

SIX ISSUES TO CONSIDER

ESCROW VERSUS REP & WARRANTIES INSURANCE

Doing an M&A deal? Buy-side representations and warranties insurance is gaining attention—but how do you determine if it's right for your deal? Here are six issues deal parties and their advisors should consider.

1 QUALITY OF REPS & WARRANTIES

ESCROW

May result in more accurate reps & warranties and disclosure schedules since sellers remain liable for breaches.

RWI

May result in broader reps & warranties and thinner disclosures schedules since the party with the economic risk (the insurer) is not the party giving the representations.

2 INDEMNIFICATION COLLECTION RISK

ESCROW

Escrow agents will generally follow written directions from the parties or a court order without weighing in on the merits of any claim. Therefore, absent any bank insolvency that is not covered by FDIC insurance, there should be minimal collection risk.

RWI

If an insurer does not pay on a claim, either because it is insolvent and unable to do so or because it disputes whether

the claim is covered by the policy, the insured party could have difficulty being made whole on any loss incurred.

3 INDEMNIFICATION COLLECTION PROCESS

ESCROW

Buyer must prove to sellers that losses are indemnifiable under the M&A agreement.

RWI

Buyer must prove to sellers and insurer that losses are both indemnifiable under the M&A agreement and covered by the RWI policy.

4 SCOPE OF COVERAGE

ESCROW

- Rep and warranty breaches
- Covenant breaches
- Purchase price adjustments

RWI

- Rep and warranty breaches, subject to RWI policy exclusions

5 PROTECTING POST-CLOSING RELATIONSHIPS

ESCROW

May involve recovering escrowed amounts otherwise due to newly acquired executives or employees.

RWI

Claims typically have less impact on newly acquired executives or employees, other than claims for fraud or losses in uninsured layers.

6 MAINTAINING PRIVILEGE

ESCROW

Privileged communications generally limited to client and attorney.

RWI

Possibility that some communications that otherwise would have been privileged, such as attorney's work product or diligence reports, will need to be shared with the insurer and thereby lose protection.

THE BOTTOM LINE

Whether an escrow or buy-side RWI is the appropriate indemnification solution depends on the circumstances of the transaction. In our view, it is not the case that either product is fundamentally better or worse than the other. Rather, it depends on which is a better fit for your transaction, which means it is important for deal parties to understand the pros and cons of escrows and RWI and be aware that either option can materially influence the transaction in non-economic ways.