

# Trending Issues in Negotiation of Indemnification Provisions

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## Representation and Warranty Insurance

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## REPRESENTATIONS & WARRANTIES (“R&W”) INSURANCE OVERVIEW

### Purpose

- Provide Insured with coverage for breaches of covered representations and warranties

### Cost

- One time premium payment typically in range of 2.75%-3.75% of coverage limits purchased

### Market Capacity

- Approximately 20 underwriting markets including carriers and managing general underwriters that underwrite on behalf of one or more insurers
- In excess of ~\$1 billion in coverage limits available
- Global market

### Parties

- Deal Parties (Buyer, Seller, Respective Counsel)
- Insurance Brokers
- Underwriters (Brokers and underwriters now staffed by many former M&A and/or insurance attorneys)
- Underwriter Counsel

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## R&W INSURANCE – BASIC CONCEPTS

- Coverage:** Protects against financial losses resulting from inaccuracies in the representations and warranties relating to the target company and/or selling shareholders. All representations and warranties generally are included in coverage, including tax matters. Environmental representations often can be insured.
- Knowledge:** Implications for Buyer-side and Seller-side policies
- Capacity:** Limits up to ~\$1 billion available in current market
- Pricing:** Generally in range of 2.5% to 3.75% of limits insured in current market (i.e., \$275,000 to \$375,000 per \$10 million in protection)
- Policy Period:** Up to 6 years for fundamental and tax reps, 3 years for general business/ops reps
- Retention:** Minimum of 1% to 1.5% of the transaction value on most transactions  
If escrow applies, retention typically drops down to a minimal retention level as escrow is released (drops to between .5% and 1% of purchase price)
- Items not covered:** Forward looking statements and projections, covenants (can be considered in some situations), known or disclosed items (may be addressed via a separate contingency policy), asbestos and PCBs, pension underfunding

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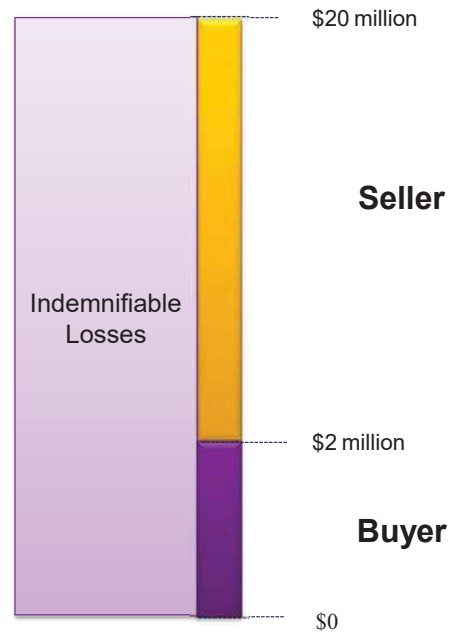
## INDEMNIFICATION WITHOUT R&W INSURANCE

### Assumptions:

- \$200 million purchase price
- 1% or \$2 million buyer deductible
- 10% or \$20 million indemnity cap
- The following losses are incurred (examples):
  - \$7.5 million loss related to undisclosed liability claim
  - \$5 million loss related to customer dispute

### Results:

- \$12.5 million in losses
- Buyer incurs first \$2 million of loss per buyer deductible
- Seller incurs next \$10.5 million of loss (i.e., from \$2-12.5 million)
- Buyer recovers a total of \$10.5 million
- Seller receives \$9.5 million following escrow release (Total sale proceeds received = \$189.5 million, with a \$200 million purchase price)



## R&W INSURANCE REPLACES SELLER'S RISK



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