



REPRESENTATIONS AND WARRANTIES INSURANCE ON TAKE-PRIVATE TRANSACTIONS IN NORTH AMERICA

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To date, in comparison to private M&A transactions, Representations and Warranties Insurance (“RWI”) has seen limited use on take-private M&A transactions (“take-privates”), primarily due to misconceptions regarding its availability and applicability. Contrary to popular belief, RWI is widely available for take-privates, with cost, cover and an underwriting process broadly comparable to what is available on private transactions – in fact, the largest RWI claim in history arose from an insured take-private. However, certain structural issues and corresponding policy adjustments must be accounted for when applying RWI to these transactions. This note explores how RWI operates on take-privates, outlines typical policy parameters, discusses due diligence requirements and highlights some exclusions that insureds may encounter.

How RWI is applied to take-privates:

RWI on take-privates functions similarly to how it operates on private M&A transactions, i.e., providing indemnification for losses arising out of breaches of representations and warranties made by the sellers/company. Of note, RWI provides synthetic indemnification irrespective of limitations in the transaction agreement which:

- 1. Limit of Liability:** provides for a limit of liability equivalent to the amount of protection a buyer requires.
- 2. Survival Periods:** extends the survival periods (which would otherwise expire at closing) to (i) 3 years post-closing for general representations and (ii) 6 years post-closing for fundamental and tax representations. The policy will also provide a 6 year synthetic pre-closing tax indemnity.
- 3. Materiality Scrape:** “scrapes” materiality (including material adverse effect (“MAE”) qualifiers and other materiality qualifiers) from the representations, both with respect to assessing (i) whether a breach has occurred and (ii) losses arising from such breach. Often referred to as a “double materiality scrape”, this is a ubiquitous feature of RWI on private M&A transactions, but it is critical to secure on take-privates given the prevalence of MAE qualifiers in the representations and warranties. Securing this RWI policy construct requires getting the insurers comfortable with the level of detail in the disclosure schedules and the due diligence the buyer is able to undertake.

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Policy parameters:

1. **Policy Limits:** typically 10% of the enterprise value (or, where relevant, the pro-rated enterprise value). For larger transactions (\$2bn+), parties sometimes buy less than 10%. With up to \$1.5bn of capacity available in the market, extremely large transactions (\$10-30bn) can be insured.
2. **Retentions:** at the time of publishing, 0.5% of the enterprise value, dropping to 0.3% after 12 months of closing. For larger transactions, lower retentions can be achieved.
3. **Pricing:** at the time of publishing, ~2.0 - 2.5% of the policy limit (assuming a minimum policy limit of 5%), but for larger transactions, the pricing can drop to ~1.5 - 2.0%.
4. **Timing:** ~3 - 5 days to secure terms and typically 1 - 2 weeks following provision of advanced form due diligence reports to fully underwrite the policy. In some very fast-moving processes, it can be underwritten in as little as 2 days.
5. **Inception Date:** it is typical for RWI policies to incept at signing, but it is possible to delay inception until after signing. Post-signing inception does carry certain risks, e.g., a breach being discovered after signing but pre-policy inception and therefore being excluded, or certain purchase agreement provisions being uninsurable. Early engagement with Atlantic's deal team to "pre-underwrite" transaction documents and due diligence reports before information is shared with insurers can mitigate these potential downsides while maintaining assurances of confidentiality.

Additional considerations:

1. **Due Diligence:** buyers will typically have access to less information on take-privates than on private M&A transactions. Atlantic will work with the buyer to identify any key areas where more detailed diligence may be required so that these areas can be flagged to the target company's management team early in the process. Insurers are cognizant of the dynamics on take-privates and take comfort from other characteristics of public companies including mandatory reporting requirements and public disclosures (which will often qualify some or all of the representations), but some insurers are more flexible than others – ensuring the selected primary insurer is comfortable with the expected scope of diligence in advance of its engagement is critical.
2. **Subrogation Rights:** under private M&A transactions, RWI insurers require an unimpeded right to subrogate against the seller(s) in the event of seller fraud. On take-privates, the underlying agreement will not contain an express waiver to the non-survival provisions. As such, it is key to ensure that insurers are comfortable with the potential absence of certain subrogation rights under the RWI policy prior to engaging them to underwrite the transaction. Furthermore, some insurers can also offer an absolute waiver of subrogation against both the target company and public selling shareholders and Atlantic will always seek to secure this position on behalf of our clients.
3. **Public Disclosures:** as is customary on take-privates, the representations may be qualified by certain public disclosures made since a given reference date (often with an exception for any risk factors or forward-looking statements included within such public disclosures). Coverage under an RWI policy typically mirrors these public disclosures although certain insurers have agreed

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to disregard public disclosures for the purpose of the policy. If the parties have bargained for a buyer friendly position under the agreement (i.e., if there are no public disclosure qualifiers or if such disclosures only apply to certain representations), several insurers will follow this position, but it should be confirmed prior to insurer engagement.

- 4. Public Shareholder Derivative Claims:** in addition to the market standard exclusions found on private M&A transactions, insurers typically exclude claims brought by public shareholders in connection with the transaction. It is sometimes possible to limit this exclusion to claims alleging the directors failed to obtain sufficient value for the company, noting this position is only available on a case-by-case basis.

ABOUT ATLANTIC

Atlantic is a specialist insurance broker, solely focused on (i) RWI; (ii) Tax Insurance; (iii) Contingent Risk Insurance; and (iv) Non-Payment Insurance. With more than 100 specialists across ten offices in the US and Canada, Atlantic has built a reputation of providing market-leading advice and has led on the placement of some of the largest and most complex RWI policies in North America, including numerous multi-billion dollar take-privates.

For more information, please go to: www.atlanticgrp.com

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