

**FACILITATING DEALS IN CHALLENGING TIMES****By: Matthew Heinz, Assistant Vice President**

In today's turbulent economic environment, many companies are finding themselves in harm's way, with limited ability either to meet debt service requirements or to refinance debt obligations coming due in the near term. As a result, the market is seeing an increase in the number of distressed deals. Buyers and sellers engaging in these types of deals face unique challenges. Buyers, although encouraged by depressed asset prices, are wary of the potential contingent liabilities that can attach to the troubled assets or companies up for sale. Conversely, sellers face the task of limiting or eliminating their post-closing exposure to these liabilities, while at the same time procuring the highest possible purchase price for their creditors and shareholders. In addition, sales of companies approaching insolvency are ripe for challenge based on theories such as fraudulent conveyance and can even be unwound in extreme circumstances.

In these instances, the transactional insurance products offered by the Mergers and Acquisitions ("M&A") Insurance Group can be of great assistance in helping the parties in a distressed deal overcome the inevitable obstacles they will face and in providing deal parties with sufficient comfort to proceed with a proposed transaction. These products include Representations and Warranties Insurance ("RWI"), Contingent Liability Insurance ("CLI"), Tax Liability Insurance ("TLI") and Litigation Buyout Insurance ("LBI").

**Representations and Warranties Insurance**

Whether selling off non-core assets or subsidiaries in an effort to reorganize or engaging in a full-blown liquidation, RWI can be used by both sellers and buyers to facilitate transactions and shift transactional risk to the insurance markets. RWI protects a buyer or seller against financial losses resulting from inaccuracies of the representations and warranties made in connection with mergers, acquisitions, divestitures and other business transactions.

Such protection can be particularly useful for both buyers and sellers in the context of distressed M&A deals. Sellers, when trying to lock in the highest possible consideration for their assets in order to both satisfy creditors and defend against any potential fraudulent conveyance challenges, may have to agree to onerous indemnification provisions. RWI can be used as a buffer to these obligations, thereby providing a cleaner break for the distressed seller looking to jettison assets or businesses.

Buyers, on the other hand, have the upper hand in many distressed transactions and can use their leverage to demand stiff indemnification protection, including high indemnity caps and extensive survival periods. This indemnity may only be as good as the paper it is written on when the buyer is concerned about its ability to collect indemnity payments from a financially distressed seller. Moreover, in Section 363 sales under the Bankruptcy Code, buyers typically do not receive any significant indemnification protection for breaches of representations and warranties from the bankrupt seller and must assume significant risk despite obtaining a "free and clear" order from the bankruptcy court. A buyer-side RWI policy can provide protection in both of these scenarios. The policy can sit along side an insolvent or near-insolvent seller's indemnity, thereby reducing the buyer's collection risk. The policy can also augment a buyer's recourse beyond a limited or non-existent seller indemnity, and extend the period in which a buyer can bring a claim.

**Contingent Liability Insurance**

CLI is designed to provide protection for contingent liabilities arising in connection with M&A transactions and can assist parties in distressed deals by ring-fencing contingent liabilities arising out of those deals.

For example, one alternative available to purchasers of distressed assets is the "foreclosure sale" under Article 9 of the Uniform Commercial Code. The foreclosure sale involves considerably less time and

expense than the more traditional Section 363 sale and, if undertaken correctly, should still eliminate junior liens on the foreclosed collateral. However, many secured creditors and potential purchasers remain wary of the process because an Article 9 foreclosure sale will not yield a “free and clear” order from the bankruptcy court – resulting in the concern that certain successor liabilities can survive the foreclosure sale and potentially result in losses to the new owner of the foreclosed assets.

CLI can be used to protect the new owner of assets following a foreclosure sale against common law successor liability claims, claims by junior creditors whose liens should have been extinguished in the foreclosure sale but for some procedural error in the foreclosure sale process, and/or claims of creditors who purportedly did not receive appropriate notice of the foreclosure sale. Each of these aspects of coverage can give a foreclosing secured creditor or an unrelated purchaser greater comfort that the distressed assets are being purchased “free and clear” of subsequent claims, absent the time and expense that would be incurred in the traditional bankruptcy process.

Of course, CLI may be useful in mitigating liabilities in more traditional distressed M&A deals as well. As its name implies, Contingent Liability Insurance can address any number of contingencies that may be preventing an M&A transaction from proceeding, including successor liability concerns, fraudulent conveyance or preference payment issues, regulatory approval matters, etc. Concerned deal participants should not hesitate to contact the M&A Insurance Group with an issue that may require an insurance solution.

### **Tax Indemnity Insurance and Litigation Buyout Insurance**

Parties in distressed deals may also face tax and litigation contingencies that can slow down or even scuttle a distressed M&A transaction. TLI and LBI can be used to address these contingencies and get the buyer and seller back on the same page.

With respect to tax issues, it is not uncommon for a buyer in a distressed deal to have concerns about potential tax contingencies arising out of the seller’s operation of the business or the transaction itself, including issues such as the tax consequences resulting from a change in ownership, executive compensation issues, availability of net operating losses in a change of control and debt cancellation issues. TLI is available to address such issues and can alleviate buyer’s concerns about related post-closing exposures.

LBI is available to address existing litigation that may be hindering or threatening to derail a deal. For example, if the seller in a distressed M&A transaction is either unwilling or unable to retain the potential liabilities emanating from a lawsuit relating to the assets or business it is selling, but the buyer is also either unwilling or unable to assume such liabilities, LBI can be used to insure the exposure and allow the parties to proceed with the transaction.

### **Conclusion**

The current economic climate makes it apparent that distressed M&A transactions will be a fixture on the transactional landscape for the immediate future. The products offered by M&A Insurance Group can be valuable tools in getting these transactions completed and providing meaningful risk transfer from the buyer and/or the seller to the insurance markets.

To learn more about transactional insurance products, please visit our website, [www.chartisinsurance.com](http://www.chartisinsurance.com), send us an e-mail at [MAInsurance@chartisinsurance.com](mailto:MAInsurance@chartisinsurance.com), or contact your insurance broker.



Chartis is the marketing name for the worldwide property-casualty and general insurance operations of Chartis Inc. For additional information, please visit our website at [www.chartisinsurance.com](http://www.chartisinsurance.com). All products are written by insurance company subsidiaries or affiliates of Chartis Inc. Coverage may not be available in all jurisdictions and is subject to underwriting review and approval. Some coverages may be underwritten by a surplus lines insurer. Risks placed with a surplus lines insurer must be placed in accordance with surplus lines laws and other applicable laws. Surplus lines insurers do not generally participate in state guaranty funds and insureds are not protected by such funds. The information contained herein is for general information only and does not constitute an offer to sell or a solicitation. The description herein is a summary only. It does not include all terms, conditions and exclusions of the policies described. Please refer to the actual policies for complete details of coverage and exclusions.