

2023 Trends in Private Target M&A: Representations and Warranty Insurance

Market Trends: What You Need to Know

Representation and warranty insurance (“RWI”) is an increasingly important feature of private company M&A transactions. Every other year since 2005 the ABA has released its Private Target Mergers and Acquisitions Deal Point Studies (the “ABA studies”). The most recent four of these studies (2017, 2019, 2021 and 2023) have looked at RWI in private company merger and acquisition (“M&A”) transactions.

As shown in these three most recent ABA studies:

RWI References

The percentage of transactions expressly referencing RWI increased from 29% in the 2017 study, to 52% in the 2019 study, to 65% in the 2021 study, before dropping back down to 55% in the most recent 2023 study.

Bound at Signing

42%, 41%, 51% and 40% of the deals with RWI reported in the four studies, respectively, expressly required the RWI policy to be bound at the signing of the purchase agreement.

Who Acquires the Policy?

The buyer acquired the RWI policy in 93%, 95%, 95% and 97%, respectively, of the RWI deals reported in the four studies.

Obligation to Pursue RWI

An indemnitee's obligation to first pursue RWI coverage was included in 42%, 42%, 44% and 47% of RWI transactions, in the four studies.

RWI Payment

In most cases, the buyer bore full, or shared with the seller, responsibility for RWI premium payments. The seller bore full responsibility for payment in 11% or less of reported transactions in the four studies.

RWI As Sole Source of Recovery

Express negative statements to the effect that RWI is not the sole source of recovery were included in 20%, 54%, 23% and 10%, respectively, of reported transactions within the four studies between

2017 and 2023.

Introduction

In M&A transactions, the definitive purchase agreement (whether asset purchase agreement, stock purchase agreement, or merger agreement) typically contains representations and warranties made by the seller with respect to the target company. Representations and warranties not only provide information to the buyer, but also operate to allocate risk as between the buyer and seller with respect to the matters covered by the representations and warranties.

Historically, sellers were responsible for damages suffered by buyers and caused by breaches of the seller's representations and warranties, through indemnification provisions. Pursuant to indemnification provisions, any given party would agree to defend, hold harmless, and indemnify the other party or parties from specified claims or damages. Those defense and indemnification obligations are often limited by time, dollar levels, and/or types of claims and damages.

In the past 15 plus years, buyers and sellers have been able to outsource the exposure to buyers from breaches of seller representations and warranties to third party insurers issuing RWI policies. This article looks at the ways that RWI is addressed in private company M&A agreements, as reflected in the relevant ABA studies.

The Growth of RWI

One of the biggest changes in private company M&A during the past decade has been the enormous growth of RWI. With RWI, buyers and sellers are able to allocate some of the post-closing M&A indemnity risk to third party insurers. RWI has gone from being a differentiator that aggressive buyers offered to a much more common feature of private M&A deals. As indemnity risk has been shifted through RWI from sellers to third party insurers, avenues for a buyer's indemnity recourse against sellers have narrowed, including through the lowering of indemnity caps and even the elimination of post-closing seller indemnity for representations and warranties (subject to narrow exceptions, such as in the event of fraud).

The most recent three ABA studies have looked at certain RWI-related provisions in reported private company M&A agreements. It is worth noting, however, that relying solely on explicit references to RWI in M&A transaction documents as evidence of RWI's usage is potentially imperfect.

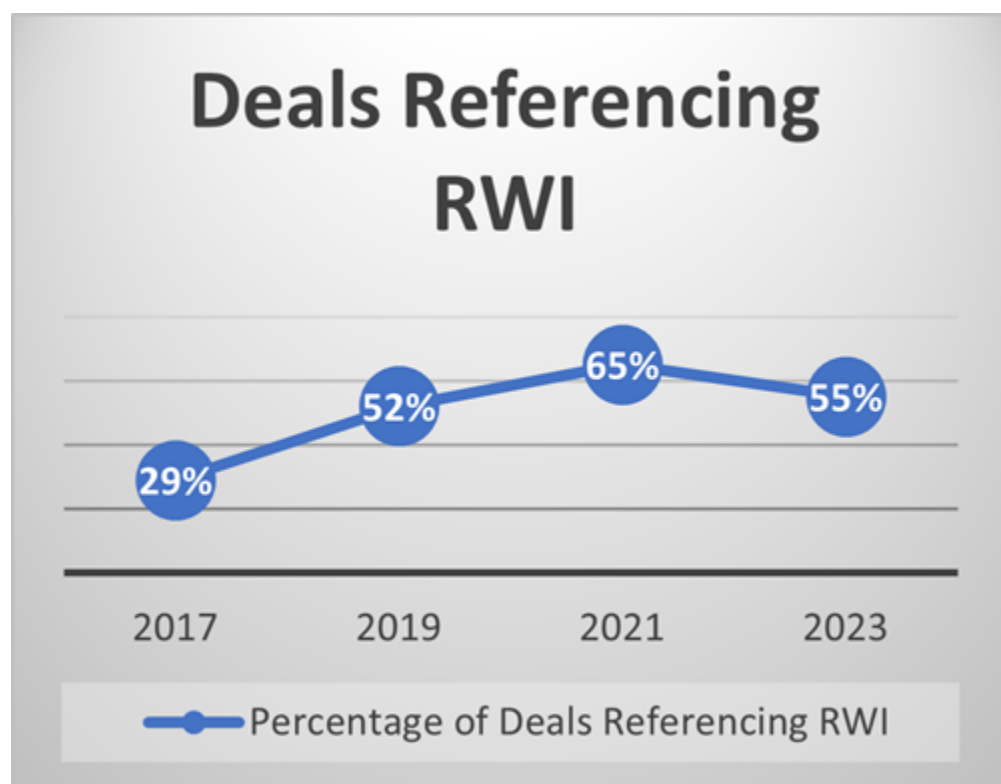
Trends in RWI

The ABA studies examine purchase agreements of publicly available transactions involving private companies. The ABA studies examine purchase agreements of publicly available transactions

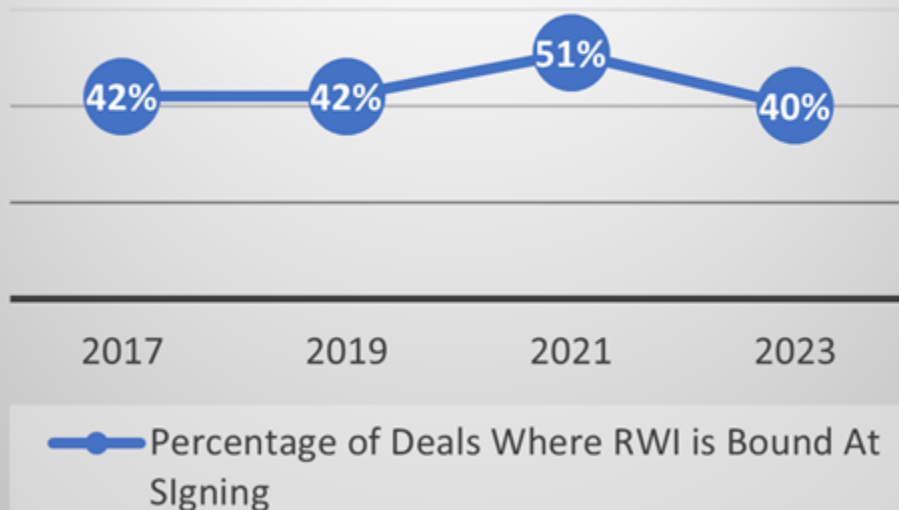
involving private companies. These transactions range in size but are generally considered as within the “middle market” for M&A transactions; the transaction values of the 108 deals within the 2023 study ranged from \$30 to \$750 million.

The ABA Study in 2017 was the first to review the use of RWI in private M&A transactions. Accordingly, ABA study data is limited to four of the ten ABA studies (2017, 2019, 2021 and 2023). Given the growth of RWI, it is fully expected that future ABA studies will continue to look at RWI.

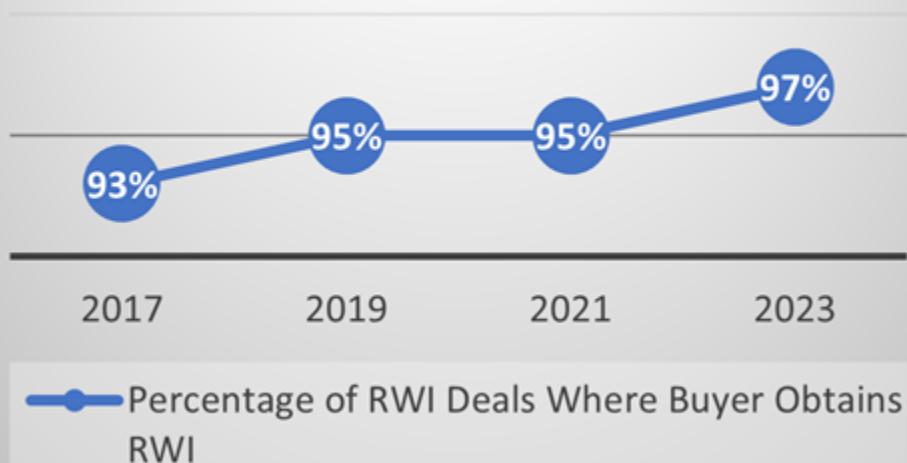
The charts below show, in a more visual manner, the trends described above with respect to RWI data as reported by the four most recent ABA studies.

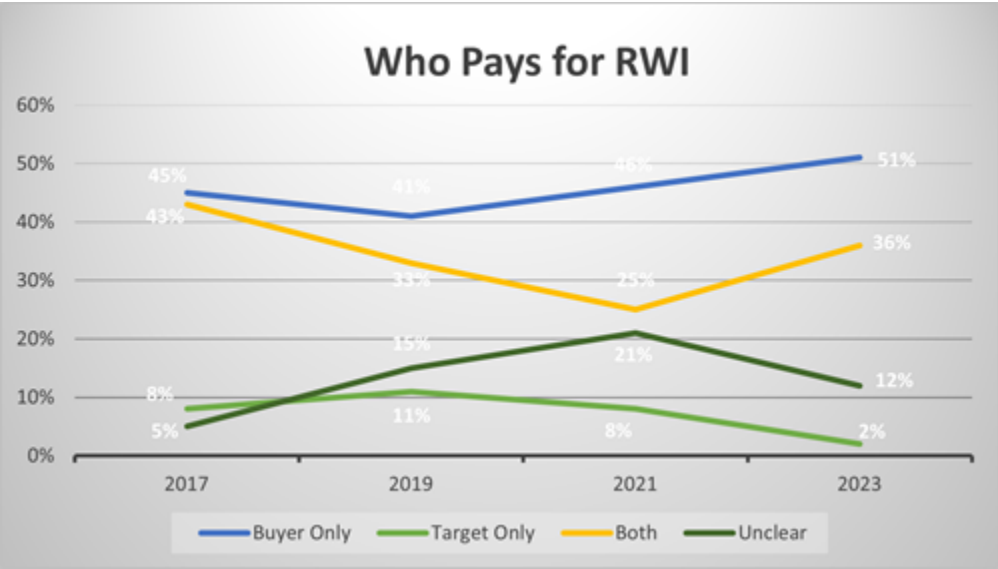
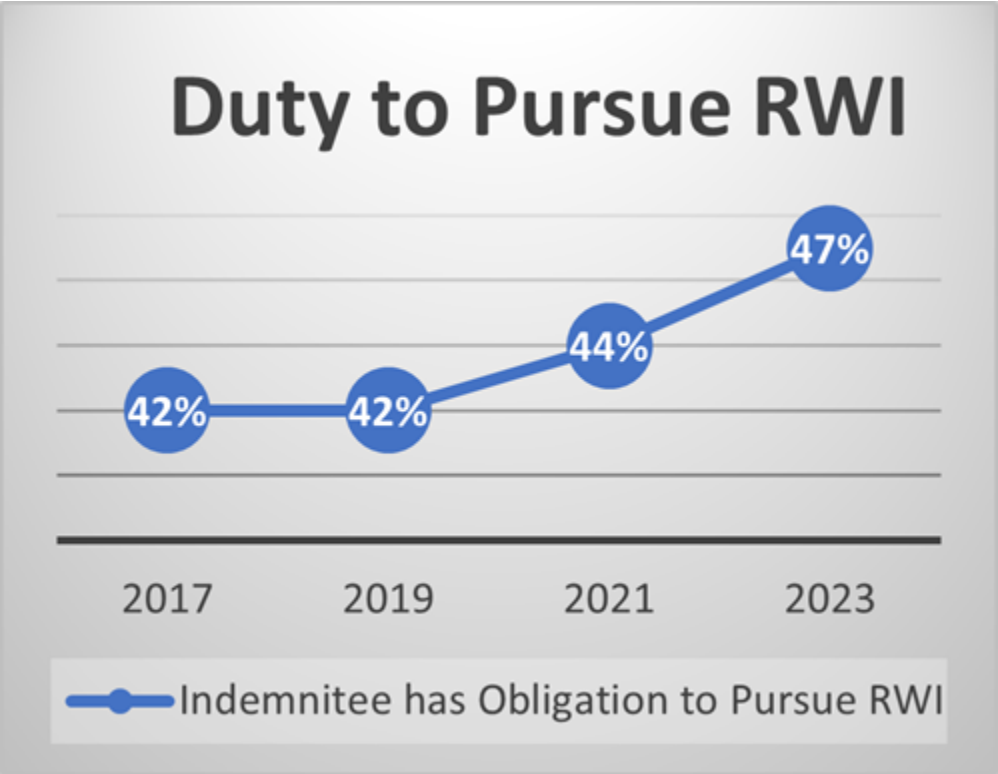


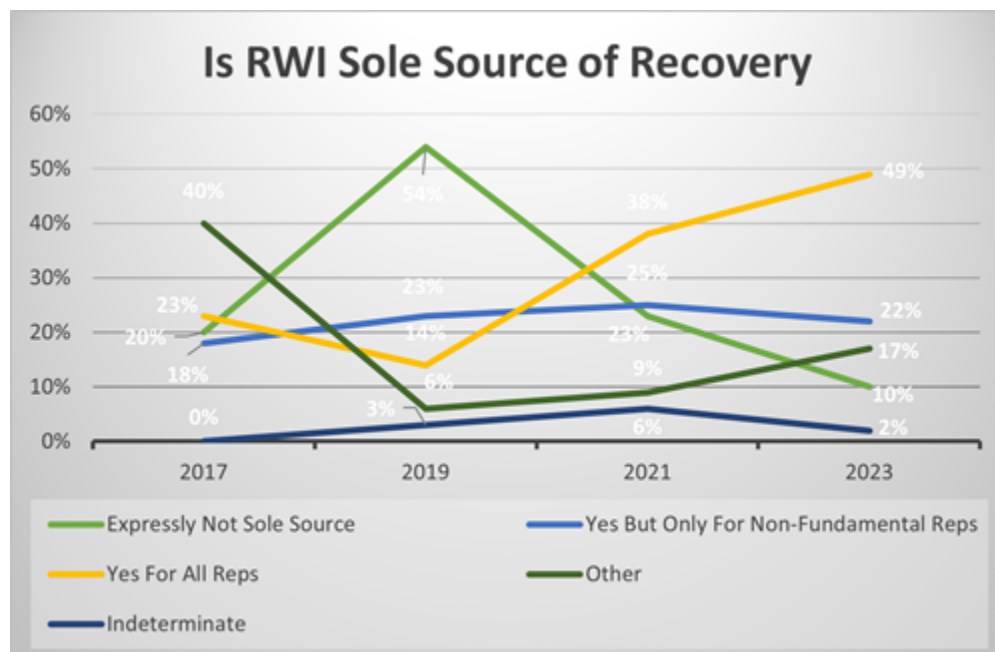
RWI Bound at Signing



Who Procures RWI







Conclusion

RWI is an increasingly important feature of private company M&A transactions. Since only the three most recent ABA studies looked at RWI, data is still too light to identify many trends beyond the fact that RWI is now seen in more than half of reported private company transactions. Even in the absence of long term data, it seems clear that RWI will continue to be an option for buyers and sellers looking to allocate representation and warranty indemnity risk beyond the primary transaction parties.

General Information

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