



TRANSACTIONAL RISK with Concord Specialty Risk

Using Insurance Capital to Enhance Deal Terms & Allocate Risk

The M&A landscape continues to transform rapidly in the use of transactional risk insurance products.

Representations & Warranties Insurance (“R&W Insurance”) has gained widespread acceptance among sellers seeking a low-indemnity (or even no-indemnity) structure. R&W Insurance is frequently used by buyers seeking to reduce their purchase price (or otherwise enhance their bid) by reducing the escrow and indemnity ceiling. The R&W Insurance policy typically has a policy period that far exceeds the typical time frame for an escrow and may exceed the time period for the survival of representations for purposes of indemnity. Some policies have detailed claim provisions that assure prompt evaluation and fair resolution of claims. These are powerful incentives to use R&W Insurance.

However, R&W Insurance typically does not cover risks that are (1) viewed as heightened or known (e.g., issues arising from or related to matters disclosed in the Disclosure Schedules or specific representations about matters that may be inherently difficult to due diligence, such as net operating losses), and/or (2) not the subject of representations but are the subject of a special indemnity (e.g., successor liability on an asset sale, or

whether CFIUS blockage will trigger a reverse break-up fee).

Essentially, R&W Insurance requires the insurance underwriter to satisfy itself that representations are not inherently too ambiguous, overly broad, or complex to be properly diligenced, that due diligence has taken place, and that heightened risks have been identified and either excluded or thought to be within the retention, etc.

Products such as tax insurance, litigation buyout and contingent liability insurance begin with the premise that a heightened risk exists. The insurance underwriter spearheads a focused diligence on transferring such risk via a policy tailored precisely for such risk. These products complement R&W Insurance. The suite of transactional risk insurance products, in their entirety, allows insurance capital to enhance M&A deal terms and allocate all risk – whether known or unknown, heightened or banal.

These products, however, still sit in the shadows of R&W Insurance. Many advisors remain unaware that these products exist and may attempt to shoe-horn their coverage into a R&W Insurance policy, which can be a frustrating experience. This article briefly introduces tax, specific litigation and other contingent liability insurance.

TAX INSURANCE

Tax insurance is purchased by or on behalf of companies with complex or uncertain tax positions. Sellers may purchase it ahead of a sale to remove the uncertainty from the bargaining table during subsequent due diligence by a buyer. Buyers may purchase it to transfer downside risk, acquire the additional tax advocacy if the tax position is challenged, and enhance the terms with the seller by removing the matter from the scope of indemnity.

M&A transactions are often enhanced by tax insurance covering:

- Issues concerning historic net operating losses
- Issues concerning Subchapter S status
- Issues concerning REIT status
- Issues concerning spin-offs, corporate restructuring, recapitalizations (e.g., valuation of basis/gain, tax-free status, cancellation of debt income, etc.)
- Issues concerning transfer pricing, related party transactions/fees, etc.
- Issues concerning nexus
- Issues concerning tax credits

SPECIFIC LITIGATION INSURANCE

Typically, the schedule of pending litigation disclosed in a M&A transaction is reviewed for whether claims against the “target” are insured under existing insurance. When they are not (or when they are not adequately insured), Specific Litigation Insurance may be available. Concord

typically insures pending litigation involving:

- Alleged breach of contract (not typically covered by other insurance)
- Alleged patent, trademark or copyright infringement
- Threatened litigation that appears to have solid legal (as opposed to factual) defenses

OTHER CONTINGENT LIABILITY INSURANCE

This catch-all category has been used to cover:

- The risk of successor liability in the context of an asset sale
- The risk of regulatory disapproval blocking the transaction and requiring a (reverse) break-up fee (e.g., CFIUS blockage of transaction)

The specialized insurance underwriters providing these sophisticated solutions understand the need for “deal-time certainty,” in all aspects of the underwriting of the risk and the finalization of the policy. These underwriters also understand the need for sustainable yet viable pricing and terms and the need for a long-term commitment to serving this sector, evidenced by professional claim handling.



GET TO KNOW: Concord Specialty Risk

Concord Specialty Risk provides transactional risk insurance and loss mitigation-evaluation services that address the risk of loss arising from mergers and acquisitions, uncertain tax positions, potential regulatory enforcement and pending or potential litigation.



David De Berry, Esq., CEO of Concord Specialty Risk

Prior to forming Concord Specialty Risk, David was Vice President at The Hartford, in charge of all claim departments within Hartford’s financial product lines. Prior to this, he established and ran The Hartford’s transactional risk underwriting unit. David has nearly two decades of experience practicing law in commercial transactions and trial work. He obtained a Masters in Tax Law (NYU) in 1986. David created the buyer-based Representations & Warranties insurance product. David also provided comment and testimony to Treasury, which resulted in the US Treasury’s revision of its temporary regulations concerning tax insurance with respect to ‘material advisor’ reporting requirements.

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