



Representations and Warranties 101

**Professional Liability Underwriting Society
Northern California Chapter**

**San Francisco, CA
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Introduction

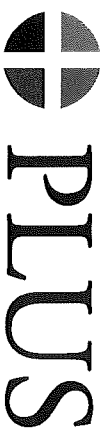
What is Reps & Warranties Coverage?

- Policy covers breaches of Representations and Warranties made by a seller to a buyer in connection with the sale of a company, a subsidiary or a basket of assets
- Reps and warranties are generally not the subject of coverage under a traditional D&O policy
- Coverage has been available in the US since the mid '90s and internationally for some time before that
- Target deal size is \$5M to \$1B (sale price)
- Two types of policies: seller-based and buyer-based
- Used as a strategic tool to help get deals done



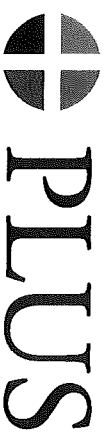
What are Representations & Warranties?

- A representation is an assertion as to a fact, true on the date the representation is made, that is given to induce another party to enter into a contract or take some other action.
- A warranty is a promise of indemnity if the assertion is false.
- The terms “representation” and “warranty” are often used together in practice.



What are Representations & Warranties?

- In M&A transactions, reps and warranties are given by both parties to disclose material information.
- The seller's reps and warranties tend to be more extensive because they include information about the target company or business and the stock or assets and liabilities being transferred.
- The reps and warranties allocate risk between the parties and serve as the foundation for an indemnification claim in case of a breach or inaccuracy.



Examples of Representations & Warranties

- Fundamental Representations:
 - ❖ Title to Shares
 - ❖ Capitalization
 - ❖ Authority
- Standard Representations
 - ❖ Financial Statements
 - ❖ Compliance with Laws
 - ❖ Inventory
 - ❖ Litigation
 - ❖ Real property
 - ❖ Taxes



Key Definitions

- **Escrow:** The amount of money required to backstop the indemnity obligations of the Seller for breaches of the reps and warranties
- **Cap:** The upper limit on damages for which the seller is legally obligated to indemnify the buyer
- **Basket or Threshold:** In essence, the “deductible” for the deal. The amount of damages from breaches that the buyer will absorb before the seller indemnity obligation
- **Survival period:** the length of time that the buyer can rely upon the seller’s reps and warranties



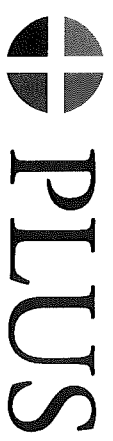
Seller-based Policies

- The insured under the policy is the seller(s) in the transaction
- Reimburses the seller for claims brought by the buyer for breaches of the reps and warranties in the sale agreement
- Misrepresentations made by the sellers to the insurer can void the coverage



Buyer-based Policies

- The insured under the policy is the buyer in the transaction
- Protects the buyer against damages that it incurs as a result of sellers' breaches of the reps and warranties in the sale agreement
- Works both as first party and third party insurance
- Approximately 80% of the Reps and Warranties policies sold in this country are buyer-based
- Misrepresentations made by the buyers to the insurer can void the coverage
- Claims are paid directly to the Buyer



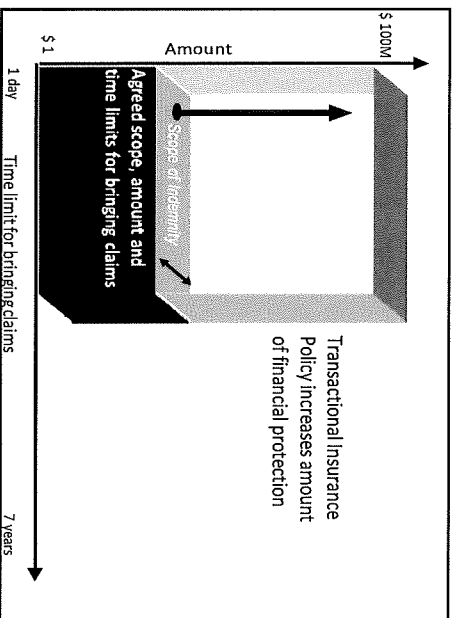
Buyer-based Policy Strategic Uses

- Allows the buyer to make an initial offer with more attractive deal terms
 - Lower escrow requirement
 - Lower liability cap
 - Shorter survival period
 - Distinguish buyer in auction process
- Bridges negotiation disagreements over deal terms
- Allows the buyer to recover damages from an insurance policy rather than from former shareholders-some of whom may be coming forward as management in the merged operations

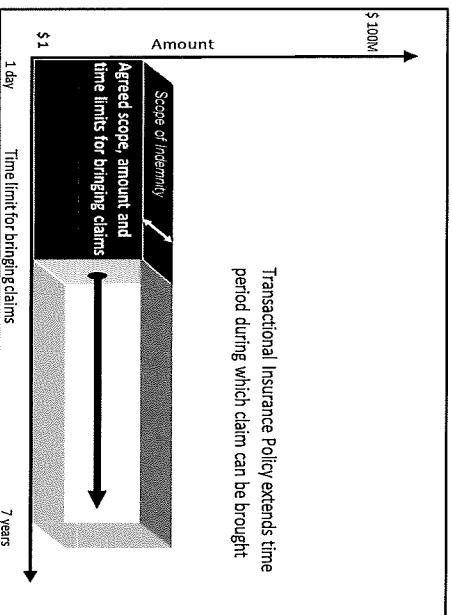


R&W Insurance – Program Structures

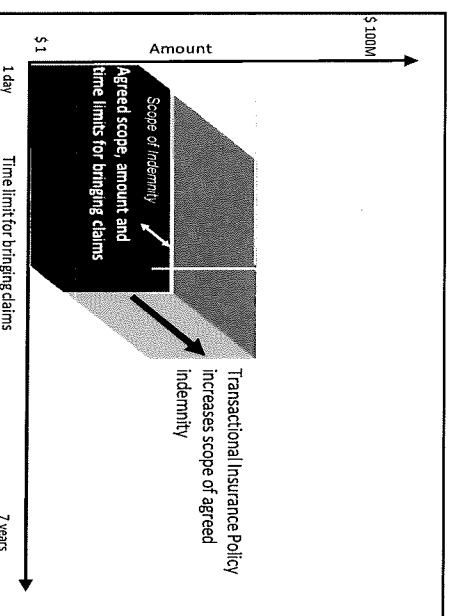
Increase Amount of Indemnity



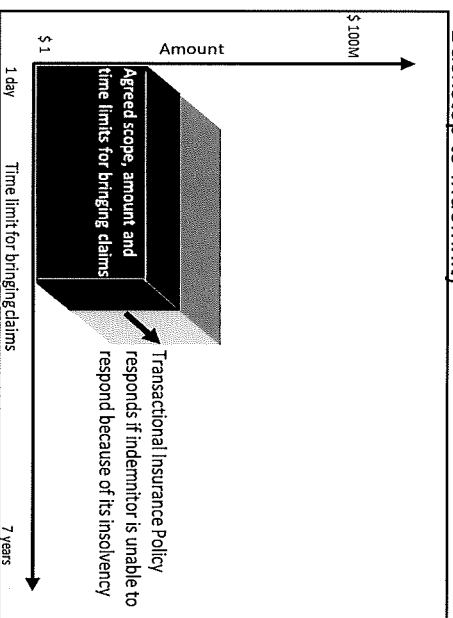
Extend Expiration of Indemnity



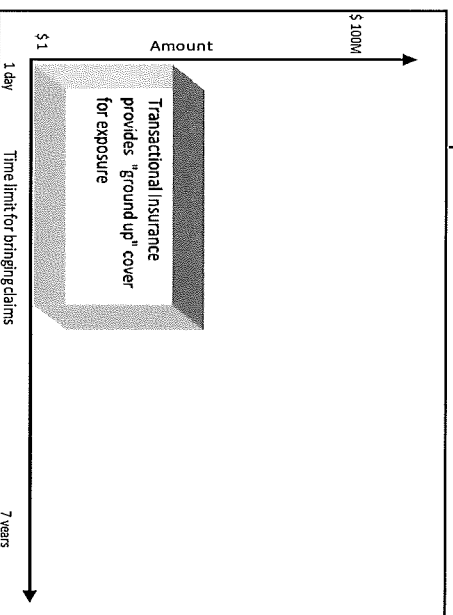
Increase Scope of Indemnity



Backstop to Indemnity



"Ground up" Cover



... or a combination of one or more of these structures.

PLUS Two Step Underwriting Process

Initial Indication Stage

- Execute NDAs
- Underwriters decline, request additional information or provide a non-binding indication
- Two – four days (depending on time constraints, multiple quotes may be offered)

Full Underwriting Stage

- Client pays non-refundable underwriting fee
- The insurer conducts in-depth review of due diligence process, reviews contents of the deal data room
- One week timeline, but faster if needed
- Insurer declines or provides bindable quotation

PLUS Required Underwriting Materials

Initial Indication Stage:

- Most recent draft of the deal document (Securities Purchase Agreement or Asset Sale Agreement)
- Draft of the disclosure schedules
- Audited financial statements of the target

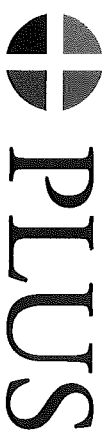
Full Underwriting Stage:

- Due Diligence reports
- Access to the deal data room
- Updated Turns of Deal Documents



Marketplace

- Ambridge Partners
- American International Group
- AWAC
- Beazley
- Chubb
- Concord Specialty Risk
- Hartford
- IronShore



Challenges in R&W Insurance Marketplace

- Strong demand for products
- Potential backlog for quote responses
- Efficiency for underwriting process
- Focus on larger transactions
- Middle market is underserved
- Coverage forms are not standard
- Limited Claims Data



Claim Activity in the R&W Marketplace

- Driver of R&W has historically emphasized deal facilitation rather than risk transfer
- Notification volume remains relatively constant
- Claim example of recent SME placement
- Notification and association process



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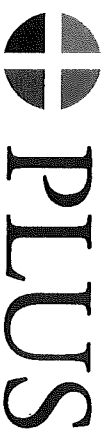
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