

M&A insurance can shield your deal from risk

Most M&A transactions come with a clear and present danger: risk. From hidden liabilities, negative tax treatment and valuation issues, to legal and environmental obstacles, many unforeseen risks could hinder your deal or halt it altogether. M&A insurance, however, may be able to protect you from these deal breakers.

R&W heads off surprises

Parties on both sides of the table can benefit from M&A insurance coverage. Representations and warranties (R&W) insurance protects buyers from postclosing “surprises” such as revenue declines and misrepresentations regarding intellectual property, major contracts or titles to assets.

It may also enable buyers to:

- ❖ Set their bids apart from competitors in an auction scenario by providing protection beyond the customary level of indemnification,
- ❖ Protect relationships with key employees by removing buyers from potential future claims against them, or
- ❖ Purchase a bankrupt company when they have no other source of risk protection.

R&W coverage also protects sellers from problems that buyers fail to fully disclose or disclose at all,

such as contingent liabilities. This type of policy typically provides coverage for three to seven years. And the noncancelable policy goes into effect when a “breach of a representation and warranty” is discovered.

Some standard business insurance policies may adequately address the risks attending smaller transactions.

Environmental risks

Uncertainties surrounding potential environmental liability — such as the extent of soil or water contamination at a manufacturing site — can stall an M&A transaction. Four types of environmental insurance are available to help protect buyers and sellers, including:

1. Environmental site liability. This type of policy protects sellers and buyers from costs related to cleanup, bodily injury or property damage. It can be structured to cover an entire company or specific work sites.

2. Remediation cost cap. This policy covers the new owner in the event of cost overruns associated with a toxic site cleanup. Helpful in guaranteeing the extent of a buyer's total liability, remediation cost coverage often facilitates transactions in which the parties can't agree on the amount of known and unknown liabilities.

3. Blended risk. This coverage protects buyers when they know they'll be assuming a seller's environmental liabilities but need an asset to offset liabilities on their financial statements. These funds could cover costs should the government shut down a facility in the future.

4. Secured creditors. This policy covers financial institutions and real estate investors against environmental risks when they back real estate transactions. Benefits are paid out when a buyer defaults on a loan because pollution cleanup that the buyer can't afford is required.

Tax liabilities and breakup fees

Tax liability insurance can reduce or eliminate contingent tax exposure when a transaction fails to qualify for an expected federal income tax treatment. This coverage can be useful if you're involved in a tax-free merger or spinoff, tax-exempt financing, or a deal that involves tax credits. Coverage, which typically is available in noncancelable terms of four to seven years, also can be extended to state and foreign taxes.

Breakup fees — paid by the party that terminates a deal against the other party's wishes — pose another risk. Insurance can cover a potential buyer if the seller walks away during takeover negotiations. Reverse breakup fee insurance protects sellers from buyers that back out.

Regulatory qualification insurance can protect both parties when a deal is terminated by neither of them. For example, a regulatory agency might refuse to approve the merger because it would violate antitrust laws. Or it could fail to meet federal, state or statutory requirements, or regulatory or accounting rules.

Legal claims

Finally, litigation buyout insurance assumes the risk of known or pending lawsuits. It can cover a broad range of legal actions — including securities, antitrust, product liability, construction, tax and intellectual property litigation.

Typically, this type of policy is purchased to protect against unfavorable rulings and to transfer litigation from the liability column of the defendant's financial statements. At times, it's also obtained to hedge against the reversal of a favorable verdict upon appeal.

Getting started

To determine how M&A insurance might affect your proposed deal and long-term business strategy, review your existing general business insurance policies for gaps that could become gaping holes during the merger process. Look in particular at your policies' limits and deductibles and determine whether you may need to combine or segregate coverage.

Because M&A insurance can be expensive, traditional forms of business insurance may — depending on the size and scope of your deal — provide a more cost-effective solution. Some standard business insurance policies may adequately address the risks attending smaller transactions.

Is it right for you?

Whether you're on the buying or selling end of a deal, M&A insurance may be able to shield you from deal-damaging risks — known and unknown — and protect your investment down the line. Talk with your M&A advisors to determine if this coverage can help mitigate the chances that something will go wrong with your next deal. ■

