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Legal Update

12.18.2015

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Originally published in *Deal Lawyers*, January-February 2016

With the increased commoditization of information as to what “is market” on M&A transactions, deal lawyers can focus quite a bit of energy on relatively small changes in deal terms. The terms ebb and flow based on market conditions but it is unusual to have a game changing shift. Not so with the use of representation and warranty insurance. The explosion in the use of representation and warranty insurance is well documented with 2015 seeing a dramatic increase in the product being used in lower middle market transactions. With more insurers entering the market, the minimum transaction price continues to drop. We have quickly seen the minimum deal price where the product might fit drop from around \$50 million to as low as \$25 million. This change can materially impact how you approach a lower middle market transaction.

From the beginning stages of planning, we work with the seller’s investment banker to discuss whether or not the bid instruction letter will indicate an expectation that the buyer will purchase a representation and warranty insurance policy. If a bid purchase agreement draft is provided to potential buyers, the bid draft itself will now often reflect this expectation and propose an indemnity package consistent with that approach.

Rather than waiting for a buyer to engage a broker, we are seeing the seller engage an insurance broker early in the process and obtaining quotes based on the proposed bid draft. The quotes are then posted in the deal data room so that the potential buyers can see that the seller has done its homework and undertaken the legwork on what product is available, at what pricing, and at what retention levels.

Obtaining quotes early can also aid in the due diligence process. The insurers often indicate areas of concern for potential policy exclusions. This can then steer the buyer and the seller in terms of areas to highlight during diligence. Buyer’s counsel will often focus on these areas in their due diligence memos with the expectation that the memos will be provided to the insurers’ outside legal counsel who is reviewing

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the due diligence and who will be part of the negotiation around policy exclusions.

Finally, making sure you have both an experienced broker and insurer is extremely important. With the product gaining popularity so quickly, not all brokers and insurers are created equal when it comes to experience, responsiveness, and an ability to timely steer the process to completion.