

# Trending Issues in Negotiation of Indemnification Provisions

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## Representation and Warranty Insurance

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**Willis Towers Watson** 

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

Purpose	<ul style="list-style-type: none"><li>• Provide Insured with coverage for breaches of covered representations and warranties</li></ul>
Cost	<ul style="list-style-type: none"><li>• One time premium payment typically in range of 2.75%-3.75% of coverage limits purchased</li></ul>
Market Capacity	<ul style="list-style-type: none"><li>• Approximately 20 underwriting markets including carriers and managing general underwriters that underwrite on behalf of one or more insurers</li><li>• In excess of ~\$1 billion in coverage limits available</li><li>• Global market</li></ul>
Parties	<ul style="list-style-type: none"><li>• Deal Parties (Buyer, Seller, Respective Counsel)</li><li>• Insurance Brokers</li><li>• Underwriters (Brokers and underwriters now staffed by many former M&amp;A and/or insurance attorneys)</li><li>• Underwriter Counsel</li></ul>

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## R&W INSURANCE – BASIC CONCEPTS

<b>Coverage:</b>	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.
<b>Knowledge:</b>	Implications for Buyer-side and Seller-side policies
<b>Capacity:</b>	Limits up to ~\$1 billion available in current market
<b>Pricing:</b>	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)
<b>Policy Period:</b>	Up to 6 years for fundamental and tax reps, 3 years for general business/ops reps
<b>Retention:</b>	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)
<b>Items not covered:</b>	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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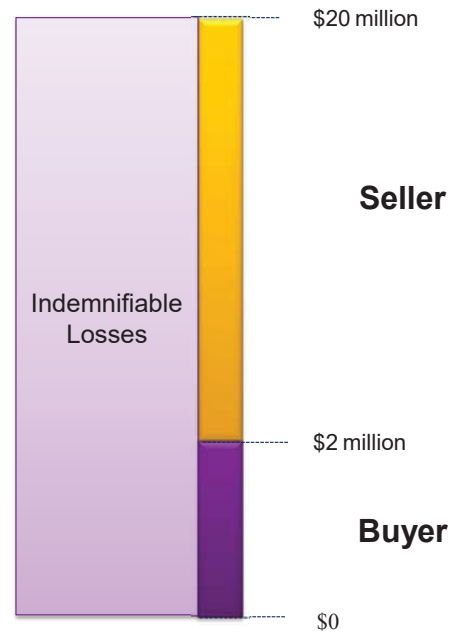
## INDEMNIFICATION WITHOUT R&W INSURANCE

### 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

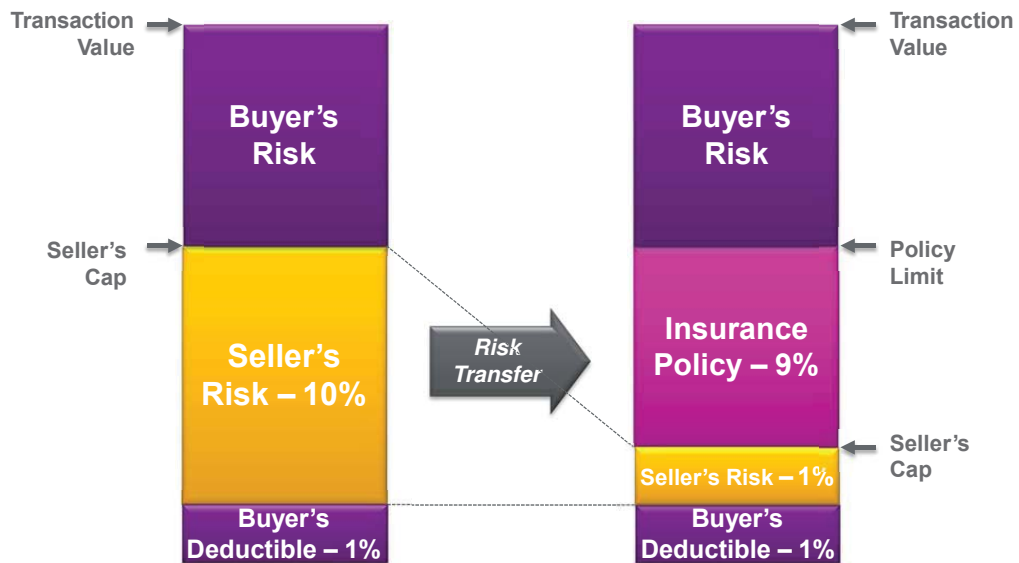
### Results:

- \$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)



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## R&W INSURANCE REPLACES SELLER'S RISK



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