

Not to be forgotten, the interplay of other insurance in Reps & Warranties claims

Representations and Warranties Insurance (“RWI”) is frequently purchased by a buyer in connection with a corporate acquisition or merger to protect against financial loss arising from breaches of, or inaccuracies in, the representations and warranties given by the seller regarding the financial condition and other aspects of the target company’s business. RWI policies generally cover “loss” arising from a breach including Defense Costs coverage and indemnity coverage. RWI insurance essentially takes the place of traditional indemnification provided by sellers to buyers – and does away with the often-complicated and time-consuming indemnification litigation against a seller – and can improve the overall negotiation process in corporate transactions. RWI policies, however, for cost and other reasons, often have sizable self-insured retentions calculated as a small percentage of the overall acquisition price (often in the range of 0.75 - 1% of the deal value). As such, some claims submitted to RWI insurers are settled at levels within the retention and do not implicate coverage. Regardless of the retention, an insured may also have access to other types of insurance covering the acquired company that can supplement any RWI coverage and often may be subject to lower retentions and other favorable terms that can protect an insured from financial loss as well. During due diligence and policy underwriting, certain underlying coverages are often addressed specifically. For example, cyber insurance coverage is often an area of heightened concern and increased focus by the parties and their professional advisors. In today’s softer market, RWI carriers inquire about the adequacy of the underlying cyber program- limits and sub-limits, coverage and loss history. Depending on the risk, they may deem the underlying cyber sufficient and simply turn to the Other Insurance provision in the RWI policy in the event of a claim. On transactions with significant data or PII exposure, however, RWI carriers may instead take an excess and no broader than adequate underlying insurance position, meaning that the RWI policy will not fill in gaps in coverage and requires depletion of underlying limits prior to its being triggered.

Insurance due diligence is critical to address the structure of historical programs for the Target company as well as an appropriate transition to the Buyer, addressing run-off, cancellation or waive in change in control provisions for claims-made policies. Buyers want to be aware of the full suite of insurance available to them should a breach of a rep, or the circumstances leading to it, trigger multiple policies.

Third Party and First Party Claims under RWI Policies

RWI insurance claims can take the form of a Third-Party Claim or First-Party/Direct Claim. A Third-Party Claim, as its name suggests, is a breach arising from a lawsuit or other claim made against the acquired company by a third party (neither the insured buyer nor seller) which calls into question the truthfulness or accuracy of the reps and warranties – for example, an employment practices claim asserted by a former employee of the acquired company or a consumer class action or a professional liability claim. Government regulators can also assert Third-Party Claims against the acquired entity post-transaction for licensing or other statutory compliance issues. These claims all raise the possibility of a breach arising from the subject matter of the relevant claim – a third-party employment claim raises a potential breach regarding the target company’s compliance with employment and labor laws while a consumer class action or regulatory claim often raises the potential of a breach of a representation of compliance with laws or “no undisclosed liabilities” representation. Similarly, management liability coverage of the acquired business may also be implicated by a third-party claim that alleges a wrongful act and calls into question the possible breach of a covered representation. It is critical to assess whether any of these types of Third-Party claims can trigger underlying Directors & Officers, Employment Practices, Fiduciary or Professional Errors & Omissions insurance as well as the RWI coverage stemming from a breach. Timely notification of these insurers is a requirement and should be addressed promptly upon discovery or receipt of any such claim.

In our experience, these other coverages are the most often implicated alongside a RWI claim:

- Employment Practices Liability and wage & hour defense costs coverage;
- Cyber/Technology E&O as well as privacy coverage;
- D&O and E&O/Professional liability;
- General Liability and Product Recall coverage;
- Workers' Comp/Employer's liability;
- Pollution/Property or Environmental coverage.

RWI Policy Dynamics

When there are multiple types of insurance coverage potentially in place for a claim, it is important to review the RWI policy's "Other Insurance" clause that addresses which policy pays first and would be considered "primary" versus which policy(ies) is considered "excess" coverage. In certain scenarios, the policies could share coverage and both carriers would contribute towards a loss based upon some formula provided by the relevant policy wording and/or applicable law. The RWI and other policies' "other insurance" clauses will determine the interplay.

Should underlying insurance pay a loss in whole or in part, it may come into question if that insurance recovery satisfies the RWI policy retention or whether the RWI retention still has to be paid by the insured once the underlying insurance is exhausted (in the event the loss exceeds the underlying insurance). In our experience, the RWI coverage allows for amounts paid by another insurer under a separate policy to erode and satisfy the RWI policy retention. However, this may not be the case under all scenarios and should be carefully reviewed as well.

Takeaways

Most critical to any claim scenario is the importance of timely notice at the time the claim is made or first becomes known, in this case both to the RWI coverage and any other relevant insurance policy. This may be a more complicated task in the midst of a corporate acquisition and business integration where the available coverage is potentially less familiar to the acquiring company. Ideally, coverages and applicable change in control provisions were appropriately addressed at closing. Insurance coverage may not be available if the claim is not timely noticed to the relevant insurer and appropriate change in control actions were not taken. Some policies have "prejudice requirements" which prohibit an insurer from denying coverage unless they have been materially prejudiced by the delay, but a "prejudice" dispute with an insurer over late notice is surely not an ideal scenario for a company to find itself in when seeking coverage for a potential loss.

It is important to partner with an insurance broker with seasoned teams dedicated to transactional risk, insurance due diligence, property & casualty insurance and claims management. An experienced transactional risk claims team understands the commercial demands and needs of sophisticated insureds and is able to more effectively navigate and ultimately expedite the claim process.