.biros@atlanticgrp.com