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Association News

IVCA Article: Highlights of the IVCA Toolkit Luncheon: ‘Representation and Warranty Insurance for M&A Indemnities’

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CHICAGO – Despite the frigid Chicago temperatures on January 22nd IVCA members gathered for the latest IVCA Toolkit luncheon. The luncheon provided a deep dive into the features and benefits of Representation and Warranty Insurance for M&A Indemnities. The Toolkit was sponsored and presented by Lockton Companies, an international insurance broker, and the McDermott Will & Emery law firm. As with all our toolkit events, the highly experienced panelists were able to cover a tremendous amount of information – with audience participation – in a short period of time.

The event moderator was Lockton’s [Casey Zgutowicz](#) and the panel consisted of...

- [Ryan Harris](#) of McDermott Will & Emery
- [Troy Phillips](#) of Beecken Petty O’Keefe & Company
- [Henry Jennings](#) of Lockton Companies

The Presentation

Henry Jennings explained that “Rep & Warranty” products have been around since the early 1990s, but have gained wider acceptance in the last several years as more participants entered the market and prices have dropped. The product supplements traditional security devices of the mergers and acquisition transaction such as Escrow, Holdback, Seller Note and Earnout. Representation and Warranty Insurance is used by both buyers and sellers to hedge against specific unknown risks from the transaction. These uncertainties can include Regulatory changes and Intellectual property challenges.

Common reasons for coverage from the sellers is for an indemnification claim made by a buyer of the business resulting from a breach of any of the seller’s representations and warranties. For the buyer, it’s for financial loss that occurs as a result of a breach of any of the seller’s representations and warranties. In a comparison between 2011 and 2012, the number of policies are up 70 percent.

Case Study

Troy Phillips and Ryan Harris then walked through a case study of a deal closing that utilized Rep & Warranty coverage. The firm was Beecken Petty O’Keefe & Company, and their business was health care...

- Health care is a heavily regulated business, and the auction was extremely competitive.
- The insurance was reasonably priced – 1.6% of the limit (inclusive of broker fee).
- Focused on coverage for breach of compliance with health care law reps in excess of the escrow to a specified cap for a longer period of time – i.e. after the survival and/or in excess of the cap, buyer only to the insurance policy – and fundamental reps
- The insurance was essential to distinguished the bid by:
 - limiting the seller’s post-closing liability;
 - provided the Private Equity fund with necessary protection for the issues the Fund was most focused on;
 - created a single source of recovery in excess of the escrow;
 - provided the lenders with comfort that there was significant coverage for breach of indemnities.

Post Presentation Reactions

As a follow-up to the luncheon, the panelists and moderator answered three questions regarding the presentation...

QUESTION: Based on the feedback you received on Tuesday, what aspect of the Rep & Warranty Insurance is least understood and what advantages does it offer?

Ryan Harris: The potential strategic value to utilizing representation and warranty insurance both from a negotiating standpoint and potentially maximizing post-closing protection.

Troy Phillips: Given Rep & Warranty insurance is a relatively new product, I think most dealmakers do not think of the product proactively as a strategic weapon in an auction process. Rather, I think most people – myself included – tend to think of Rep & Warranty insurance reactively as a solution to a specific problem or issue in a deal. I expect as the product matures you will see it become a more standard part of auction processes.

Henry Jennings: Based on the feedback, it quickly became apparent that the insurance industry has more work to do in educating PE and VC firms about R&W policies – particularly the flexibility of the product to address buyer or seller issues. With this knowledge, deal professionals will have another tool in their toolbox to help them strategically negotiate transactions.

Casey Zgutowitz (Moderator): There is still a misconception that Reps and Warranties insurance can only be structured on the buy side or sell side and/or that its benefits are limited in scope, and that is based on parties historical experience with the product. Truth is, whether you’re a buyer looking to distinguish your bid or a seller looking for a cleaner exit with locked in returns, the product is very flexible and can provide benefits much broader than that.

The product has come a long way since originally introduced 15 years ago, and has evolved with the changing needs of both the buy and sell side. Today, benefits include a much more efficient process and more competitive premiums than when initially introduced. And, we now have more defined policy and claims data available confirming this coverage “works” and will cover claims.

Q: What element of the case study did you find to be most useful in expanding on the advantages of R and W insurance?

Harris: Details relating to ease of process, timing and cost.

Phillips: One of my biggest concerns the first time I purchased a Rep & Warranty policy was the amount of time that it might take given the significant workload already required in the last few weeks of a deal. Hopefully, the case study illustrated that the product is both flexible and relatively easy to place with only modest involvement by the PE firm.

Jennings: Having the case study presented by a PE user and their attorney was most useful. Having a peer discuss how the product provided distinct value was key to developing credibility.

Zgutowitz: There were critical items in the transaction that could have prevented it from closing, including diminution in value and specific billing and collection considerations. A reps and warranties policy with broad coverage was negotiated, including for these two key elements. In the end, the reps and warranties policy created efficiency and provided the necessary comfort for Beecken Petty O'Keefe, its lenders and the sellers, allowing the deal to close.

Q: What did you all personally learn about the subject by moderating or sitting on the panel?

Harris: That the market – to the extent represented by the audience – is still skeptical of the insurance product, including the ability to collect on the policies.

Phillips: I learned various ways to use the product strategically as both a buyer to distinguish a bid in an auction and as a seller to drive more purchase proceeds upfront and reduce residual risk from a transaction.

Jennings: I gained better insight into a deal attorney's and a client's perspective about the product and the underwriting process.

Zgutowitz: Reps and Warranties does not come in one shape or size and is not limited to any size transaction or industry type. The product has evolved over time to meet the needs of all parties involved and will continue to do so. One should keep an open mind when looking at reps and warranties and consider building it into the diligence process for every transaction where questionability of reps and warranties exists – you may just be surprised at the added efficiency it brings as well!

To view the a more comprehensive powerpoint presentation, click [here](#).

For pictures from the event, click [here](#).