

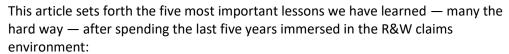
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5 Lessons For Submitting A Successful R&W Insurance Claim

By William O'Neil and Gretchen Scavo (March 27, 2020, 5:57 PM EDT)

The past decade has seen an unparalleled level of M&A activity, fueled in large part by the growth and success of private equity investors. This seller-friendly environment has been aided by the advent and increased use of buy-side reps and warranties insurance. To illustrate, the estimated number of R&W insurance policies written in North America rose from just 40 in 2008 (\$541 million in coverage) to more than 1,600 in 2018 (more than \$38.6 billion in coverage).[1]

The product has become near ubiquitous in private equity-backed transactions. This sharp increase has naturally resulted in a greater number of R&W insurance claims. Claims are submitted under nearly one in every four R&W insurance policies. We have prepared this article to educate deal professionals and M&A practitioners regarding the best practices we have observed for submitting a successful R&W insurance claim.





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1. Do not approach R&W insurance claims like litigation.

Although R&W insurance claims can certainly turn adversarial and end up in litigation, that is not the goal and we recommend you avoid approaching claims as adversarial. Unlike a defendant in litigation, who is interested solely in defeating the plaintiff's claim, an insurer has a contractual and common law obligation to fairly adjust each claim in good faith.

Give the carrier an opportunity to fulfill this obligation before taking an aggressive approach. Of course, if the carrier refuses to do so or if you have a genuine disagreement with the carrier over liability or damages, litigation may become necessary and appropriate.

2. Hire an experienced damages expert early in the process.

Unlike traditional litigation where the expert discovery process is back-loaded late in the litigation lifecycle, in an R&W insurance claim, it is best to engage an expert to prepare an analysis of your loss (typically referred to as a proof-of-loss report) as early as possible, and preferably before the claim is

even submitted to the carrier.

In an ideal world, this proof-of-loss report would be attached to the claim notice. We have also found it very beneficial to engage damages experts who are seasoned in the R&W insurance claims environment. It is a small, tightly-knit community where credibility in the eyes of the carriers and the experts they regularly engage is paramount.

Hiring an expert who is credible and a known commodity in the insurer's claims department can inure to your benefit. In this regard, we recommend hiring a different firm from that which performed the buy-side quality-of-earnings report, as the latter will often be a key witness in the claims process. An additional benefit of engaging an expert early in the process is that it will allow for a better understanding of the strengths and weaknesses of the claim before it is submitted to the carrier.

3. Be thoughtful about assessing your loss.

When preparing your proof-of-loss submission, thoughtfully analyze — with the assistance and input of your damages expert — whether multiplied damages may be available and appropriate. Assuming the target was purchased on the basis of an earnings before interest, taxes, depreciation and amortization, or EBITDA, multiple, be sure to (1) identify the measurement period (the applicable trailing 12 month, or TTM, period), (2) analyze the EBITDA impact of the loss on the TTM EBITDA, and (3) assess whether the loss has resulted in a temporary or more durationally significant impairment to the earning power of the target.

In making this assessment, you (and your damages expert) should review the key correspondence regarding the pricing of the transaction beginning with the letter of intent through any final investment committee memoranda. You should also consider how the buyer and seller handled other issues that arose prior to closing that may have affected the purchase price or TTM EBITDA.

In quantifying loss, the goal is to simulate the hypothetical repricing of the transaction that would have taken place had the seller made a truthful or accurate representation prior to closing of the breach on which the R&W insurance claim is based. It is the delta between what the buyer paid and what the buyer would have paid, but for the inaccurate representation that typically captures the buyer's expectancy or benefit of the bargain damages.

4. Work with counsel with R&W insurance claims experience.

R&W insurance claims are a niche specialty. There are only a small handful of seasoned, experienced practitioners with a track of record of successful outcomes in this space. Unlike traditional litigation, there is little publicly available precedent to guide R&W insurance claim resolution, as the vast majority are either settled or resolved through confidential arbitrations.

This reality heightens the need to work with experienced practitioners in this area. This is an industry where credibility and personal relationships matter, and can be used strategically to positively affect outcomes. Hire trusted counsel who can guide you through the claims process and position your claim for a successful outcome.

5. Manage expectations regarding the claims process.

The R&W insurance claims process requires a significant amount of collaboration and cooperation with

the insurer. It often takes 4-7 months to get a formal coverage position and financial proposal from the carrier to resolve the claim. Insurers are bureaucracies by nature with some amount of red tape to cut through, particularly in the R&W insurance space where most market participants are managing general underwriters, or MGUs.

An MGU syndicates risk for insurers and does not have any personal financial exposure to pay claims. Although the MGU will manage the claims process, it will regularly be providing updates to, and seeking approval from, the applicable carriers on your risk. This process understandably takes time.

Policyholders should also have realistic expectations about the types and amount of data the carrier is likely to request from the buyer and the importance of responding timely to the carrier's requests. The carriers will almost always retain their own damages expert who will issue a variety of data requests that typically involve a fairly invasive review of the documents related to the negotiation and pricing of the transaction (often including the buyer's financial model).

Gathering as much relevant documentation and other information as possible early in the claim investigation process will help to expedite claim resolution and reduce the burden on the buyer throughout the claims process.

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[1] Advisen – Hemenway, Chad. "Transaction insurance takes the 10-year challenge." Advisen, 6 Feb. 2019. https://www.advisen.com/tools/fpnproc/fpns/articles_new_1/P/330996328.html? rid=330996328&list_id=1 At the time of publication, reliable figures for 2019 were not yet available, but we predict those will reflect even greater growth from 2018.