



A Small World After All: R&W Insurance in Cross-Border M&A

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It's not a secret that M&A Representation and Warranty Insurance ("RWI") is a valuable tool for domestic United States mergers and acquisitions transactions or that RWI usage is no longer limited to European or private equity buyers and sellers, however, the cross-border capabilities of RWI are less well known and those capabilities have grown in recent years.

As each deal is a facts & circumstances underwriting decision, insurers have been reluctant to publish clear guidelines on exactly which cross-border transactions will be insurable. However, a great deal more transactions in more countries, at smaller¹ and larger sizes and with more complex features are insurable than most people realize. In fact, RWI has become a powerful and generally under publicized tool in cross-border M&A space.

This article is designed to serve as a blueprint for the new capabilities of RWI insurance in cross-border transactions. It outlines: (1) the geographic scope of RWI policies, (2) certain recent and significant policy options which permit savvy buyers to reduce key risks associated with local law governed transactions and (3) factors which increase the likelihood of a cross-border deal being insurable.

The Global Scope of RWI

RWI is potentially available in every cross-border transaction where neither the target nor the acquirer is in an OFAC-sanctioned or otherwise embargoed country. However, underwriting interest will vary dramatically based on the jurisdictions involved. A good measure of potential underwriting interest is the Transparency International Corruption Perceptions Index—high corruption jurisdictions will garner less interest and higher premiums than lower corruption jurisdictions.

The number of emerging market products being offered had dramatically increased in the 12-24 months prior to the date of the article and AIG was the significant market leader in terms of emerging market coverage. It is expected that RWI insurance will continue to expand in terms of offered geographic scope.

- Underwriter interest is reportedly very strong for the Asia Pacific region (including India), the Eastern European region and South Africa. Interest exists but is more moderate for Latin American transactions and inbound China transactions.
- Underwriter interest is reportedly low for internal transactions between Chinese buyers and sellers and for inbound transactions into Russia.

¹ For example, Wachtell has recently noted that it is possible to obtain a billion dollars or more in insured limits for a single transaction and Acquinex has now launched a pre-packaged RWI insurance policy targeted at smaller transactions in the European market. The Acquinex product does not require extensive underwriting Q&A or a formal underwriting call.

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- Both parties can be from expanding markets: for example, recently a Turkish in-bound transaction to Brazil was insured.
- There may be market specific exclusions, such as China Circular 698. There are also jurisdictions where FCPA coverage is wholly unobtainable based on current conditions.

Strategic Policy Features: Jurisdictional Risk Hedging

Policy features are ever expanding and can be discussed with a broker; however, four recent features have captured the imagination of frequent cross-border deal lawyers in terms of their ability to ameliorate certain major common risks in cross-border transactions.

Remove the Full Data Room Disclosure—For a premium enhancement, the UK and European deal term that the entire data room is deemed disclosed for purposes of indemnity claims can be removed—to the extent permissible by governing law and assuming corresponding changes are made to the underlying purchase agreement. If this option is selected, the concept of “fair disclosure” is limited to no claims declarations and there is less risk that indemnity claims will be defeated by unread or unclear documents in the data room.

Amelioration of Local Law Delay, Litigation & Political Risk—In some jurisdictions, a UK or US law governed policy can be paired with a local law governed purchase agreement.² As a result, all claims larger than the retention will be governed by US or UK law and will be subject to arbitration or litigation in the US or UK.

In some local jurisdictions, this means that, for the first time, major purchase agreement claims can be resolved on timelines that are years quicker and with dramatically more predictable case law results. For example, in India, litigation resolution timing expectations can exceed 5 years from the date of suit and the judge is unlikely to have the M&A case law volume of the Delaware Court of Chancery. The availability of this option is governed extensively by regulatory laws effecting the insured party.

In addition, in nearly all jurisdictions and with all insurers, claims receive a degree (usually a significant degree) of global review by insurer head offices in the US or UK. The practical result of this organizational structure is that claims will be reviewed and resolved by the insurer in a manner and on time scales which are not out of step with the expectations of multi-national corporations and PE funds and which may dramatically exceed expectations for local law interactions with seller parties.

Finally, in some cases, a separate insurance product is also available—Political Risk Insurance. This insurance can provide coverage for risks that are commonly excluded from ‘Material Adverse Effect’ closing conditions in the US.

Covered risks can include: confiscation, expropriation, or nationalization, currency inconvertibility and non-transfer, and political violence (including terrorism and war). This coverage can add substantial buyer confidence to acquisitions in high risk jurisdictions.

What Kind of Deals Are Insurable—Generally, any global deal can be submitted to a broker who can send the deal out for quotes from insurance providers or, if the deal is unusual, the broker can run the transaction by underwriters on an informal basis for an initial assessment of interest.

Cross-border deals are generally susceptible to the same basic factors of insurability as domestic deals, such as the size of the risk retention and the underlying terms of the purchase agreement. However, below are some factors which, in addition to geography, are emphasized in the cross-border context, that help increase the odds of insurability.

- Established Players: The participation as a buyer or seller of an established PE fund, multi-national entity or public company with a track record of due diligence and deal capability will increase interest.

² The pairing will result in a gap between the governing law of the policy and the purchase agreement. For example, rights under the policy would be governed by New York or UK law, but the policy would require that the underlying law of the purchase agreement would govern the interpretation of whether an insurable breach of the purchase agreement has transpired. In the event of a dispute with the insurer, a reasonably foreseeable result would be AAA arbitration in New York, interpreting the policy under New York law and the acquisition agreement under the laws of the target jurisdiction.

- Quality Due Diligence: The presence of high quality law firms and accounting firms conducting due diligence with full reports available to the insurer on a Vendor DD or buyer paid basis will also increase the odds of insurability. A fulsome and complete data room may also assist.
- Target Not Highly Regulated: Targets in highly regulated (under local law) industries which would require specific industry legal experience by the insurer may not be the subject of substantial insurance interest. Not every industry that is highly regulated in the US and UK is highly regulated under local law, which allows for some surprising coverage, for example significant covered food and pharma regulatory representations are possible in some jurisdictions.
- Seller Recourse/Seller-Indemnity: Although a factor for all RWI policies, the presence of some “skin in the game” from the sellers is a major factor for insurance interest in the RWI context. This can be as low as 1% of the enterprise value of the target, with the key question for underwriters being whether the amount is meaningful enough to the warrantor sellers to align interests with the insurer and incentivize effective disclosure. Where the warrantor sellers are individuals, the amount required to meet this test will be comparatively low.

Thinking Ahead

Cross-border deals can exaggerate the ever-present gap between buyers’ and sellers’ estimates of potential indemnity claims where, for example, local law is not well settled or discretionary damages are permissible. As a result, the “size of escrow” for the indemnification provisions debate can seriously endanger the success of certain cross-border transactions.

Although not appropriate for every transaction, it’s nice to know, as a buyer or seller that RWI may be an option to bridge the escrow size gap or reduce local law enforcement risk. From a cost perspective, the cost of cross border RWI insurance as a whole is more expensive, but not dramatically out of line with comparable US or UK RWI policies. Like US and UK transactions, the claims payment experience for cross-border RWI policies has been favorable when compared to private indemnity claims.³

³ AIG’s recent Claims Intelligence Series Publication (2017) indicates that, in 2011-2015 policies where claims for over \$100,000 occurred, 55% percent of such claims incurred a claim cost (includes payout) of over \$1,000,000. AIG also reports it has made a number of claim payments over \$10,000,000. <https://www.aig.com/content/dam/aig/america-canada/us/documents/insights/aig-manda-claims-intelligence-r-and-w.pdf>

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