ambridge®

Representations & Warranties Insurance

Case studies

Duration of indemnity

The buyer in a transaction requires that the indemnity given by the seller apply to breaches or inaccuracies of the representations and warranties that are discovered for up to thirty six months after closing. The seller is only prepared to offer an indemnity for breaches or inaccuracies discovered up to the twelve month anniversary of closing. A *DisclosureGap*® policy may be issued to cover losses resulting from claims first discovered by the buyer after the twelve month anniversary and before the thirty six month anniversary of closing.

Quantum of indemnity

The final deal point in a sale agreement is the quantum of the amount of the indemnity (or "indemnity cap") that the seller will provide to the buyer for losses suffered as a result of the inaccuracy or breaches of representations and warranties. The buyer requires an indemnity cap of $50,000,000 (or 25 percent of the transaction consideration). The seller is only willing to provide an indemnity cap of $20,000,000 (or 10 percent of the transaction consideration). A *DisclosureGap*® policy with a $30,000,000 policy limit may be issued to respond to losses that exceed $20,000,000.

Scope of warranties

A key deal point in a sale agreement is the wording of the representations and warranties relating to intellectual property. The buyer's board of directors requires its standard wording for any acquisition where the intellectual property of the target is a critical part of the business. The seller is unwilling to agree to the requested wording. A *DisclosureGap*® policy may be issued with coverage provided to the buyer for any losses they incur as a result of the inaccuracy or breach of the representations and warranties worded in the manner required by their board.

Financial ability of seller to perform under agreed indemnity is questionable

The seller has agreed to the scope, duration and quantum of the indemnity for losses incurred by the buyer as a result of the inaccuracy or breach of the representations and warranties. The seller has suffered operating losses and is highly leveraged and will be using the proceeds from the sale to pay off most of its bank debt causing the buyer to be concerned about the seller's ability to perform under the indemnity. A *DisclosureGap*® policy may be issued to respond to losses covered under the indemnity in the event that the seller is not financially able to meet its obligations.

Indemnity not available because target is a public company

The target company in a transaction is a publicly traded company. While the parties have agreed to the scope of the seller's representations and warranties, they do not survive closing as the proceeds of the transaction will be distributed to the shareholders of the target leaving the buyer with no recourse. A *DisclosureGap®* policy may be issued to respond to losses incurred by the buyer for breaches of the seller's representations and warranties in excess of an agreed retention.

Indemnity not available because seller is a company reorganizing under Chapter 11

The target company in a transaction is one of the few valuable assets of a company reorganizing under Chapter 11 of the Bankruptcy Code. While the buyer has agreed to the scope of the representations and warranties, they do not survive closing as the proceeds of the transaction will be distributed to the creditors of the seller leaving the buyer with no recourse. A *DisclosureGap®* policy may be issued to respond to losses incurred by the buyer for breaches of the seller's representations and warranties in excess of an agreed retention.

Indemnity not available because seller intends to liquidate after closing of transaction

The target company in a transaction is the final portfolio investment of a private equity fund that will make a final distribution and liquidate after the transaction closes. While the buyer has agreed to the scope of the representations and warranties, the seller is not willing to provide an indemnity to support the seller's representations and warranties as this would prevent distribution of the fund's assets to its partners. A *DisclosureGap®* policy may be issued to respond to losses incurred by the buyer for breaches of the seller's representations and warranties in excess of an agreed retention.

Buyer's lenders require additional protection

The buyer in a transaction is a private equity fund. As such, most of the transaction consideration will be borrowed from a consortium of lenders. While the buyer is satisfied with the scope, quantum and duration of the indemnity given by the seller to respond to breaches of the seller's representations and warranties, the credit committee of the lead lender requires that the quantum of the indemnity be increased by 20% above the agreed amount. A *DisclosureGap®* policy may be issued to respond to losses incurred by the buyer for breaches of the seller's representations and warranties in excess of an agreed retention.

Seller unwilling to make any representations and warranties

The seller of a business is the foreclosing bank. As it has not been involved in the management of the business, it is only willing to sell on an "as-is where-is basis" and is not willing to provide any representations and warranties. The buyer is a group of private equity funds that have completed significant due diligence on the business being purchased. While the buyer believes that it has identified all of the risks, there are certain facts about the business that would normally be addressed by representations and warranties (and supporting indemnities given by the seller). If any of these facts were materially inaccurate, the impact on the target business could be significant. The buyer may work with underwriters to develop a *DisclosureGap®* policy that will respond to losses it incurs as the result of identified "synthetic" representations and warranties being inaccurate or breached.

Non-management seller(s) unwilling to provide indemnity

The non-management sellers of a closely-held business have been inactive in the target business for many years and are unwilling to bear their proportionate liability under the indemnity that the buyer has required as respects losses resulting from the inaccuracy or breach of any of the seller's representations and warranties. A *DisclosureGap®* policy may be issued to cover the non-management sellers' proportionate liability under the indemnity that the buyer has required.

Seller cannot liquidate because of an indemnity given in an old transaction

The shareholders of a privately held company have sold off all of their key assets and have voted to liquidate the company. The only remaining potential liability of the company is the indemnity provided to the buyer under a sale agreement that closed several years ago to cover losses incurred as a result of breaches of the seller's representations and warranties when selling its largest subsidiary. The company's board is not prepared to authorize a final distribution until this potential liability is addressed. A *DisclosureGap®* policy may be issued to cover the company's liability under the indemnity.

Investor providing seed money for start-up venture with intellectual property

While a seed investor has been provided with representations and warranties made by the entity about the intellectual property that is key to the venture, the start-up will not, practically speaking, have any assets to indemnify the investor if any losses are incurred as a result of any breaches of such representations and warranties. A *DisclosureGap®* policy may be issued to indemnify the investor for losses incurred as a result of the inaccuracy or breach of the intellectual property representations and warranties.

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