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# Trending Issues in Negotiation of Indemnification Provisions

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## Overview of Representation & Warranty Insurance

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## Rep & Warranty Insurance Summary

- **Typical coverage of rep & warranty insurance (“RWI”):**
  - RWI generally covers breaches of sellers’ reps and warranties in a definitive acquisition agreement
  
- **Potential benefits of RWI:**
  - Enhance auction bid or bridge negotiation gaps (price, length of claim period)
  - Reduce seller escrow amounts and overall indemnity exposure
  - Ease process by streamlining negotiation/documentation of agreement

## Rep & Warranty Insurance Summary

- **Growth of RWI**
  - RWI introduced in US in late 1990s, but initially used sporadically
  - RWI usage has grown dramatically since 2012
    - Pre-2012, market wary of collectability of claims and viewed RWI as prohibitively expensive and time consuming to obtain
    - ~2012, perception shifted
      - lower premiums and increased demand
      - allowed insurers to expand capacity, enable more flexible and expedient underwriting, and simplify claims process (claims paid in ordinary course)
  
- **Impact on auctions**
  - Pre-2015, early users of RWI had a competitive bidding advantage and could often preempt auctions with favorable terms
  - From 2015, bidders may be at competitive disadvantage without RWI (or offer of RWI-like indemnity terms, self-insuring the risk)

## Rep & Warranty Insurance Summary

- **Exclusions**
  - Known breaches of reps (“actual knowledge of actual breach” by identified deal team members of the insured)
  - Vary by deal (and specialty policies may cover exclusions), but often include:
    - Environmental issues (absent clean Phase I reports)
    - Employee classification / FLSA issues
    - Certain state tax issues
    - Specific issues identified in underwriting
  - Other matters usually not covered include any adjustments to purchase price, breaches of seller covenants, punitive damages

## Rep & Warranty Insurance Summary

- **Typical context**
  - PE seller (seller seeks quick/unconditional return of capital to LPs)
  - Middle market between \$100-\$500MM of enterprise value (“EV”)
    - Not yet efficient for <~\$5MM of risk, but trending downward
    - Risk amounts >\$50MM may require syndication, which reduces certainty of coverage and thus utility of RWI in bid process
- **Pricing fairly consistent, assuming clean underwriting:**
  - Total cost: ~50 basis points of EV (for policy for 10% of EV)
  - Premium typically ~4% of policy limit plus minor underwriting costs
- **“No seller indemnity” deals**
  - Can utilize RWI to provide a public company style deal with no seller indemnity (“NSI”)
  - NSI policies available, but at higher price (+~25-75 BPs)
  - Buyers/insurers leery of removing seller’s incentive to get reps right

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